

Commentary: The Distribution of Income in Industrialized Countries

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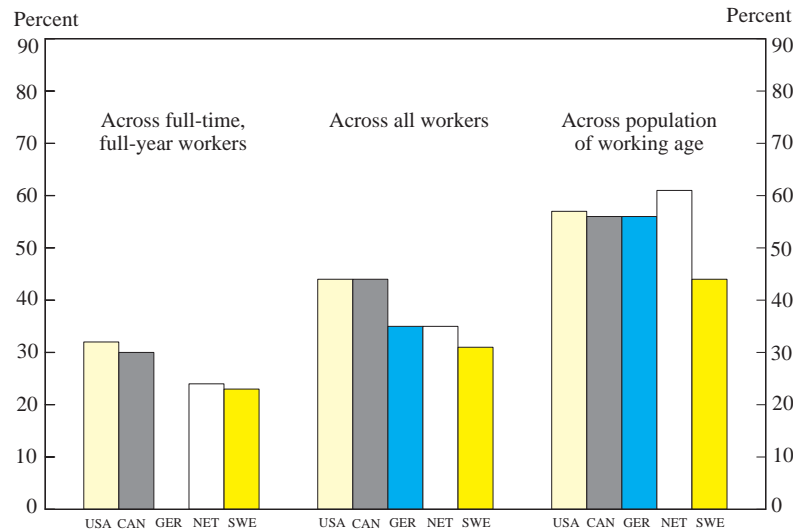
Tony Atkinson makes four main points that I mostly agree with. In this intervention I will add some evidence based on recent work at the Organization for Economic Cooperation and Development (OECD).

Trends in income and earnings dispersion differ across countries

Atkinson's first point is that not all countries have experienced widening income dispersion. Analysis conducted at the OECD supports the conclusion that trends in income dispersion were uneven over the one or two decades leading up to the mid-1990s, but also suggests that in the majority of the 10 countries we examined, it increased.¹

One footnote worth making in the context of earnings distributions is that they usually only consider the distribution of earnings across those individuals who have jobs. But employment rates vary a lot across countries—in part because some people have been priced out of the labor market. A few years ago a thought-experiment was conducted at the OECD: What happens if one calculates the distribution of earnings not across those who have jobs but across all those who could have jobs? That is, for five countries the distribution of earnings across the whole working-age population was examined, counting in

Chart 1
Earnings Inequality: Gini Coefficients
in the Late 1980s



Source: OECD.

also the zeroes, that is those without jobs and therefore with zero earnings (Chart 1). This is a rough but suggestive way to account for the effect of differences in the employment rate.² Among the interesting findings was that when you calculate earnings dispersion the usual way, the United States has the widest dispersion, but when calculating the earnings dispersion across the whole working-age population, dispersion was fairly similar across most countries and the United States actually had less dispersion than the Netherlands. On both definitions, Sweden had the most compressed distribution, which reflects that not only are Swedish wage rates fairly compressed, but employment is also pretty high. Whether the point still holds after the downturn of the Swedish economy in the early 1990s remains to be seen.

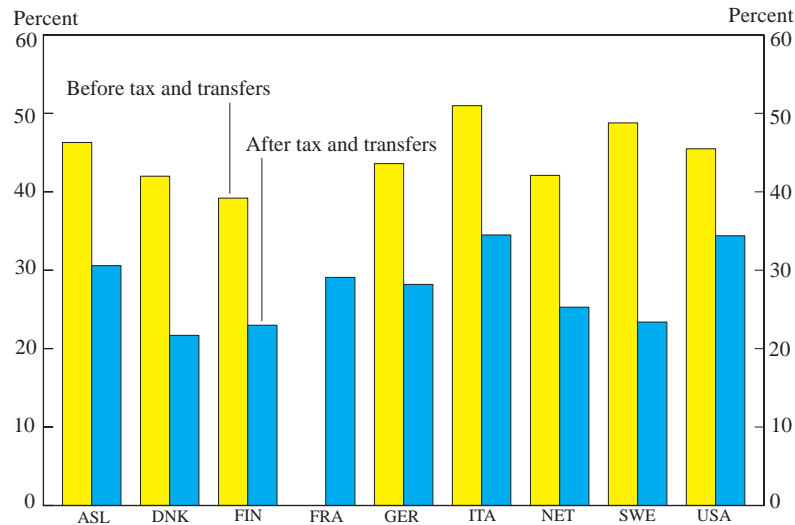
Dispersion matters for the assessment of levels and trends in living standards

There is little to add to Atkinson's second point. It is obviously true that if a country has higher average incomes and higher dispersion of incomes than another country, then those at the bottom of the income distribution in the first country may be worse off than those at the bottom of the income distribution in the second country. Atkinson first shows that there is a clear geographic pattern in the distribution of household disposable income, with Scandinavia and Benelux having the lowest dispersion and the Anglo-Saxon countries the highest. He then presents some calculations that suggest that being in the lowest quintile in Germany actually makes you better off than being in the lowest quintile in the United States—even though average incomes in the United States are much higher. Atkinson also tries to adjust trends in average incomes over time for the change in income dispersion—implicitly arguing that growth that is associated with increased dispersion is less good than growth that is associated with declining dispersion. While this might be an interesting attempt, as he says, this only confirms that “Those at the bottom of the distribution did not share in rising prosperity.” The adjustment to the rate of growth applied by Atkinson and originally suggested by Sen is, however, somewhat arbitrary. The result that, on an adjusted basis, the improvement in the growth rate observed in the United Kingdom in the 1980s with respect to the 1970s completely disappears, should be interpreted with care.

The evolution of income distribution is the result of many factors

Atkinson's third point is an important one. In fact, the recent widening of income distribution in the United Kingdom can only partly be explained by a widening of earnings dispersion. Atkinson also points to the importance of the tax/transfer system in explaining deviations between earnings and income distribution. We recently looked at this issue for 10 OECD countries (the United Kingdom excluded). Our conclusion was that the tax/transfer system in all countries acts as an important equalizing force (Chart 2).³ Our analysis of

Chart 2
Gini Coefficient Before and After Tax and Transfers
in the Early 1980s

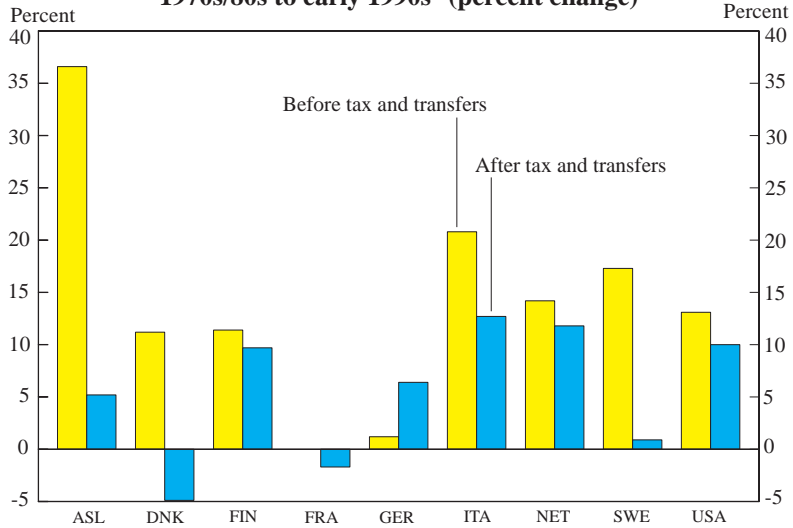


Source: OECD *Economic Outlook* (1997).

trends over the 10 to 20 years leading up to the mid-1990s showed that market incomes had become more unequally distributed across households. Indeed, changes in the distribution of labor income seem to have accounted for most of the change in the income distribution. Looking at disposable incomes, the picture was slightly less uniform. Their dispersion increased in most countries but generally less than that of market incomes (Chart 3). Thus, taxes and transfers have acted as an increasingly equalizing force in most countries. A second point of interest is that the increased equalizing force of taxes and transfers appears to reflect the increasing share of taxes and transfers in GDP rather than an increased “progressivity” of the tax/transfer system.

Atkinson only mentions in passing another phenomenon, which is important for the mapping between individual earnings distribution

Chart 3
Changes in Gini Coefficient Before and After
Tax and Transfers
1970s/80s to early 1990s¹ (percent change)



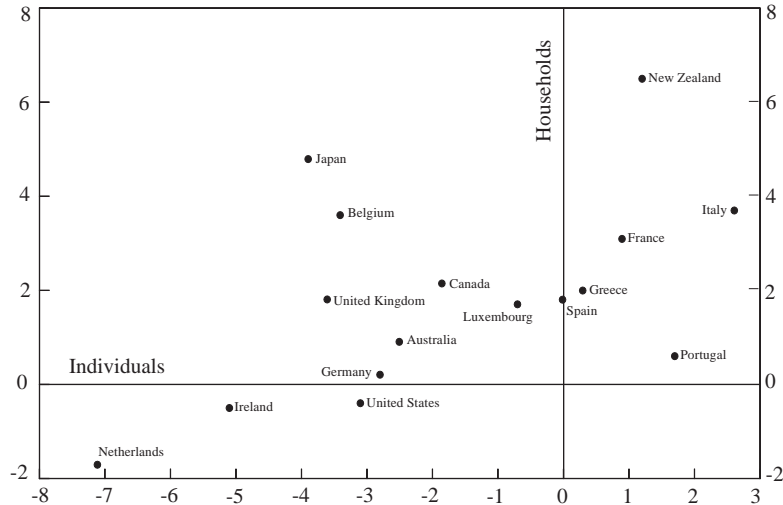
¹Time periods are: Australia (1975-94), Denmark (1983-94), Finland (1986-95), France (1979-90), Germany (1984-94), Italy (1984-93), Netherlands (1977-94), Sweden (1975-94) and United States (1974-95).

Source: OECD *Economic Outlook* (1997).

and disposable income distribution by households. I am thinking about household formation. There are several aspects here that I would emphasize:

- First, there has been an increase in share of two-earner households and this has led to a widening in the gap in income between two-adult and one-adult households.
- Second, in some countries, there appears to have been a tendency toward polarization of two-earner households. That is, increasingly, high earners have tended to be married to high earners.

Chart 4
Changes in Nonemployment Rates
Working-age Individuals and Households¹
Percentage point changes, 1985-1996²



¹Nonemployment rates for both individuals and households are calculated over the working-age population (15 to 64 years old). Working-age households are defined as households where there is at least one adult member of working-age, except for Australia, the Czech Republic, Japan, Mexico, New Zealand and Switzerland, where they are defined as households with a head of working age.

²Australia, New Zealand, the United States: 1986-95; Japan: 1987-92; the Netherlands, Portugal and Spain: 1988-1998. Data for Germany relate to the former West Germany. Source: OECD *Economic Outlook* (1996).

- Third, there has been a tendency internationally for nonemployment to become more concentrated on some households. A recent OECD analysis conducted over 16 countries has shown that in 11 of these countries over the 1985-1996 period, the nonemployment rate for working-age individuals fell. But the share of households without employment rose in 13 of the 16 countries (Chart 4).⁴ (Further work at the level of disposable income suggests that a good part of the increase in inequality can be attributed to the rise in the share of non-worker households, although the size of this effect varied

considerably across countries.⁵ Related to this, poverty is a phenomenon, which is much more prevalent in households without work. For five countries, poverty rates across working-age households have been compared conditioning on whether they had adults in work or not. In fact, the poverty rates in workless households were from three to 10 times higher than in the working households. Perhaps not surprisingly, the United States came out as having the highest poverty rate among working households.

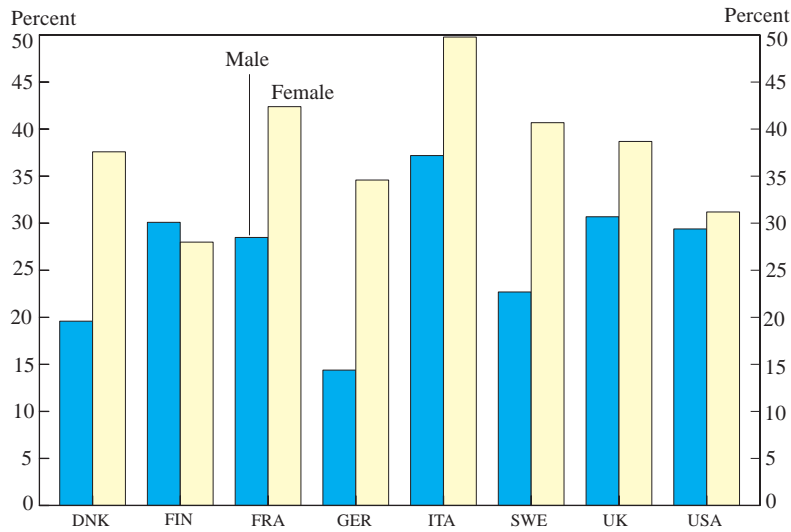
The link between macroeconomic developments and income distribution needs studying

One can only agree with Atkinson's fourth point about the complexity of this relationship. On one side, he observes that the relationship between individual unemployment and poverty is not clear-cut (and this shows why it is important to consider households without any employed component rather than unemployed individuals, when one studies such a relationship). On the other side, he also shows how complex is the relationship between the macroeconomic distribution of factor incomes (labor and nonlabor incomes, or factor shares) and the distribution among households. Also the Romers' paper for this conference addresses the link from macroeconomic developments to income dispersion. That, of course, still leaves the question about the link in the opposite direction.

A final point

Let me end by addressing a qualification that Atkinson makes at the beginning of his paper. It is that one should be careful about drawing too strong conclusions from looking at snapshots of the income distribution. More crucial than the distribution of annual incomes across individuals is the distribution of lifetime incomes. And these are not identical because individuals over their lifetimes move within the income distribution. Some recent quantification of such mobility as regards the earnings of people in full-time employment shows a perhaps surprisingly similar picture across the countries covered by data.⁶ Chart 5 shows the share of people in the lowest

Chart 5
Retention Rates in Low Earnings
After Five Years¹



¹Share of low-paid workers in 1986 who were low paid also in 1991. Low-paid workers are defined as workers belonging to the bottom quintile of the earnings distribution across full-time wage and salary workers.

Source: OECD *Economic Outlook* (1996).

quintile of the earnings distribution in 1986 who were still there after five years. Across countries, the proportion is roughly one-third. So mobility seems to be quite high even if it differs across different groups, being generally highest for young workers, and even if some of those who move away from the lowest quintile may have moved out of employment altogether.

We do not know much about the development of earnings and income mobility over time. But for the few countries where we have data, it seems that it has remained reasonably constant. That suggests that where the dispersion of static income and earnings distributions have increased, the dispersion of the distribution of lifetime incomes has also increased.