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In It Together

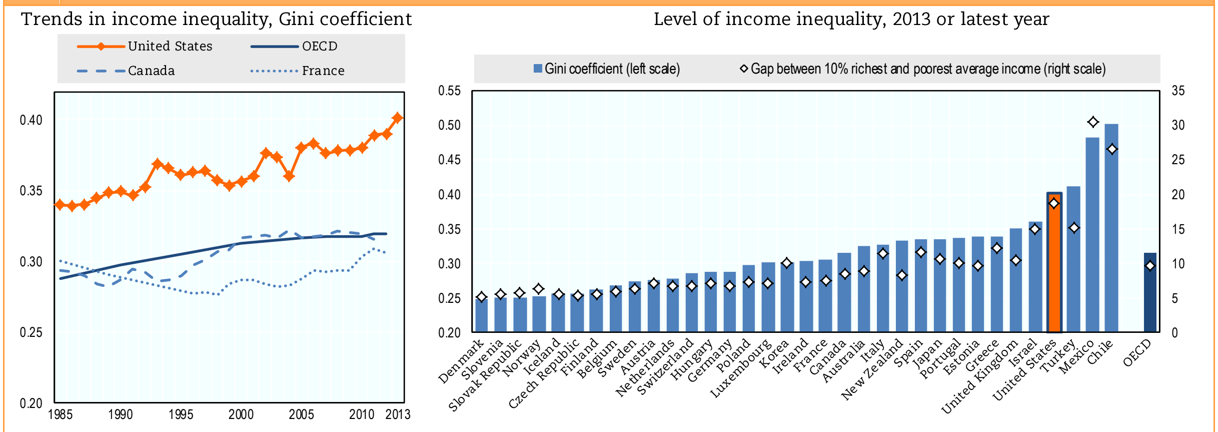
Why Less Inequality Benefits All

...in the United States

What is the issue?

- **Income inequality in the US is high and has been rising further in recent years**. In 2013, the average income of the top 10% was 19 times higher than that of the bottom 10%, up from a ratio of 11 to 1 in the mid-1980s and 12.5 to 1 in the mid-1990s. This compares to an OECD average of 9.6 to 1 in 2013 (Figure 1).
- Wealth inequality is even higher than income inequality. In the US, the top 10% owns around 76% of all net wealth, while the top 10% of income earners get 30% of income. **The financial crisis has exacerbated the concentration of wealth**. Between 2007 and 2013, net wealth fell on average 2.3%, but it fell ten-times more (26%) for those at the bottom 20% of the distribution.
- **Income poverty** (measured as half of the national median household income) **affects around 18% of the population** in the United States, a rate considerably higher than the OECD average of 11%.
- **Between 2008 and 2013**, real average household disposable income increased by 2.5%. **Household income at the bottom 10% fell by 3.2%, while at the top 10% it increased 10.6%**.
- **In the last three decades, low-income households have not benefited at all from income growth**. After accounting for inflation, the average income of the bottom 10% in 2012 was 3.3% lower than in 1985 (Figure 2), despite overall household income increasing by 24%.
- While the average household income (corrected by purchasing power differences) in the US is about 14% higher than in Canada and about 25% higher than in Germany and France, the **average income of the bottom 10% in the US is 42% lower than in Canada and about 50% lower than in France and Germany** (Figure 2).

Figure 1: Trends and levels of disposable income inequality



The Gini coefficient scores 0 when everybody has identical incomes and 1 when all the income goes to only one person.

Why is it important for the US?

Redistribution through income taxes and cash transfers is considerably lower in the United States than in most other OECD countries. They reduce income inequality among the working-age population by 20%, the OECD average is 26% and around 30% in France and Germany.

Differently from most OECD countries, the US tax-benefit system does not create large work disincentives for people to move from inactivity to part-time work. This is partly due to in-work benefits such as the **EITC, which incentivises people to take up low-paid jobs**.

On the other hand, the **tax-benefit system creates disincentives for workers to move from part-time to full-time jobs, more than in the OECD average**. This is also partly due to EITC, which is withdrawn as earnings increase.

Tax-benefit measures implemented in the United States between 2007 and 2010 included a number of fiscal stimulus measures. Some measures were rolled back later as the economy started to recover. Fiscal stimulus measures included permanent and temporary increases in tax reliefs and tax credits; extending the duration of unemployment benefits; replacing the "Food Stamp

Program" with "Supplemental Nutrition Assistance Program"; and reducing payroll tax rates in 2011 and 2012.

Overall, **tax-benefit measures implemented between 2007 and 2013 helped families to cope with effects of the crisis, mainly due to higher social benefits**. The impact was particularly positive for families that were out-of-work and earning below the average wage, mainly due to changes in unemployment, social assistance benefits and tax credits. Families with middle to high earnings gained from cuts on taxes and, especially, social contributions, but these measures were rolled back in 2013.

In the US, a large share of households has high levels of debt. Three in four households are in debt and one in four is over-indebted (debt-to-asset ratio above 75%). This exposes them to sizeable risks in the event of sudden changes in asset prices, with implications for the vulnerability of the economic system as a whole.

While in most countries the fall in employment drove the rise in labour income inequality between 2007 and 2011, **in the United States both lower employment and a widening wage gap contributed to earnings** inequality during the crisis years.

Higher female employment and work intensity as well as a lower gender wage gap had a strong equalising effect in the US. Had female work conditions remained the same as 20 years ago, household income inequality would have been almost 3 Gini points higher than today (see Figure 3).

Figure 2: Average disposable income of bottom 10%, in US$ PPP and inflation adjusted, total population, 1985-2012

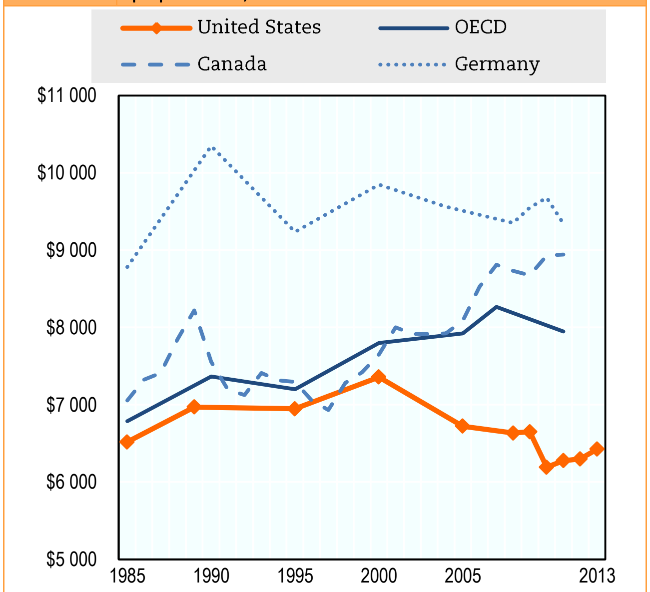
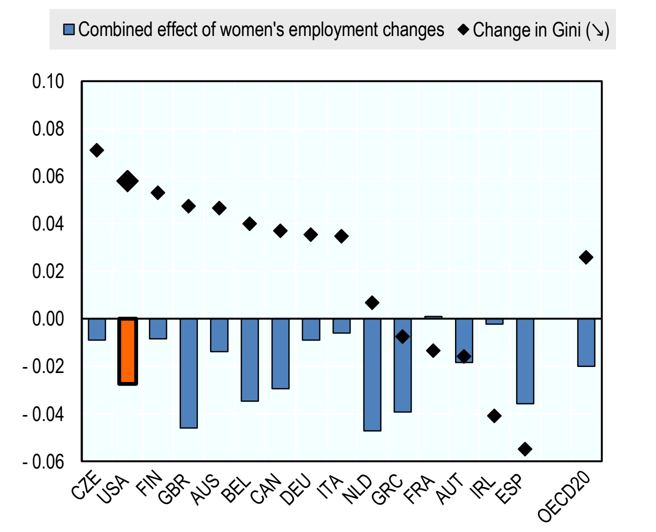


Figure 3: Women's employment has an equalising effect



To tackle inequality and promote opportunities for all, countries should adopt a comprehensive policy package, centred around four main areas: Promoting greater participation of women into the labour market, fostering employment opportunities and good-quality jobs; strengthening quality education and skills development and adaptation during the working life; and a better design of tax and benefits systems for efficient redistribution. In the United States, this would include initiatives such as:

- Make more use of in-work benefits (e.g., EITC) to encourage people not only to take up paid work but also to increase work intensity as well as provide additional income support to low-income households.
- Simplify means-tested transfer system in order to reduce administrative costs and increase take-up of vulnerable groups.
- Promote the up-skilling of the workforce by investing in the vital early childhood period and compulsory education, thus ensuring equality of opportunity for children from disadvantaged backgrounds. Facilitate the transition from school to work and create incentives for workers and employers to invest in skills throughout the working life.
- Make use of top earners' greater capacity to pay taxes by raising their tax rates, improving tax compliance, eliminating or scaling back regressive tax deductions. Reassess and address loopholes on taxes on capital income, property, wealth and inheritance.
- Improve access and quality of public services as a longer-term social investment to foster upward mobility and create greater equality of opportunities in the long run.