OECD (2011), *Divided We Stand: Why Inequality Keeps Rising*

www.oecd.org/els/social/inequality

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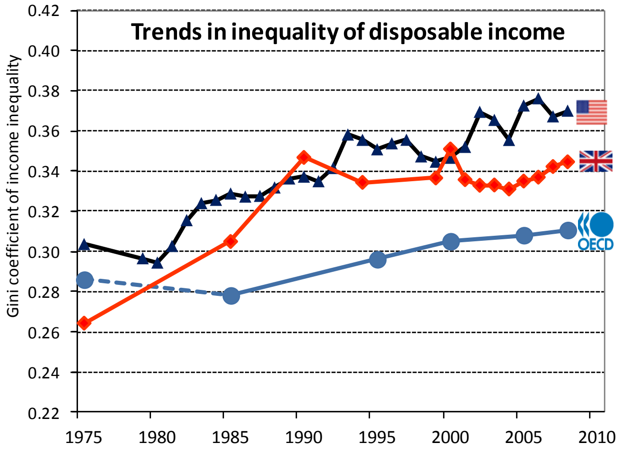
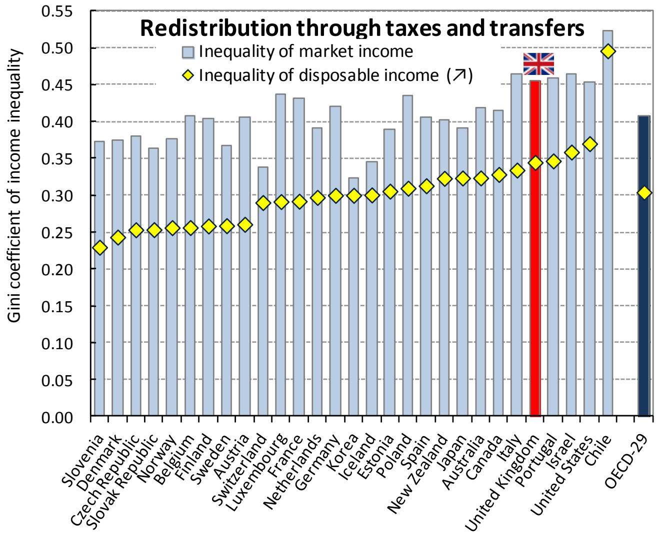
COUNTRY NOTE: UNITED KINGDOM

Income inequality among working-age persons has risen faster in the United Kingdom than in any other OECD country since 1975. From a peak in 2000 and subsequent fall, it has been rising again since 2005 and is now well above the OECD average.

The annual average income of the top 10% in 2008 was almost GBP 55,000, almost 12 times higher than that of the bottom 10%, who had an average income of GBP 4,700. This is up from a ratio of 8 to 1 in 1985. Taxes and benefits reduce inequality by a quarter in the United Kingdom, in line with the OECD average. [Figure6.1]





Notes: The Gini coefficient ranges from 0 (when all people have identical incomes) to 1 (when the richest person has all the income). Market incomes are labour earnings, capital incomes and savings. Disposable income is market income plus social transfers less income taxes. Incomes are adjusted for household size. Data refer to the working-age population. Information on data for Israel: http://dx.doi.org/10.1787/888932315602

Key findings:

- *Top income shares doubled.* The share of the top 1% of income earners increased from 7.1% in 1970 to 14.3% in 2005 [Table9.1]. Just prior to the global recession, the top 0.1% of top earners accounted for some 5% of total pre-tax income. At the same time, the top marginal income tax rate saw a marked decline: dropping from 60% in the 1980s to 40% in the 2000s, before its recent increase to 50%.

- *The higher-paid worked more hours*. As in most other OECD countries, the UK recorded a trend towards an increasing divide in hours worked between higher- and lower-wage earners. Since the mid-1980s, annual hours of low-wage workers remained stable at around 1050, while those of higher-wage workers augmented from 2240 to 2450 hours. [Table4.A1.2]

- *More workers became self-employed.* About one-half of the increase in individual earnings inequality is explained by changes in self-employment income as on the whole the self-employed earn less than full-time workers. Their share in total earnings increased by one fifth since the mid-1980s and among the self-employed, the gap between high and low earners has risen.

- *More people are marrying within the same earnings class.* Unlike many other countries, the earnings gap between wives of rich and poor husbands has grown strongly: this gap was about GBP 3,900 in 1987, but increased to GBP 10,200 in 2004.

- *Transfers and taxes became less redistributive.* Between the the late 1970s and mid 1980s, the tax-benefit system in the UK offset more than 50% of the rise in market income inequality. This effect has fallen in the subsequent decades.
- *Benefits became less redistributive despite being more targeted towards the poor*. This was largely driven by declining benefit amounts. It was also due to more people working, often at low-wage jobs and so not qualifying for benefits. And lastly due to tighter eligibility conditions.
- *Taxes became less equalising.* Reduced progressivity has cut the redistributive effect of income taxes approximately by half. Lower progressivity was due in part to the removal of the higher-rate tax brackets and a reduction in the basic tax rate.
- *But public services improved their impact on reducing inequality.* Social spending in the UK relies more on public services (such as education, health etc.) than on cash transfers: spending on services amounts to over 15.4% of GDP while spending on cash transfers is some 10% [Figure8.1]. These services reduce inequality more than almost anywhere else, and this impact has increased over the 2000s.

Key policy recommendations for OECD countries from Divided We Stand

- Employment is the most promising way of tackling inequality. The biggest challenge is creating more and better jobs that offer good career prospects and a real chance to people to escape poverty.
- Investing in human capital is key. This must begin from early childhood and be sustained through compulsory education. Once the transition from school to work has been accomplished, there must be sufficient incentives for workers and employers to invest in skills throughout the working life.
- Reforming tax and benefit policies is the most direct instrument for increasing redistributive effects. Large and persistent losses in low-income groups following recessions underline the importance of government transfers and well-conceived income-support policies.
- The growing share of income going to top earners means that this group now has a greater capacity to pay taxes. In this context governments may re-examine the redistributive role of taxation to ensure that wealthier individuals contribute their fair share of the tax burden.
- The provision of freely accessible and high-quality public services, such as education, health, and family care, is important.

The roles of globalisation, technological progress and regulatory reforms

Divided we Stand also looks into the impact of global developments on rising wage dispersion and employment trends over the past quarter century up to the 2008-09 financial crisis. For the OECD area as a whole, the following key findings emerge:

- Globalisation, i.e. the rapid trade and foreign direct investment integration that occurred in all OECD countries over the past quarter century did not – per se- play a major role in driving growing wage dispersion. However, globalisation pressure affected domestic policy and institutional reforms (see below).
- Technological progress led to higher wage differentials: advances in information and communication technologies in particular have been more beneficial for workers with higher skills.
- Regulatory reforms and changes in labour market institutions increased employment opportunities but also contributed to greater wage inequality. More people, and in particular many low-paid workers, were brought into employment. But one of the consequences of more low-paid people in work is a widening distribution of wages.
- The rise in the supply of skilled workers provided a sizeable counterweight to offset the increase in wage inequality resulting from technological progress, regulatory reforms and institutional changes. The upskilling of the labour force also had a significant positive impact on employment growth.