#### The Inequality We Want: How Much is Too Much?

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TRIM

#### ROADMAP

- (A) To address inequality effectively, we need to know where to locate it;
- (B) Inequality is defined mainly in the extremes of the distribution, particularly at the top (across countries and over time);
- (C) The indicators we use to measure inequality must be able to detect changes in the tails;
- (D) Making explicit the *actual* concentration at the very top and offering a threshold of max. inequality that should not be surpassed might help to curb it;
- (E) This paper will present such an option: Palma v.2.

### WHAT ARE WE TALKING ABOUT?

- World income inequality (relative)
- Comparing shares of countries' top income groups
  - Sample of 116 countries from the WYD-2008 (top 5% income earners)
  - Subsample of 41 countries from LIS (top 1% income earners)
- > Over time (~1990-2010)
  - Subsample of 25 countries

#### (A) WHERE IS INCOME INEQUALITY LOCATED?

- Inequality is defined in the tails!
- Key features of contemporary income distribution:
  - > the (increasing) share the top
  - vs. a relatively stable middle (Palma's 50-50 rule)

# (A) Income shares by population groups (116 countries, WYD-2008)

#### Graph 2: Income Distribution in 116 countries, by population share (2008)



Deciles 1-4 Deciles 5-9 Ventile 19 Ventile 20



Source: constructed with data from Milanovic 2014.

#### (B.1) LOOKING INSIDE THE TOP DECILE (116 countries)

Even within top decile distribution is highly unequal, skewed towards top percentiles (D10 has highest Gini coefficient compared to all other deciles)

Graph 3: The Top of the Income Distribution for 116 countries (2008)



Source: constructed with data from Milanovic (2014).

## (B.1) Income shares top 1% (41 countries; LIS data, latest year)

Graph 5: 41 Countries Ranked According to their Top 1%



#### (B.2) Developments over time: Income share top 1%, 5% and 10%



Source: constructed with data from LIS (2014)

## (B.2) Income share top 1% (25 countries; LIS data, ~1990-2010)

Graph 8: Income share held by the top 1% in 25 countries (1990-2010)



### (C) INDICATORS?!

#### Graph 1: Inequality in Mexico 1950-2012 (development of the Palma Ratio and the Gini Coefficient) 7 1 6.5 0.9 6 0.8 5.5 0.7 Gini Coefficient Palma Ratio 0.6 5 4.5 0.5 0.4 4 0.3 3.5 3 0.2 2.5 0.1 2 0 1950 1957 1963 1968 1977 1984 1989 1992 1994 1996 1998 2000 2002 2004 2005 2006 2008 2010 2012 - Gini ----- Palma

- Gini vs. Palma" shows: if we care about concentration, indicators must be sensitive to changes in the extremes.
- So is the 10/40 ratio the solution?

## (C) Income shares top 1%, 5% and 10% (41 countries; LIS, latest year)

Graph 5: 41 Countries Ranked According to their Top 1%



#### (D) ALTERNATIVES: EXTENDING THE PALMA FAMILY

#### Graph 6: Comparing the original Palma with the Palma v.2 and v.3



- Palma v.2: ratio of top 5% to bottom 40%
- Palma v.3: ratio of top 1% to bottom 40%
- Habemos indicator! Now what?

### (E) HOW MUCH IS TOO MUCH?

- So where is the threshold?
- Without going into the (necessary) idiosyncratic ethical discussion here, how about a "technical"

PALMA V.2 = 1 ?

Because world average Palma v.2 = 1, and it means that the top 5% income earners secure as much of total income as the bottom 40% – i.e. a person in the richest 5% of the population owns 8 times the share of one in the poorest 40% – lends itself as a cut-off point.

#### (E+) From the inequality we have, towards that we want

Of course it is not enough to only have the right indicator, and fix a threshold: we also need concerted policy action! Table 2: Income Distribution in Mexico and Denmark,Before and After Taxes and Transfers (1963-2010)

	Mexico		Denmark	
Year	Gini Market	Gini Net	Gini Market	Gini Net
1963	55.203	49.760	46.744	25.456
1968	55.555	52.523	57.727	26.707
1970	55.639	52.741	60.561	30.843
1975	56.291	53.244	53.237	28.190
1978	51.933	49.296	46.851	25.609
1980	49.433	47.199	43.118	25.465
1983	45.683	44.053	40.985	25.313
1985	44.840	43.445	40.617	25.002
1988	46.061	44.765	41.900	25.616
1990	47.193	45.956	43.371	25.810
1993	49.014	47.739	43.633	23.152
1995	49.145	47.550	43.289	21.800
1998	50.296	48.700	43.221	22.266
2000	50.201	48.600	42.296	22.500
2001	49.482	47.517	42.197	22.555
2002	49.096	46.800	42.117	22.607
2003	48.407	46.305	42.251	22.702
2004	47.678	45.700	42.404	22.800
2005	47.935	45.750	42.872	23.041
2006	47.975	45.628	43.326	23.274
2007	48.217	45.967	43.181	23.346
2008	47.577	45.235	44.109	23.901
2009	46.984	44.654	45.039	24.476
2010	46.390	44.073	46.707	25.347

Source: adapted from Solt (2009)

### CONCLUSION

- Income concentration at the very top is higher than expected from the information provided by "standard" inequality indicators.
- Such levels are unlikely to be in the (best) interest of the majority of people.
- Improving the distribution starts with measuring it appropriately first, with an indicator fit for purpose: to detect changes in the tails (esp. top).
- We then need to fix an objective (threshold), the "too much", below which we want to remain (e.g. as an indicator for the attainment of the Sustainable Development Goals?), and formulate policy accordingly.
- The indicators proposed here (Palma v.2 and v.3) could help us getting there: to "the inequality level we want".

#### **THANK YOU!**

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