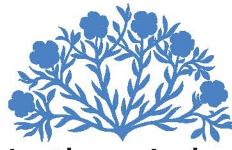

# Knowledge Exchange Seminar Series (KESS)

7 June 2017

**DEPRIVATION IN NORTHERN IRELAND, 1.30-3.20pm**

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**2.05-2.25pm:**

**'Assessing the risks of economic inequality**: the impact on societal wellbeing and economic development'

1. What is 'economic inequality'?
2. Economic inequality is increasing in the Western world
3. The social and health implications
4. The economic implications
5. Economic inequality is a complex social problem
6. Public policy implications for Northern Ireland

This briefing has six parts, each of which will be introduced in turn.

### 1. What is 'economic inequality'?

Economic inequality is typically measured as inequality in the distribution of income, and less commonly as inequality in the distribution of wealth.

The **Gini Coefficient** provides a summary statistic to show the overall level of inequality in a given country. A score of 0 indicates perfect equality, and a score of 1 (or 100) indicates perfect inequality (where one person has all income or wealth).

Other commonly used metrics include the ratio between the average income of the top 20% and bottom 20% in society, or similar 'quantile ratios'. More recently, tax data has been examined to show the absolute income share held by different groups in society, such as the income share held by the top 10% or top 1%.

Some researchers argue that a more holistic definition of economic inequality should be used, in order to take account of the vlaue of public services, the effects of indirect taxation, different family compositions and dependencies and differences in the cost of meeting a decent standard of living (O'Connor and Staunton 2015). From this perspective, economic inequality should be understood as **inequality in the distribution of 'net economic benefits'**.

### 2. Economic inequality is increasing in the Western world

In 2013, the Gini Coefficient for the UK was **0.523** (or 52.3) for market incomes—that is, incomes from all forms of market activity, employment, rental income, dividends, etc. The Gini Coefficient was significantly lower, **0.341**, when the effect of taxes and 'social transfers' (pensions, disability payments, unemployment payments and other welfare payments) was taken into account.

In 1975, the Gini Coefficient after tax and transfers was **0.269**, which indicates the rise of income inequality in the UK over this period.

The figure [1], shows that the Gini Coefficient for market income (red and white columns) is, unsurprisingly, higher in all OECD countries than net income (blue columns). This demonstrates several things. Firstly, the welfare state is 'alive and well', and social transfers in particular play a vital role in reducing the overall level of income inequality across the OECD. Secondly, however, OECD countries vary considerably in the extent to which their markets generate inequality and in the extent to which their welfare systems counteract that inequality.

The UK is among the most unequal OECD countries for the market distribution of income. The welfare state makes income inequality significantly lower, however the UK still remains the most unequal European country in terms of net income inequality, with only Israel, the USA, Turkey and Chile having a greater level of income inequality after taxes and transfers.

The next figure [2] shows selected OECD countries—Denmark, Germany, Ireland, the UK and the USA—which illustrate the rise of net income Gini since the 1970s. There has been a steady rise in income inequality since the 1970s in all cases, which is associated with market liberalisation and aspects of global trade and technology change.

A different type of data is shown in the next figure [3]. Researchers have compiled data from national tax authorities to show the actual income share held by different groups, such as the top 10% and the top 1%. For the same five countries, four of them—except Denmark—show a strong trend in the rise of the income share of the Top 10%.

In the USA, the Top 10% now take more than half of all market income (50.5%), a level of inequality that last pertained in 1939. In the UK, the Top 10% take 39.1% of all market income, compared to 27.8% in 1975. (This increase in the Top 10% share helps explain the change in net income Gini Coefficient for the UK for the same period, from 0.269 to 0.341).

**Figure 1: OECD data on market and post-tax/post-transfer GIni Coefficients**

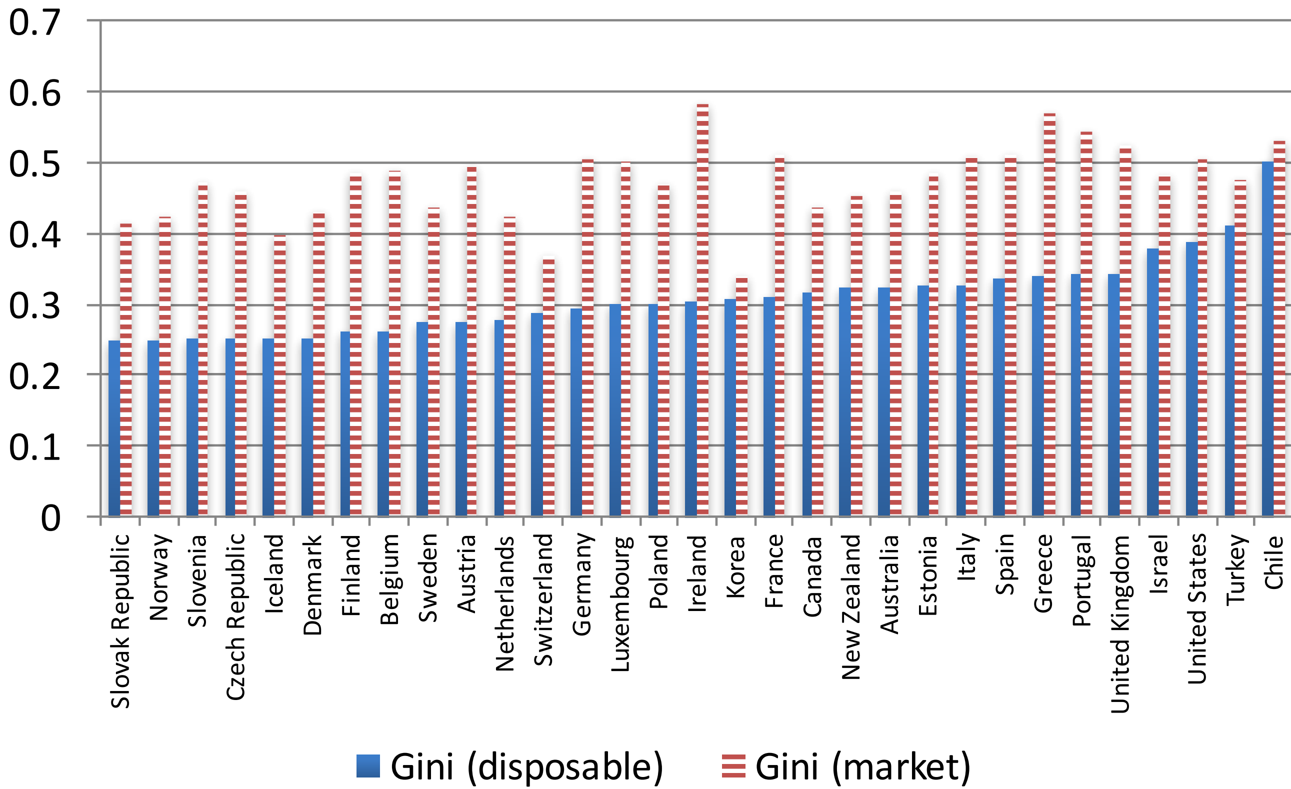



**Figure 2: Gini Coefficient 1974-2014, selected OECD countries**

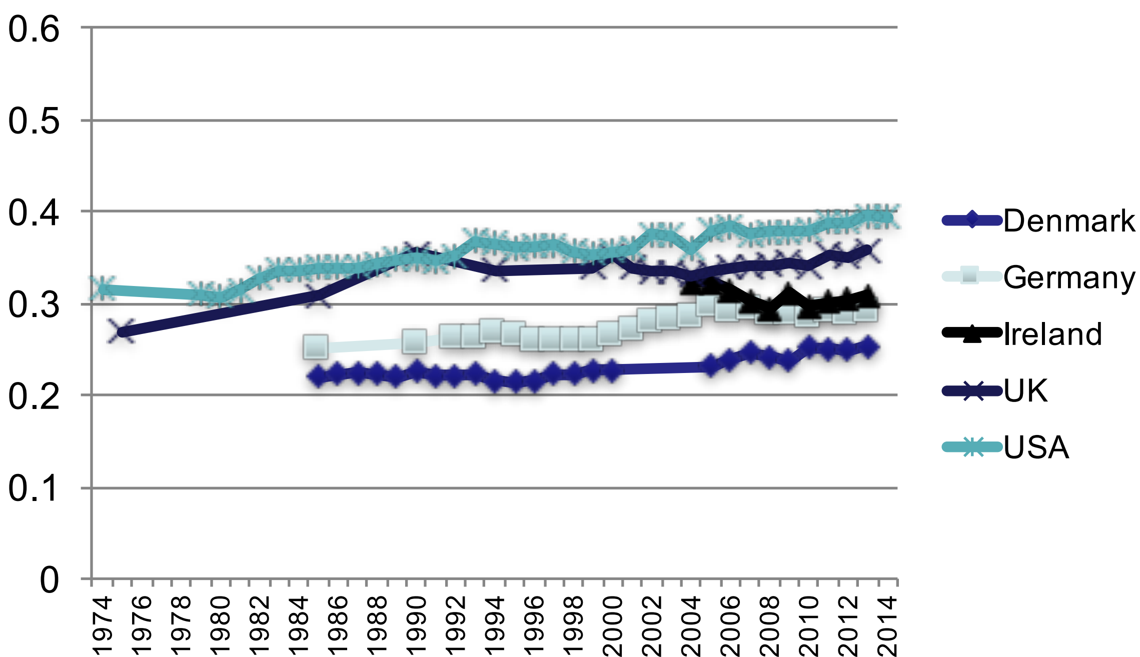
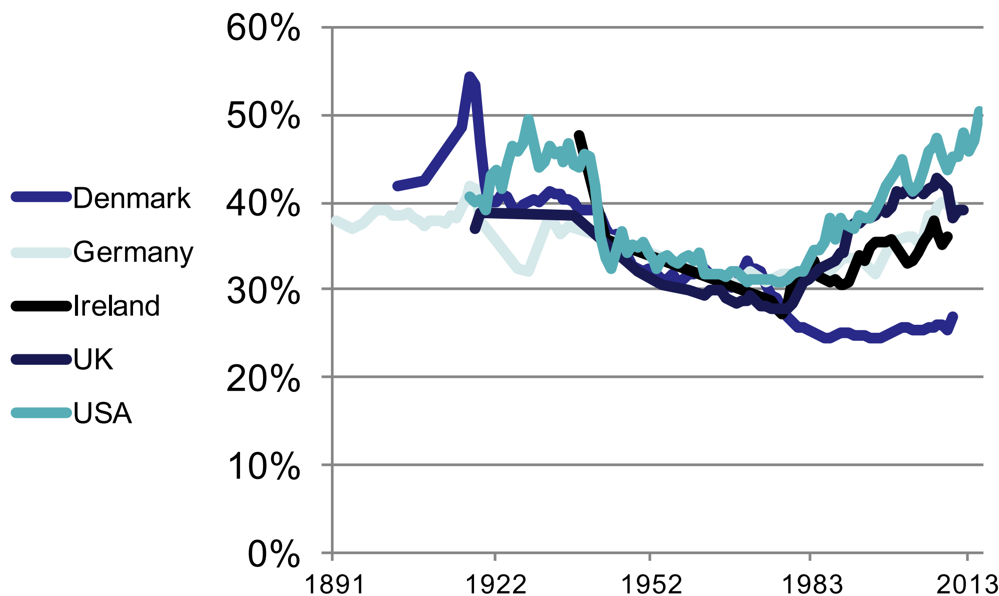


**Figure 3: The Income Share of the Top 10%, selected countries (World Income and Wealth Database)**



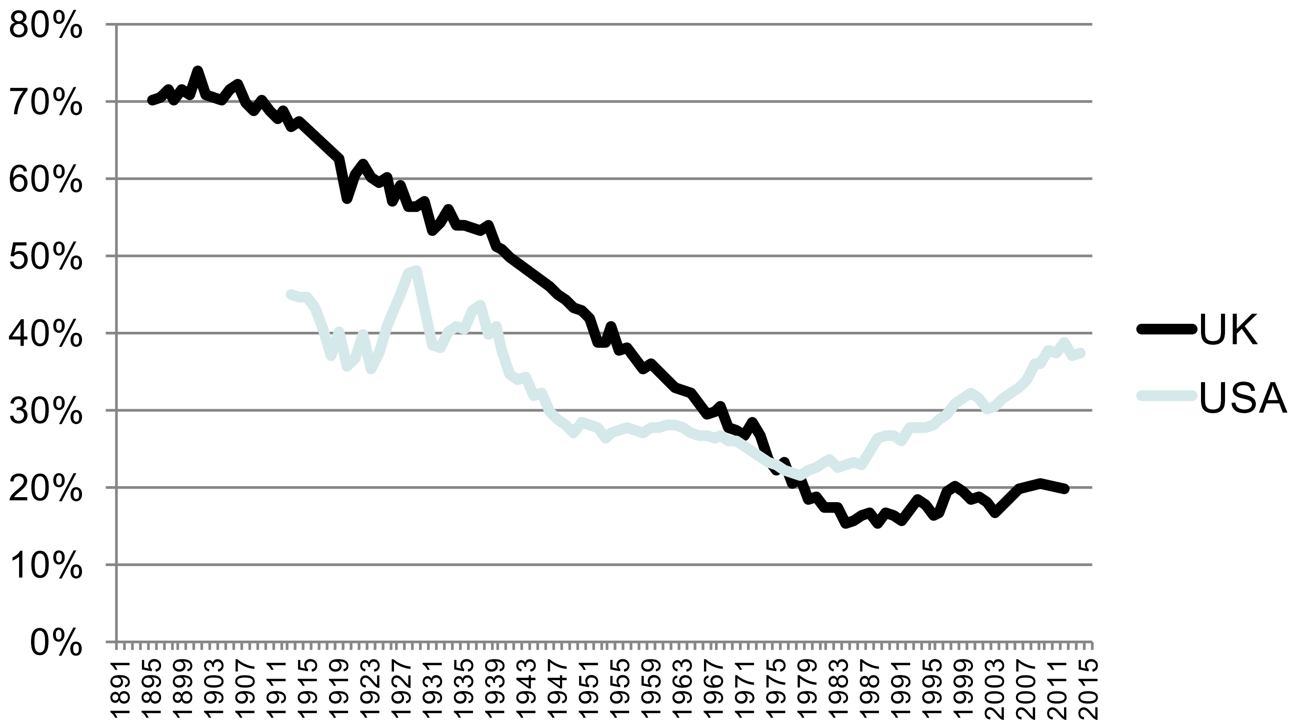

Using the analogy of a *Matryoshka*—a set of nested Russian dolls—our understanding of income and wealth dynamics has changed due to the analysis of tax data. Not only has the Top 10% income and wealth share grown faster than the rest of society, but the income and wealth of the Top 1% is disproportionately larger than the rest of the Top 10%. Within the Top 1%, a disproprtionate share goes to the Top 0.1%. Within the 0.1%, a disproportionate share goes to the Top 0.01%. And so on.

At an extreme, a small number of multi-billionaires now have more personal wealth than the populations of entire countries.

One risk is the return to 'patrimonial capitalism' (Piketty 2014)**.** For most of human history, wealth was held in few hands, which led to very low levels of economic growth and low levels of innovation, as well as widespread deprivation. Only in the few decades since the Second World War has there been widely shared prosperity, along with greatly accelerated technical progress and high levels of economic growth. A risk for the current economic system is that we are returning to pre-war levels of the concentration of wealth.

As illustrated in the figure [4], the Top 1% in the USA now has nearly 40% of all wealth. This level of wealth concentration last pertained in the 1930s. While home ownership and pension funds, among other factors, maintain a lower concentration of wealth in the UK, there is nonetheless a trend towards a greater concentration of wealth in the UK.

**Figure 1: Wealth share of the Top 1% (UK and USA)**




**3. The social and health implications**

Various studies have shown a strong relationship between a society's level of income inequality and a range of social and health problems. *The Spirit Level* shows a correlation between inequality and worse outcomes in terms of life expectency, maths and literacy, infant mortality, homicides, imprisonment, teenage births, trust, obesity, mental illness (including addiction), and social mobility (Wilkinson and Pickett 2009).

In 2008, Professor Sir Michael Marmot was asked to chair an independent review—known as the 'Marmot Review'—to propose evidence-based strategies to reduce health inequalities in England. The key messages from this report include:

- There is a social gradient in health – the lower a person's social position, the worse his or her health. Action should focus on reducing the gradient in health.
- Health inequalities result from social inequalities. Action on health inequalities requires action across all the social determinants of health.
- Focusing solely on the most disadvantaged will not reduce health inequalities sufficiently. Actions must be universal, but with a scale and intensity that is proportionate to the level of disadvantage ("proportionate universalism").
- Action taken to reduce health inequalities will benefit society in many ways. It will have economic benefits in reducing losses from illness associated with health inequalities. These currently account for productivity losses, reduced tax revenue, higher welfare payments and increased treatment costs.
- Economic growth is not the most important measure of our country's success. The fair distribution of health, well-being and sustainability are important social goals. (Marmot 2010)

### 4. The economic implications

Three major OECD reports on economic inequality (OECD 2008, 2012, 2015) have demonstrated the rise of income inequality and poverty, not least based on a growing wage gap between employment at the top and bottom of the labour market. The OECD's econometric analysis confirms that inequality is dragging down economic growth, and this has major implications for economic policy. Not least, the OECD confirms that 'trickle down' from the wealthy to the rest of society does not occur, and there is no necessary trade-off between policies to encourage equality and policies to encourage economic growth—indeed, we need both. The OECD notes the urgency of the situation by referring to a 'tipping point' having been reached in relation to economic inequality.

Research by IMF officials shows a link between income inequality, private sector debt and financial instability (Kumhof et al. 2015, Ostry et al. 2016). Greater inequality may lead to a more pronounced 'boom and bust' cycle in the economy, with the risk of more frequent and more severe economic crises.

### 5. Economic inequality is a complex social problem

Former US Vice President Al Gore has developed a rare ability to explain the complex phenemenon of climate change through his work in making public presentations on the scientific and economic implications of global warming; for example, through the documentary film *An Inconvenient Truth* (2006).

In a similar way, economic inequality is technically a 'complex social problem'.

This implies that:

- It is complicated to define and explain
- It involves a lot of data and modelling (and jargon)
- It is big—it has major effects on society and the economy
- There are many causes
- It is hard to predict
- It is going to affect us all, sometimes in unexpected ways
- It is the responsibility of many organisations—in fact, it is everyone's responsibility
- Most of us will have to change some of our ideas and expectations
- Most of us will have to change things we do in our everyday lives

The complexity is particularly obvious if we define economic inequality as the distribution of 'net economic benefits'.

We need to take into account the value of public services, the impact of indirect taxes as well as direct forms of taxation, the diversity of family composition and dependencies—not least with divorce, remarriage and an ageing population, the different capacities of households—including disability, and the actual cost of meeting a decent standard of living. For example, a household may manage to maintain their income, but they may see their leisure time erode, their public services decline and their job security and future retirement becoming increasingly precarious. We need better data to take account of family time, leisure time, unpaid care work, social networks, precariousness, etc. If we only look at the income distribution data, it could report no change in their circumstances. Standard metrics like the Gini Coefficient do not always correlate with people's experience of insufficiency or insecurity.

## 6. Public policy implications for Northern Ireland

Understanding economic inequality as a complex social problem—a multi-part, multi-cause issue—helps to frame the policy solutions that are needed.

It is clear from the evidence that income distribution—and 'fairness' in the economy more generally—are linked to health and social problems. The effects of income inequality on economic growth (GDP) imply that this must concern every political party that wishes to ensure sustainable growth.

We need to move beyond a narrow focus on after-tax household income and to develop more sophisticated 'public value accountancy' to show the value of public services and to demonstrate how they can counteract economic insecurity and deprivation.

This links to the idea of joined-up and outcomes-based public policy (as per the last draft Programme for Government in Northern Ireland), where the aim is to achieve the optimum level of societal well-being, not just to count unit costs or the number of actions taken by public agencies.

Two examples are given, which illustrate some approaches to reducing economic inequality.

In a recent speech (April 2017) by Christine Lagarde, Managing Director of the IMF, several suggestions are made:

- When the benefits of growth are shared more broadly, growth is stronger, more durable, and more resilient
- Technology has been the major factor behind the relative decline of lower- and middle-skilled workers' incomes in recent years, with trade contributing to a much lesser extent
- There are concerns that automation will progressively jeopardize employment growth in emerging and developing economies as well
- Greater emphasis on retraining and vocational training, job search assistance, and relocation support can help those affected by labor market dislocations
- Commitment to life-long learning—from early childhood education, to workplace training, to online courses for seniors
- Today's policies should not disadvantage future generations, who would be left to pay for the imprudent actions of today's generation. That includes a damaged environment, dilapidated infrastructure, and high public debt

The recommendations from the Marmot Review include that reducing health inequalities will require action on six policy objectives:

1. Give every child the best start in life
2. Enable all children, young people and adults to maximise their capabilities and have control over their lives
3. Create fair employment and good work for all
4. Ensure healthy standard of living for all
5. Create and develop healthy and sustainable places and communities
6. Strengthen the role and impact of ill-health prevention

Beyond that, better data and analysis of economic inequality in all its dimensions would help to inform policies to reduce the negative economic, social and health effects of inequality.

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