

Mechanisms of income inequality: what we talk when we talk about income inequality

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Outline

- A. Main preliminary questions about income inequality concepts
 - Inequality of what?
 - The steps shaping the income distribution
- B. Inequality trends according to various income concepts and measures
- C. Main drivers and policy implications

Income inequality concepts

A starting point: cliché about income inequality

- Focus on inequality because of ethical judgements, processes shaping it and consequences on other dimensions (e.g. growth, health, social cohesion, democracy)
- In public debate powerful but groundless and inconsistent cliché about the seriousness of income inequality (Franzini and Raitano, 2026, “La disuguaglianza oltre i luoghi comuni”):
 - It is not an issue since it is not actually rising
 - It fosters higher economic growth
 - It is the outcome of individuals’ merits
 - The actual serious issues are poverty and inequality of opportunity
 - It is a simple phenomenon depending on a single driver with simple policy implications

Main questions about inequality

- A preliminary remark: no exhaustive theories about inequality mechanism => complex phenomenon depending on many determinants acting in various steps
- Preliminary crucial questions (also for empirical analyses):
 - Factor or personal distribution?
 - What is the best indicator of individual living standard? Considering income, which kind of income?
 - What time unit must be considered?
 - What is the best unit of observation? Person or household?

Factor or personal distribution

In the past main focus on factor distribution: profit and wage shares. Factors were a sufficient conditions for inferring personal distributions

Currently, main focus on personal distribution for various reasons:

- Complex links between factors and households
- Individuals and households earn incomes from several sources
- Growing increase of “within inequalities”, inside the different sources => how to consider earnings super-rich?
- The model of wage-earning male breadwinner disappeared
- A high share of incomes does not pass through the market

Anyway, factor shares capture a major mechanism driving market income inequality

The proxy of individual living standard

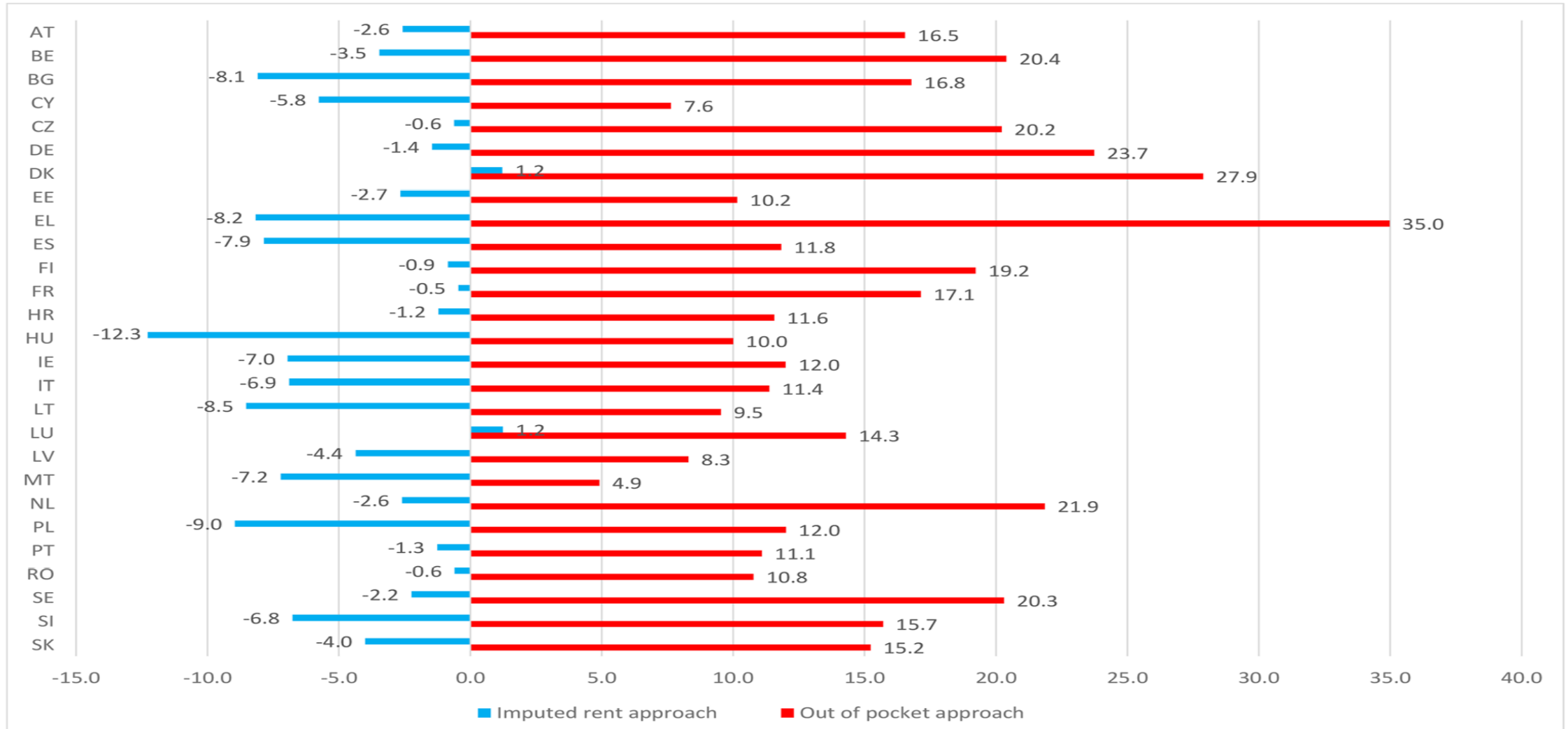
Interest on the distribution of individuals' economic wellbeing => which is the best variable for identifying it? Monetary or non-monetary indexes? Mono or multidimensional indexes?

- a) Income
- b) Consumption
- c) Wealth
- d) Functionings and capabilities
- e) Happiness

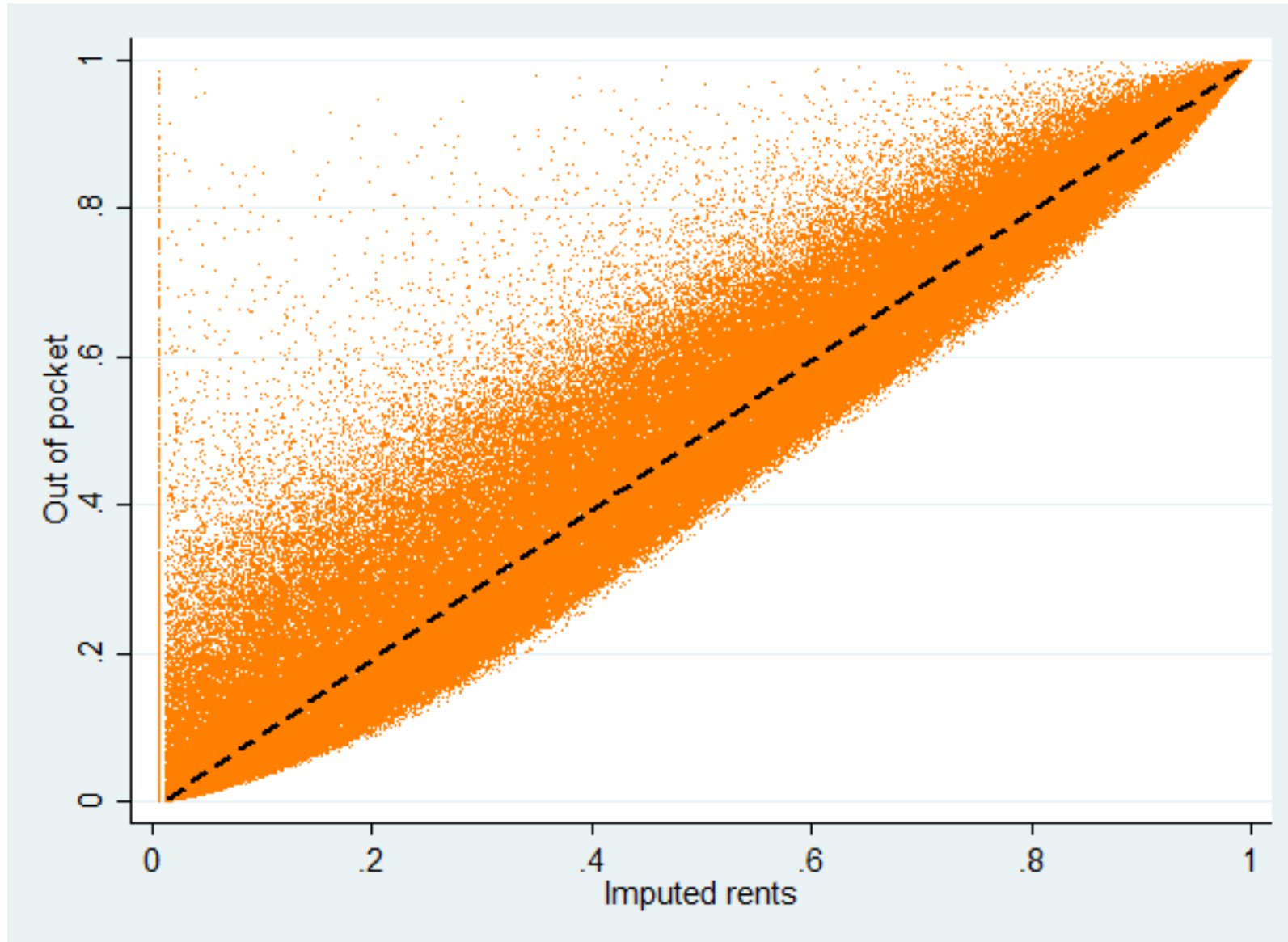
Pros and cons of focusing on income

- Is income an exhaustive proxy of individuals' economic wellbeing?
- Monetary and non-monetary flows should be considered
- “Full income” concept: consumption plus change in wealth in a given time => potential consumption
- Is it possible to exactly compute all income components? What happens with, e.g.: self-employment earnings, capital gains and changes in asset values and in durable goods; unpaid work; housing imputed rents; in-kind welfare transfers; fringe benefits
- Mismeasurement biases the measure of inequality and individual rankings
- What is the effect of inflation on income and on economic wellbeing?
- Is it enough equalizing real wages when price levels diverge across areas?
- Towards income net of the spending for basic goods?

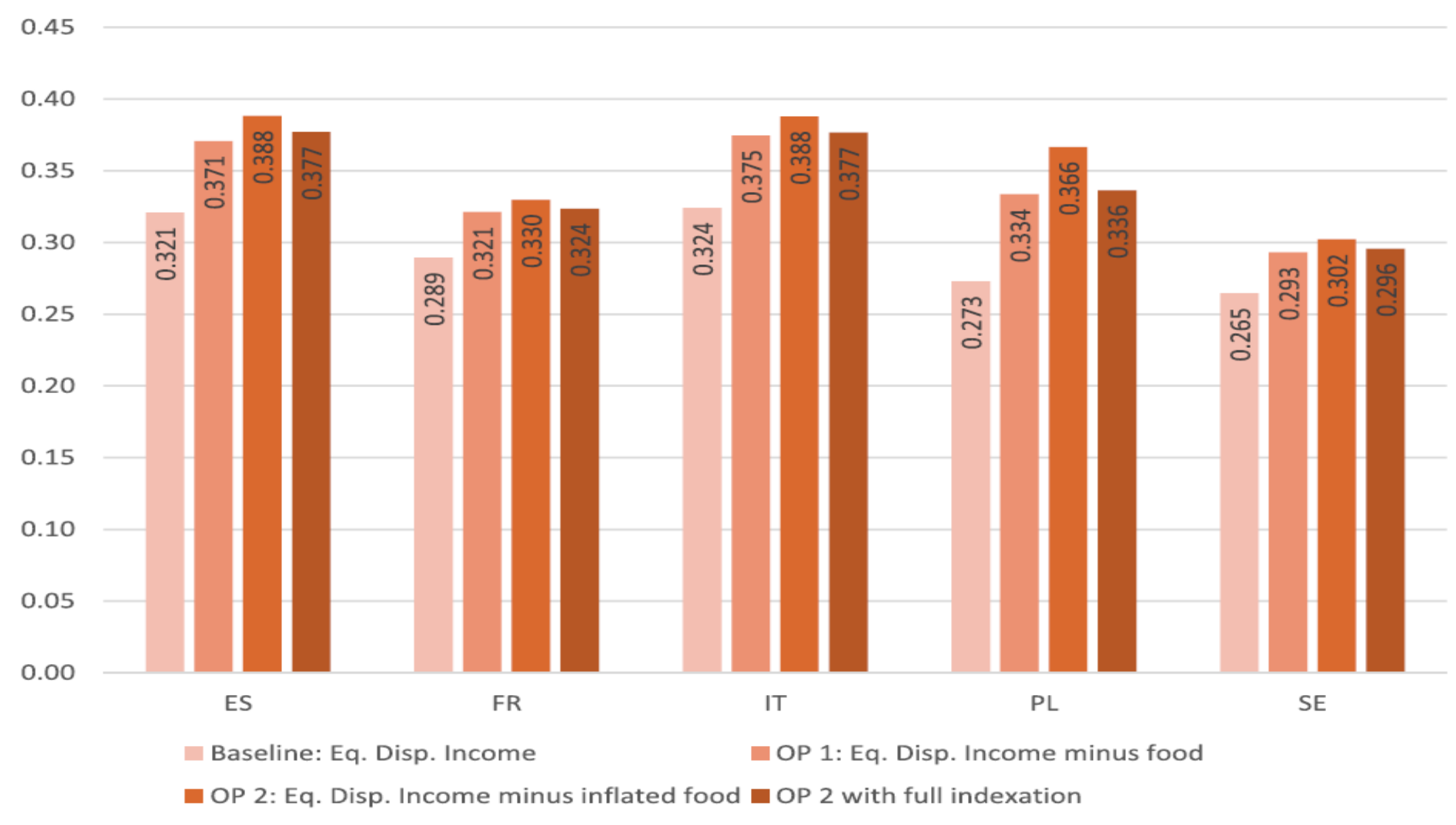
Gini changes when considering housing in the income concept



Reranking from IR to O.P. in the EU



Food inflation and Gini index changes



The steps shaping personal income distribution

From individuals to households; from distribution to redistribution.

1. Individual labour earnings:
 - Hourly wages, time of work, unemployment spells.
2. Household (equivalised) market incomes:
 - Household composition; number of income recipients, non labour incomes.
3. Household equivalised disposable incomes => what taxes and transfers are considered?
 - Are pension transfers redistributive? Are all effects of policies measurable?
 - Different mechanisms of inequality in the various steps => price and composition effects
 - What are the links between individual outcomes and household conditions? Is household composition affected by individual economic conditions?
 - Public policies can act in all steps => redistribution or predistribution?

The time unit

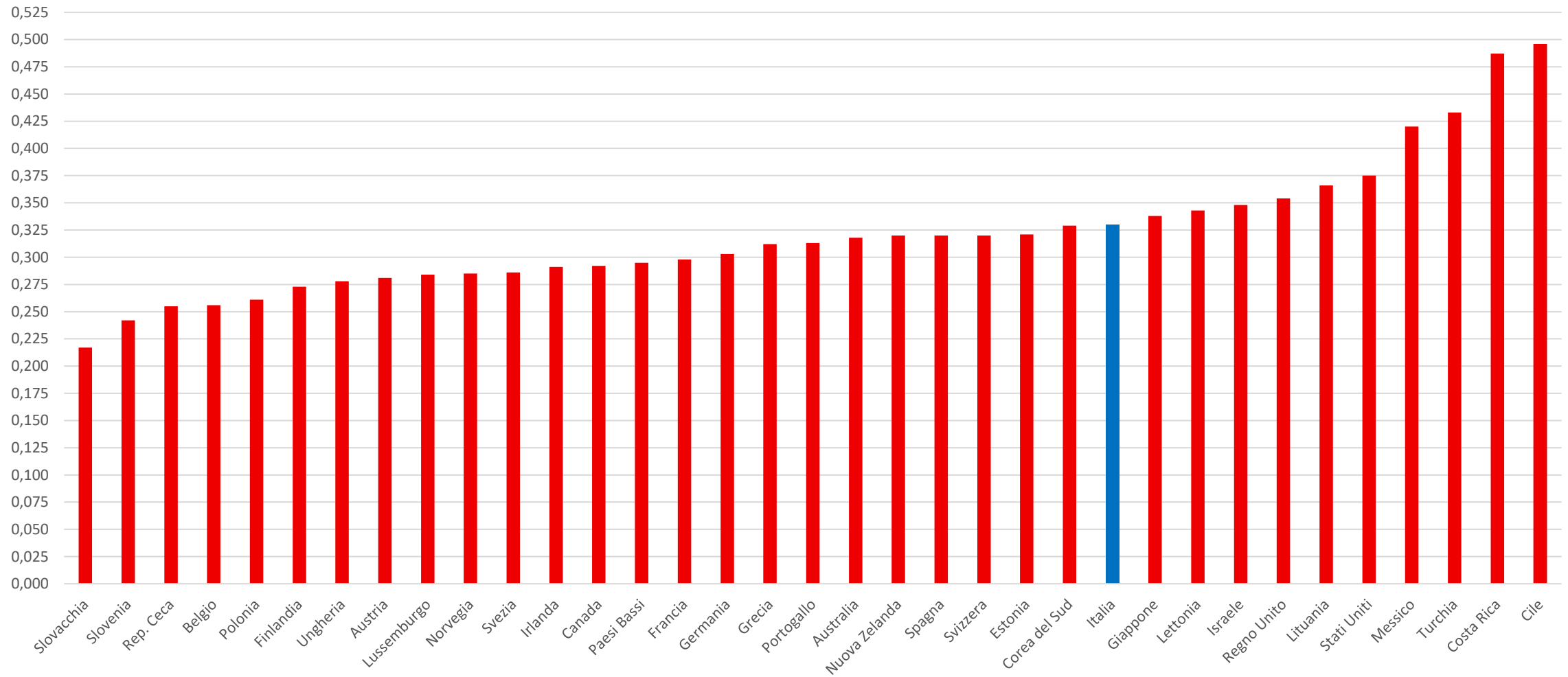
- Which is the time unit to be considered for assessing individual welfare and income? May we rely on annual values?
- Transitory or permanent inequalities?
- Intra-generational and inter-generational mobility
- Main limits of data availability: differences between panel and cross sections
- Which data are available for analyzing income inequalities?
- Differences between administrative and survey dataset => towards admin-survey linked data?

The unit of observation

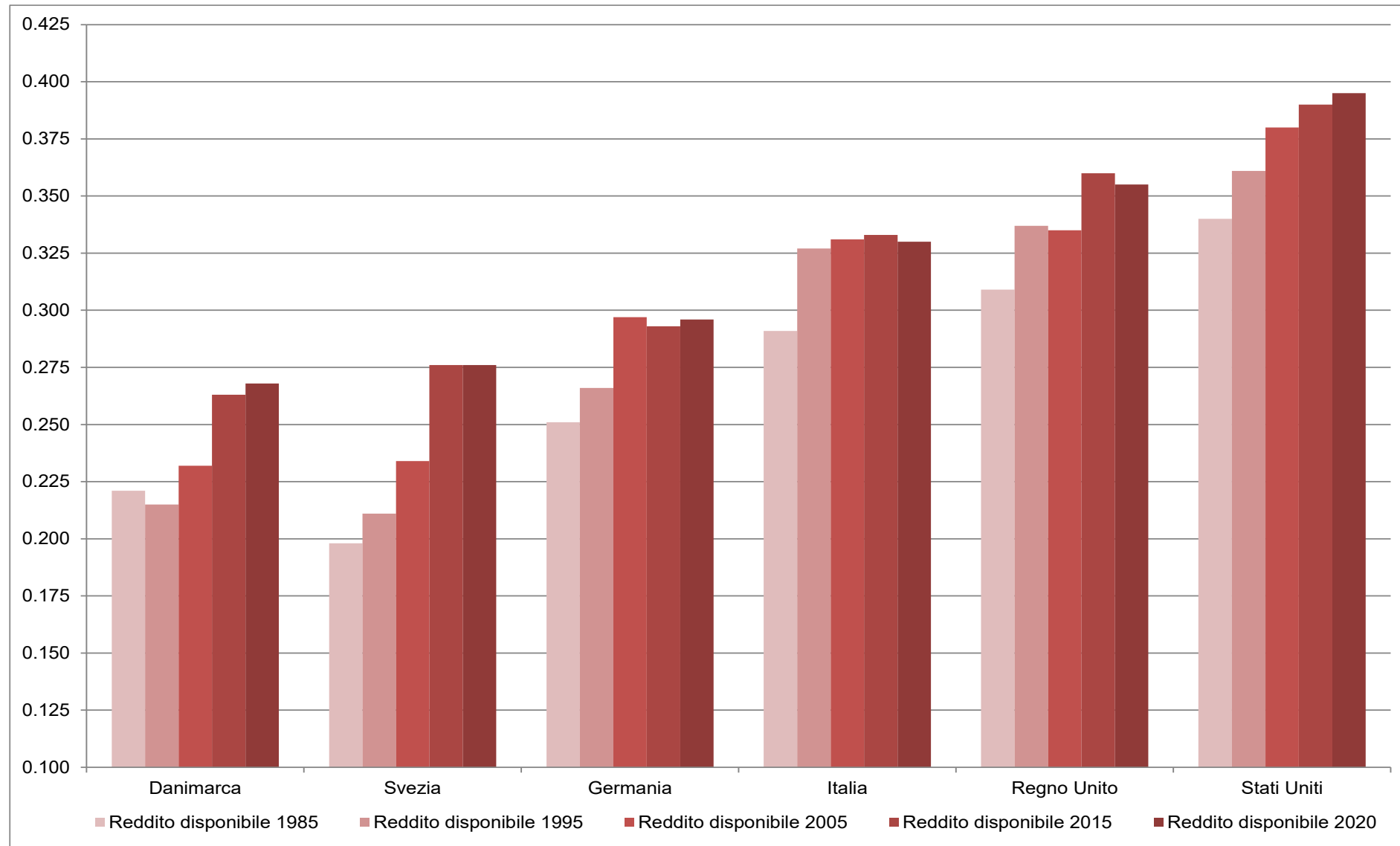
- Individual or household?
- Role of the household crucial:
 - When labour earnings or transfers are not received (e.g. children, housewife)
 - Returns of scale from living together
 - Is there an intra-family inequality?
- How to compare incomes of households of different dimensions?
- Is total household income a good proxy of family wellbeing?
- The role of equivalence scales: coefficients for homogenizing household incomes.
- No consensus on the best equivalence scale
- The chosen scale changes the relative position of larger and smaller households, as it happens in the Italian MI case

***Some data about income inequality
levels and trends***

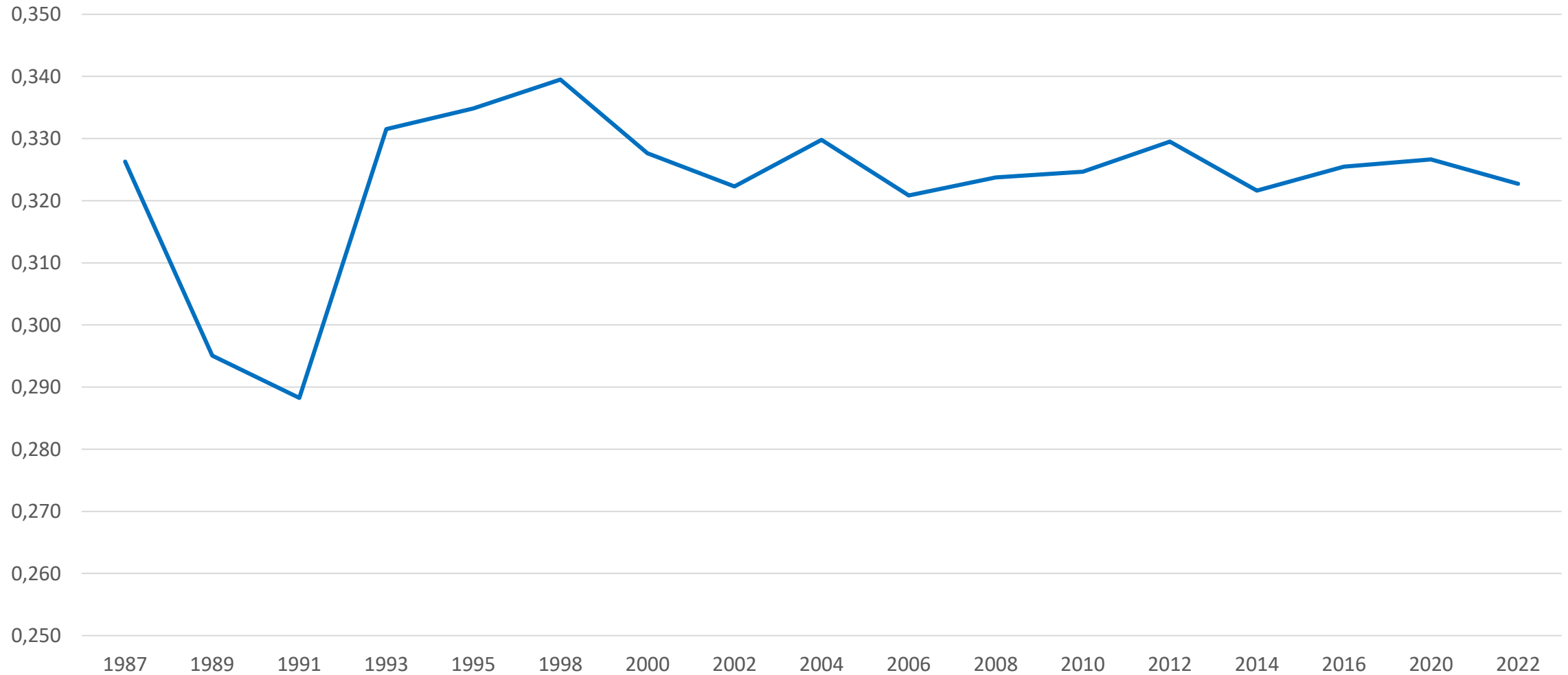
Disposable income inequality in OECD countries (2022)



Trend of disposable income Gini in major OECD countries



Gini of disposable income in Italy

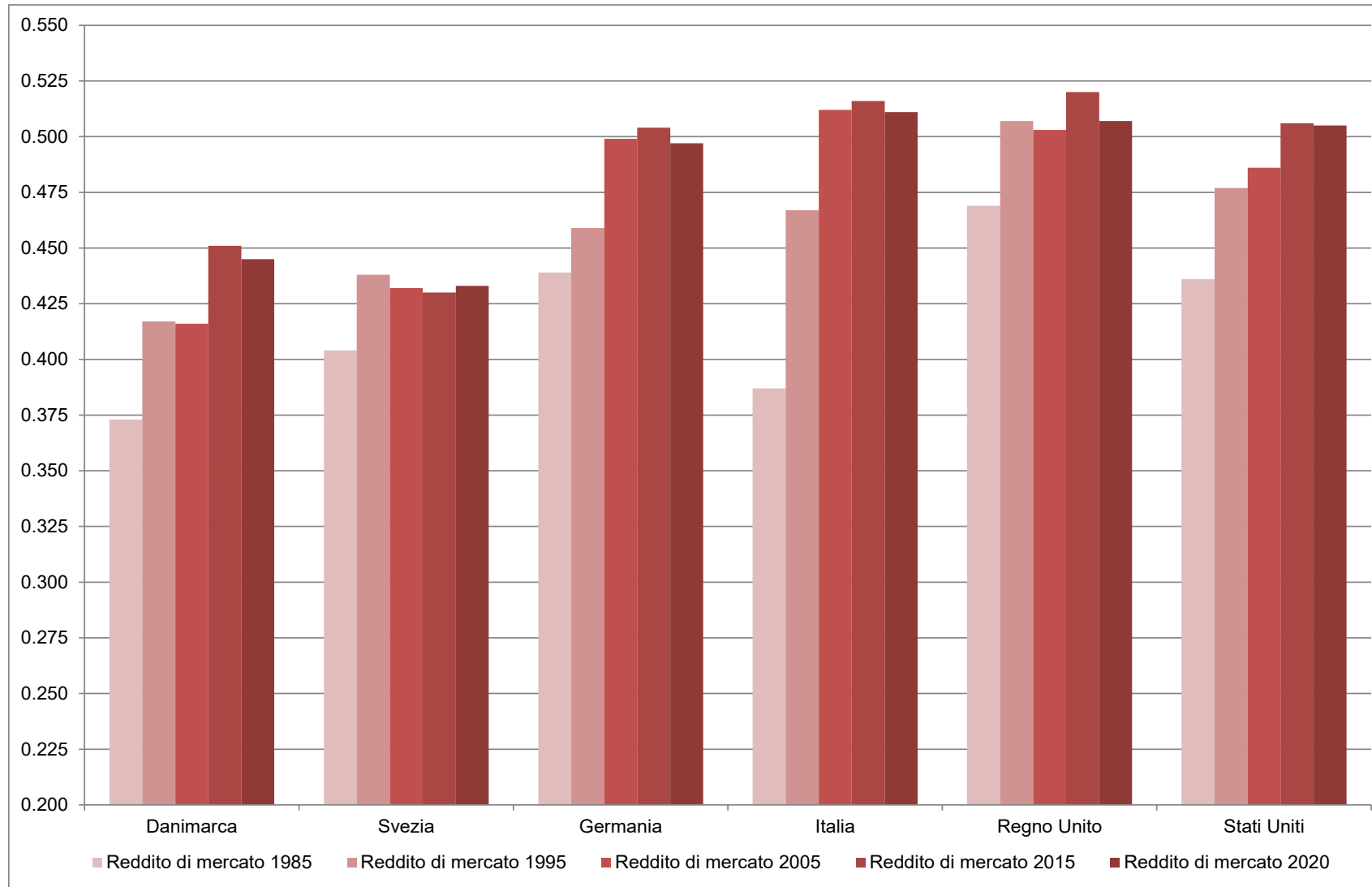


How to evaluate a constant income inequality?

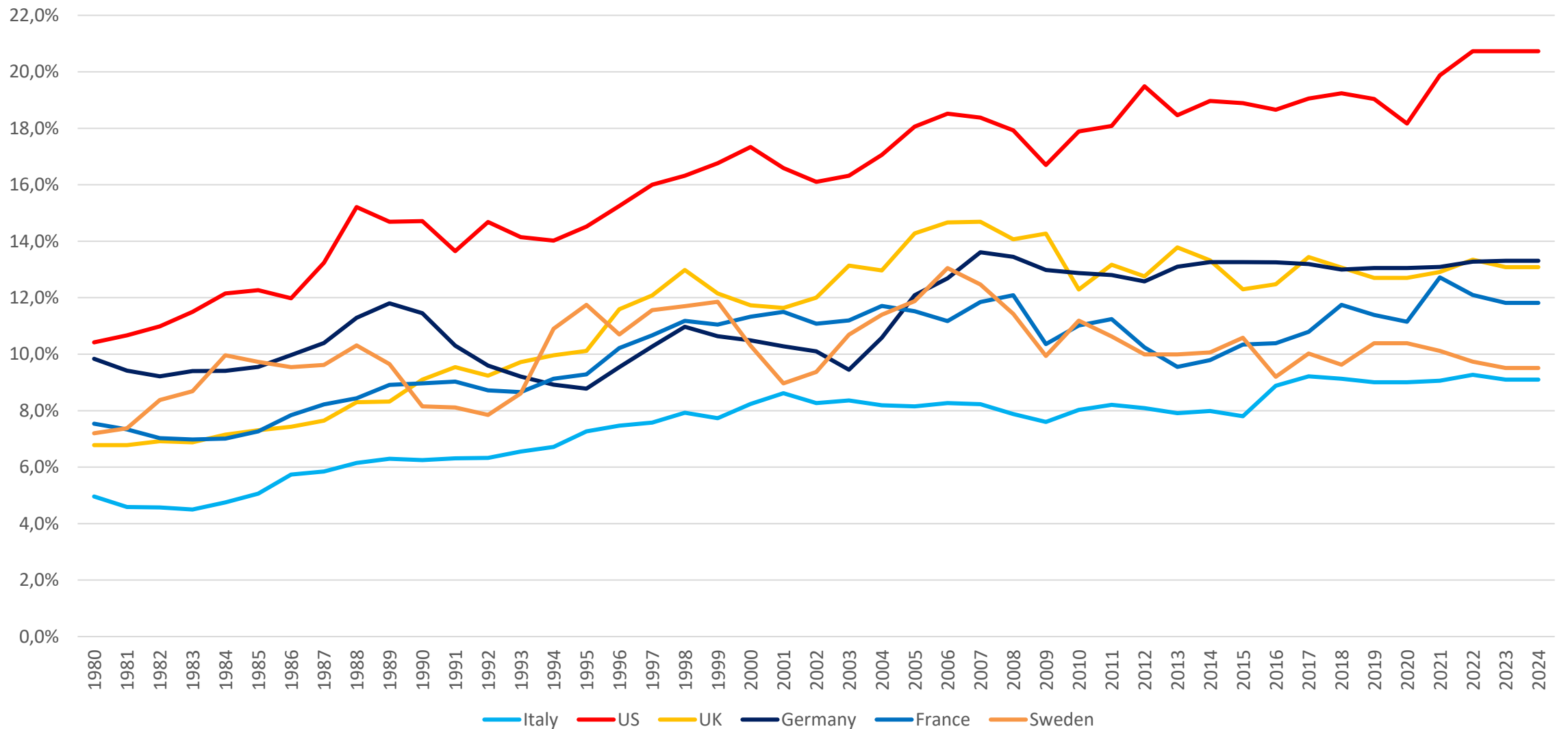
Optimism vs pessimism

- Is there a gap between actual trends and perceptions?
- Is it enough looking at the inequality trend independently of the level?
- Can we trust on available data? What is happening at the tails of the income distribution?
- Are there changes in major phenomena not captured by usual data?
- Should we go beyond standard disposable income measures to capture actual trends of wellbeing?
- Should we look at the processes shaping disposable income inequality? What is happening to wages and market incomes? And to redistribution?
- What income dimension to assess trends of the earnings distribution? Is it enough focusing on contractual unitary wages?

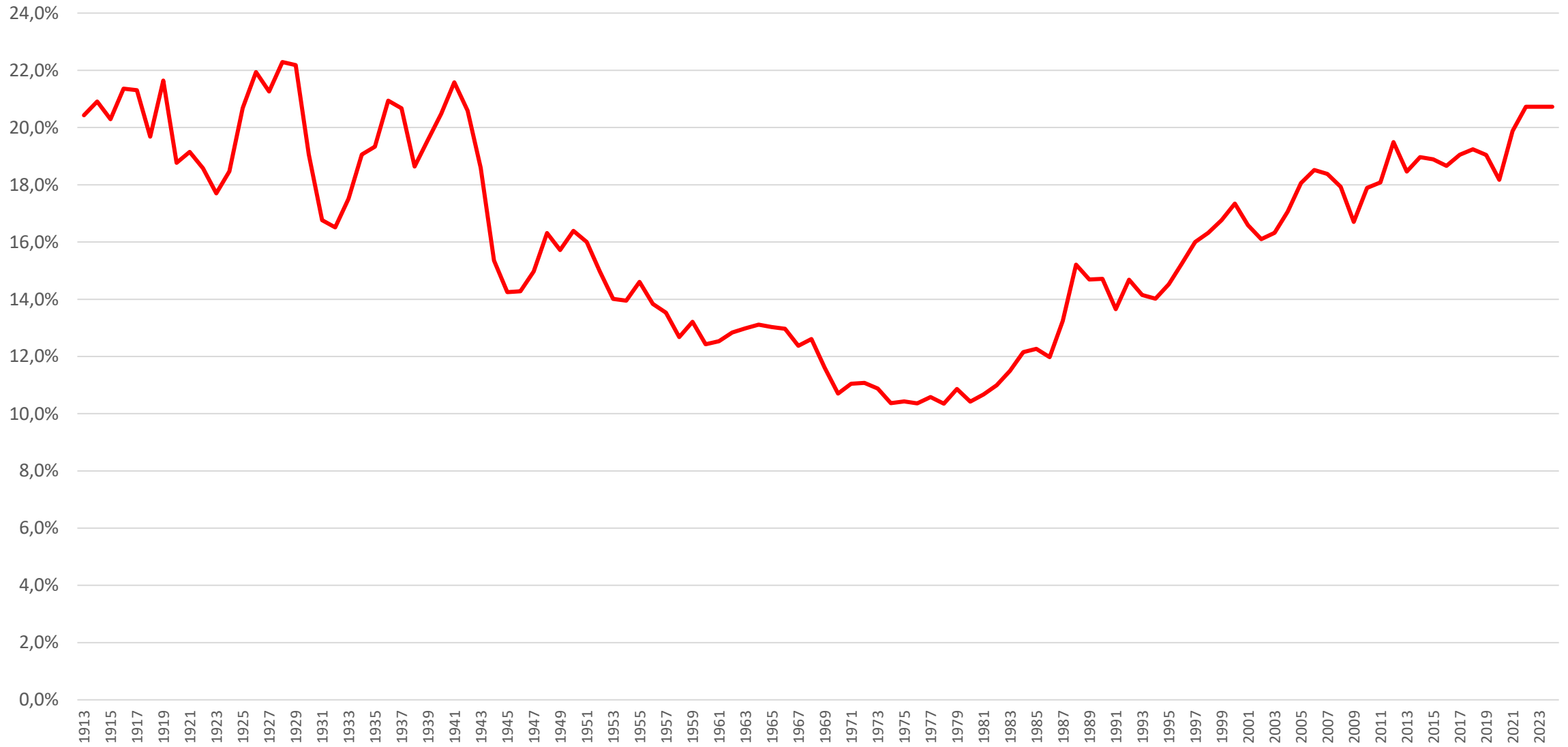
Trend of market income Gini in major OECD countries



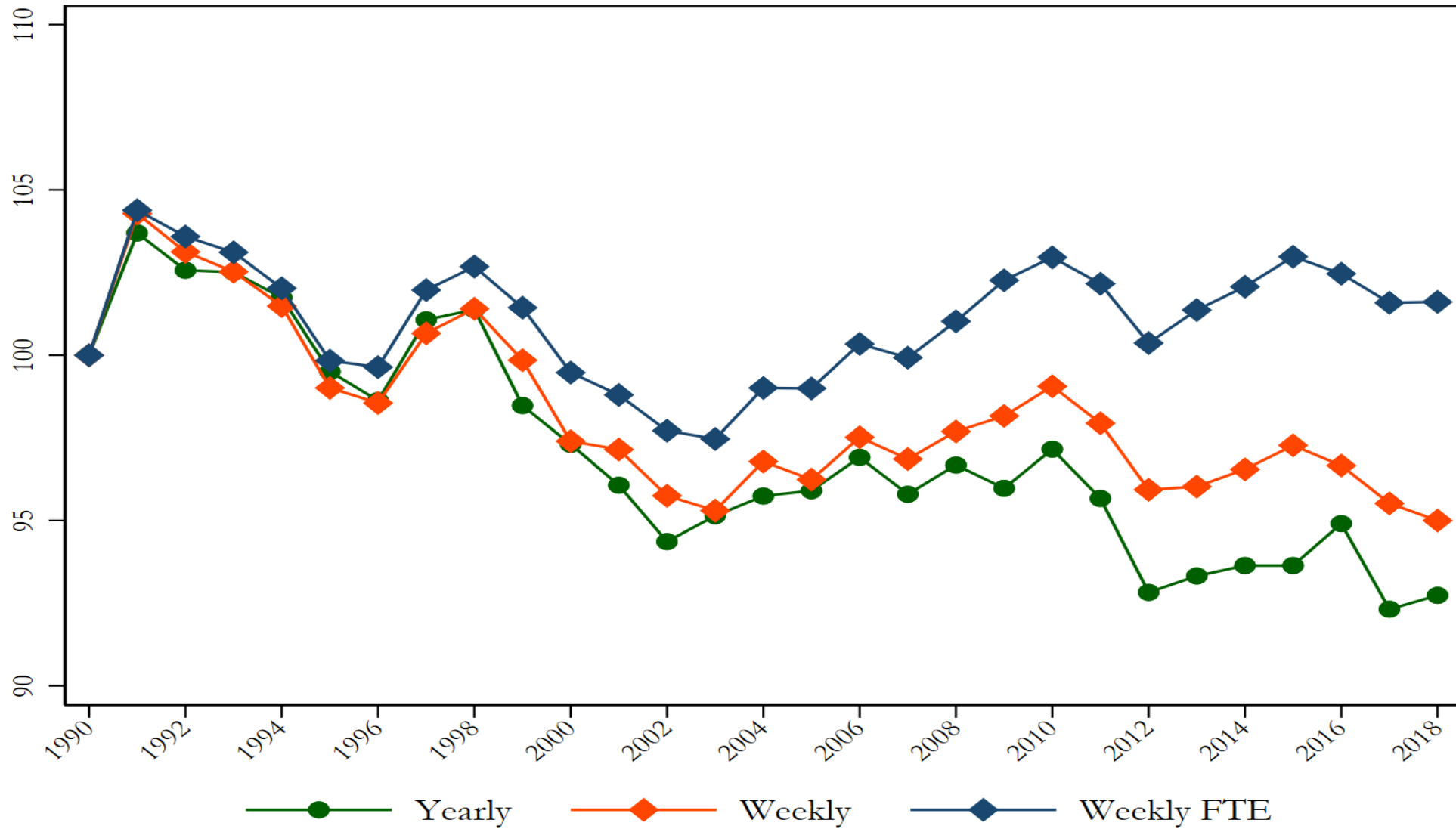
Trends of top 1% income shares in major OECD countries



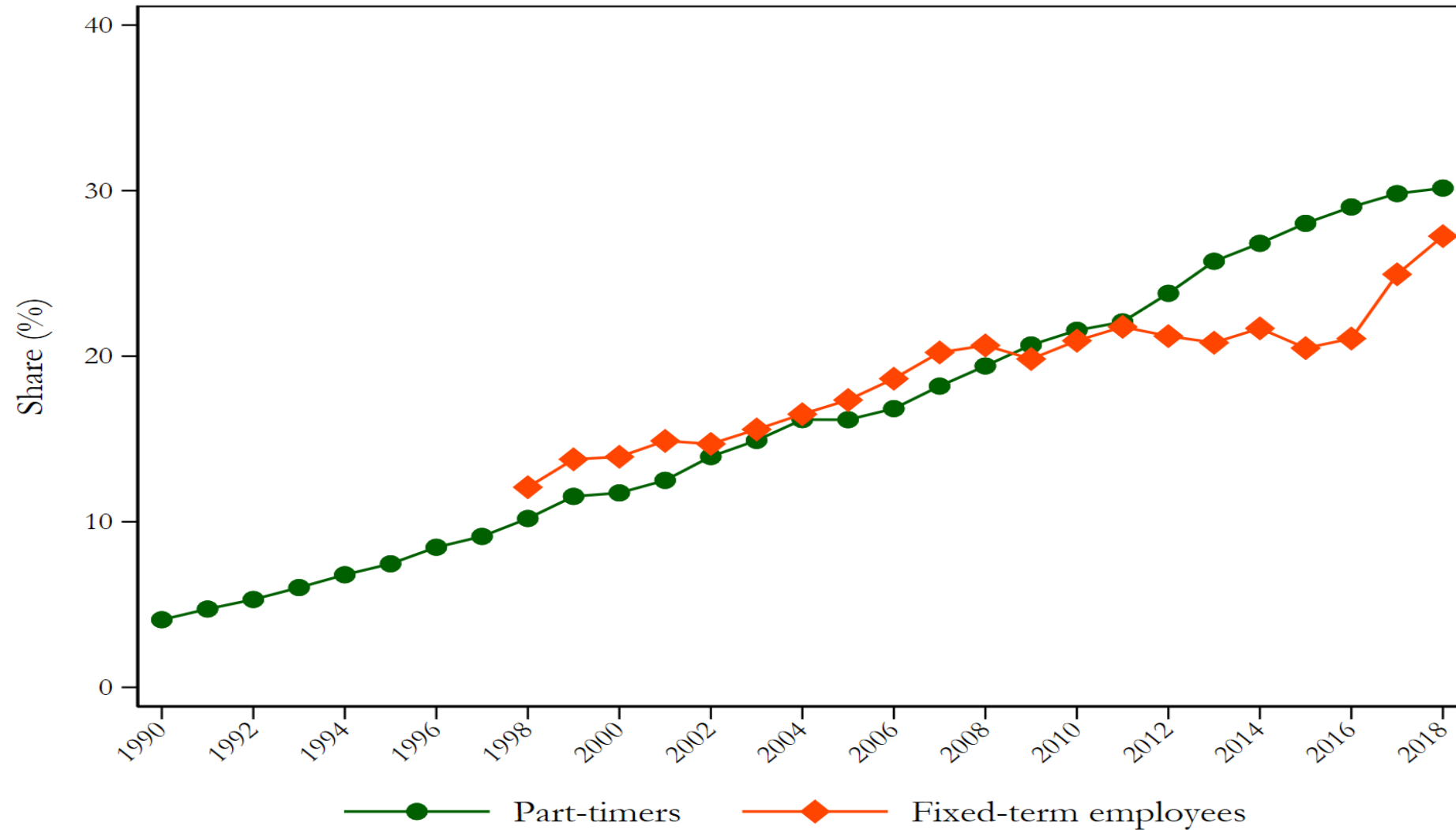
Long run top 1% trend in the US



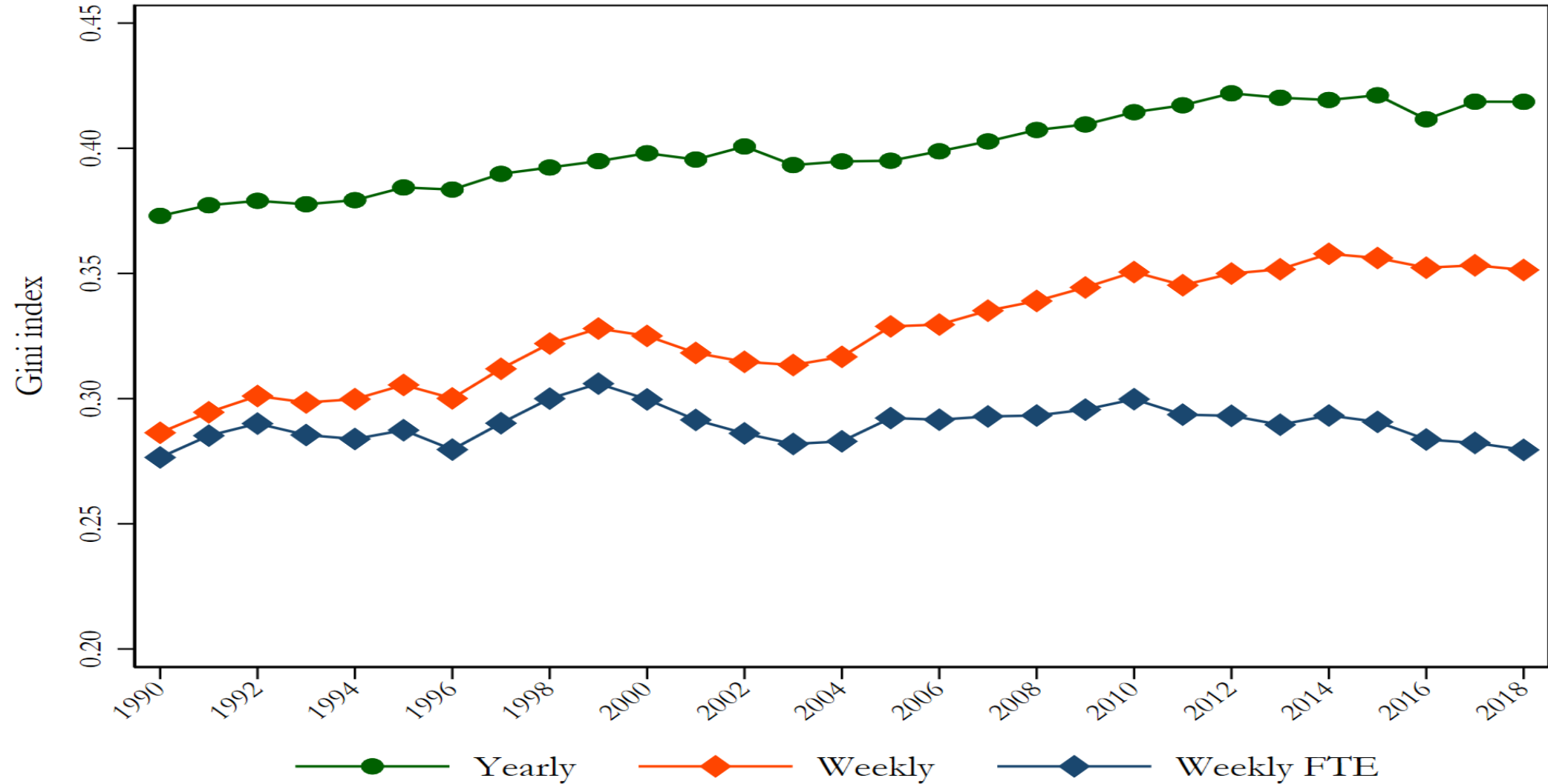
Trend of median gross earnings in Italy



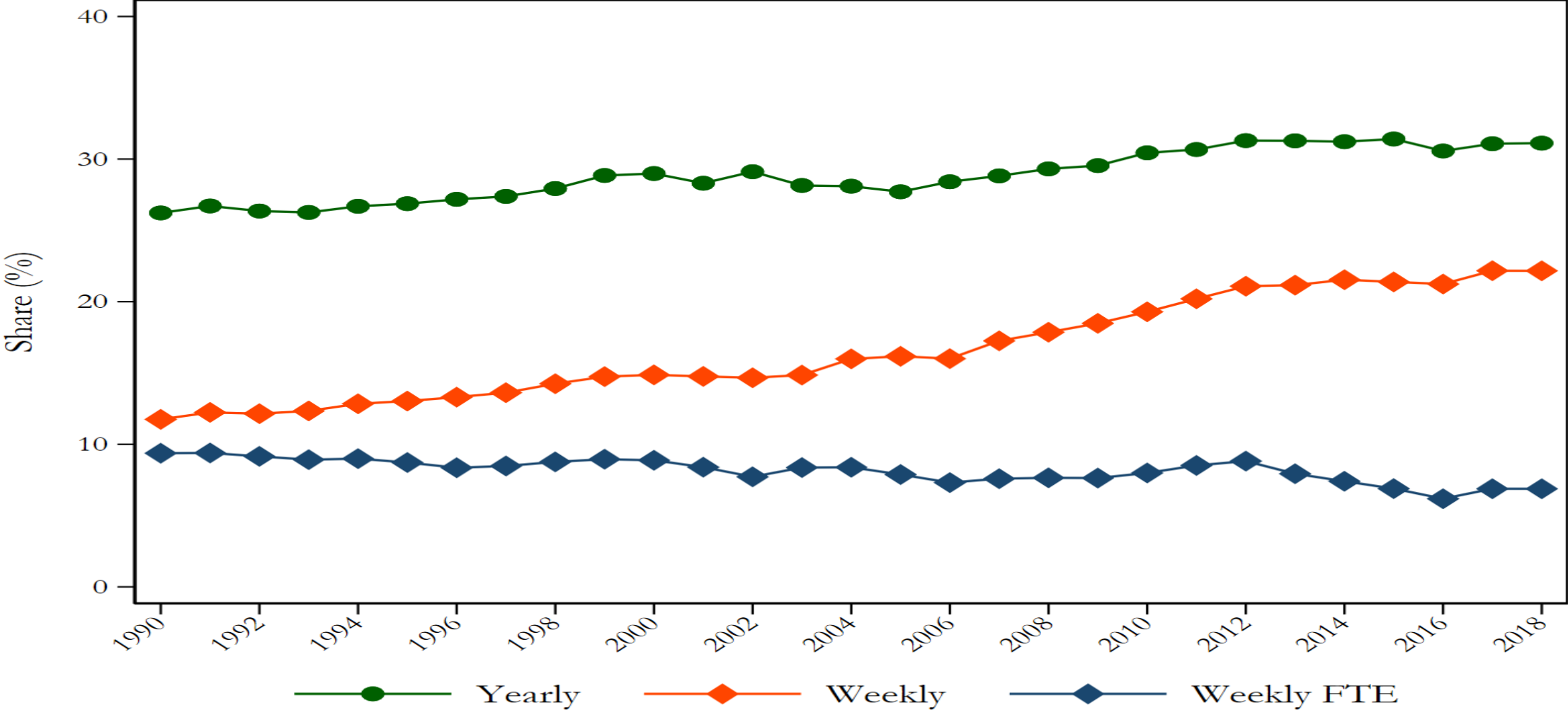
The spread of non-standard contracts in Italy



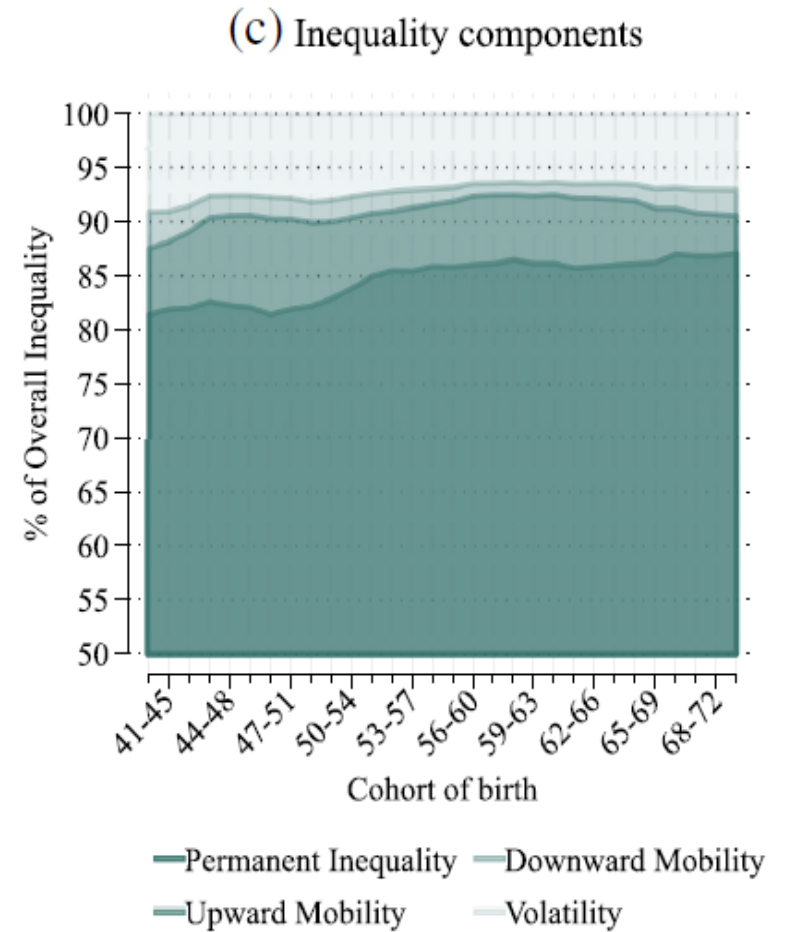
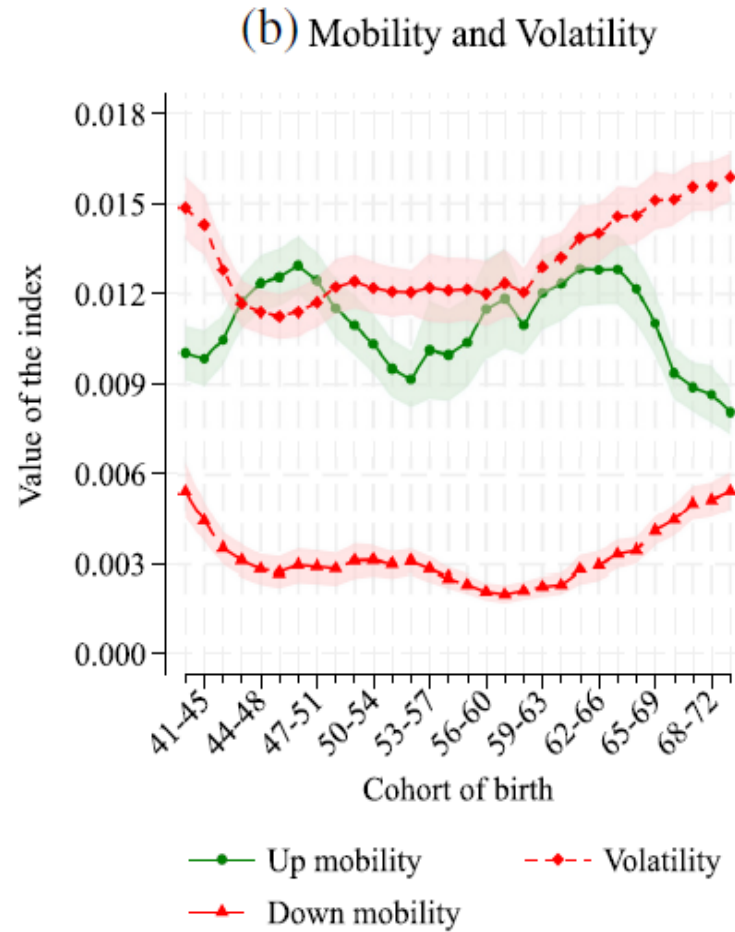
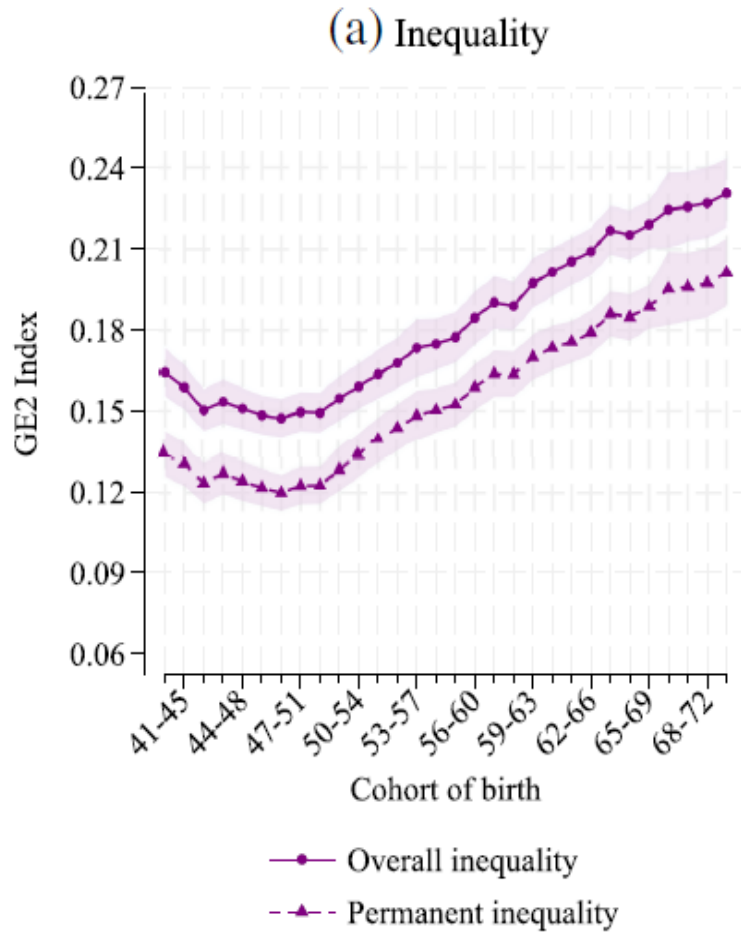
Gini of gross wages in Italy



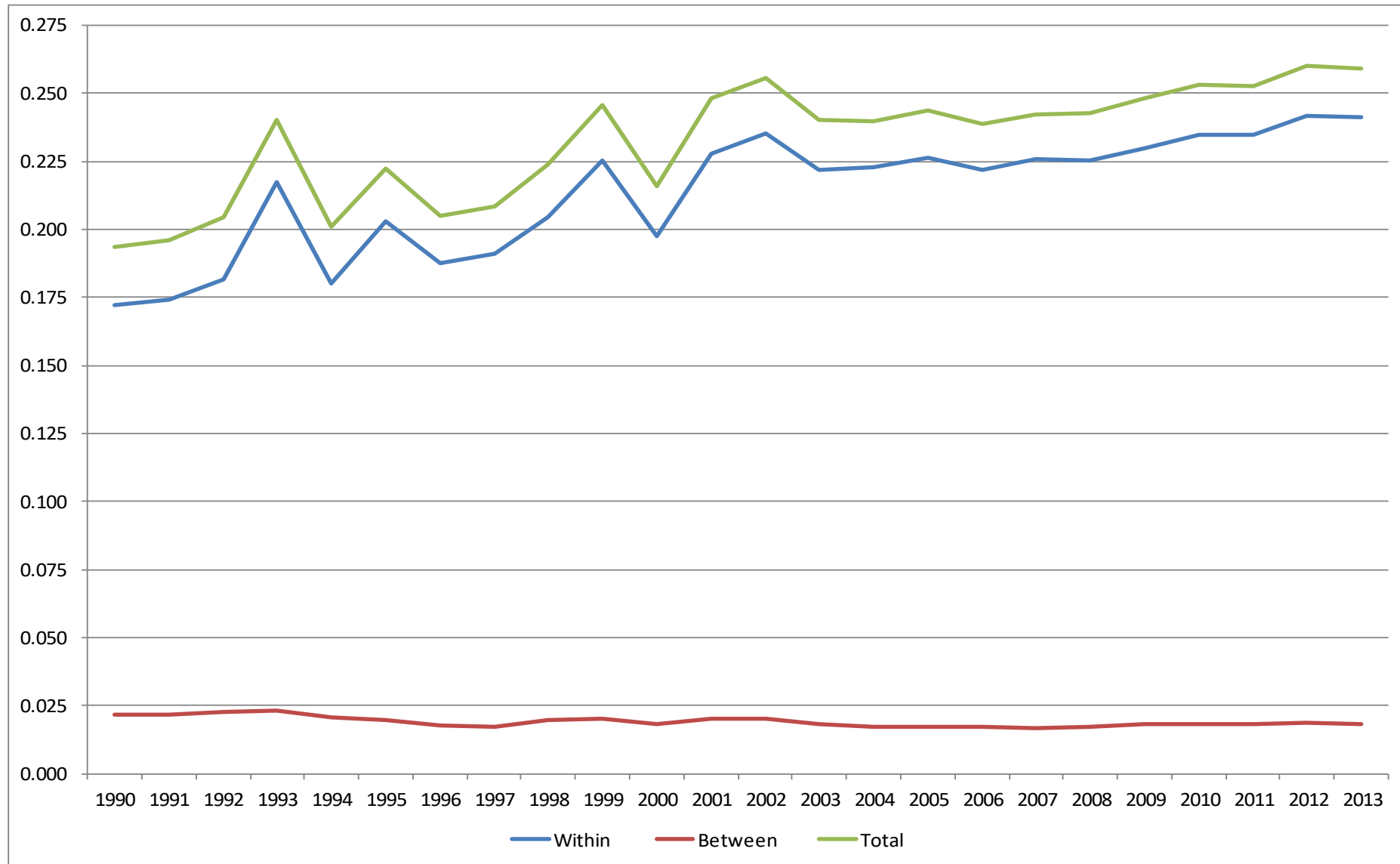
Trends of low pay in Italy



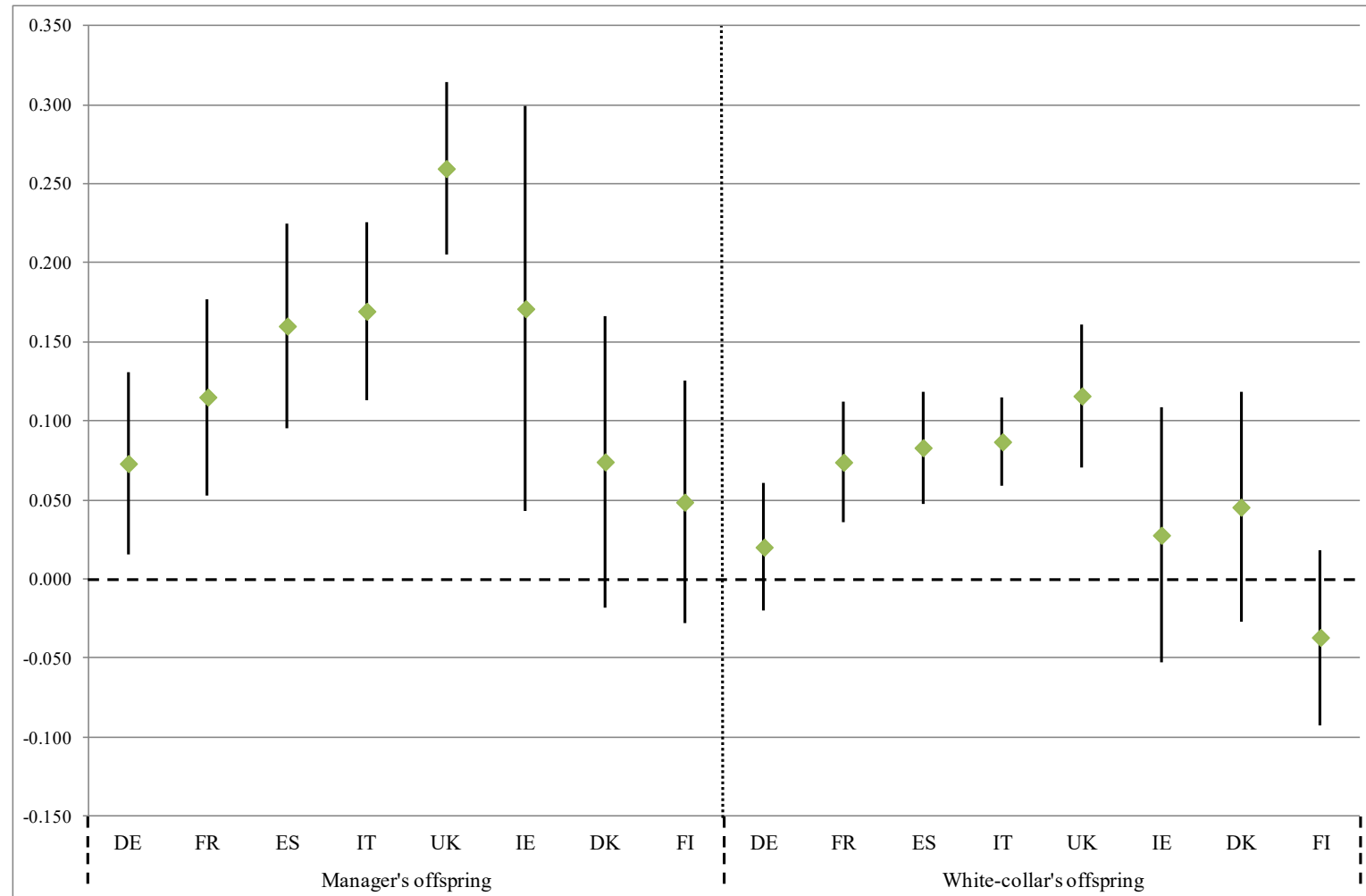
Is wage inequality persistent along the career?



Do inequality trends depend on between education gaps?



Parental background and children earnings controlling for education



Drivers and policy implications

The usual drivers of inequality

- Generalised rise in inequality but no common trends across countries and independent of the income concept
- Conventional wisdom: changes in skill premia (between inequality) due to technological progress and globalization affecting demand and supply of differently skilled workers => from SBTC to routinization
- Are these trends strengthened by globalization? Offshoring and China syndrome
- A reassuring process driving inequality, associated with abilities and market efficiency => policies should mostly redistribute to compensate losses

Concerns about the usual drivers

- Are these trends natural and unavoidable?
- Is a single explanation sound due to the multiple country experiences?
- Are skill premia actually responsible of the rise in top incomes?
- Are intergenerational inequality and inequality of opportunity only mediated by education and abilities? Is there a role played by market failures and nepotism?
- Are predistributive measures – favouring endowments and changing market rules – needed?

Further (maybe main) drivers

- May different country experiences be due only to exogenous and common drivers? => Country specific policies
- What are the determinants of super-earnings? Talent and popularity in “winner takes all markets” or power producing rents? Are markets really competitive and “meritocratic”? Is there an oligarch capitalism?
- What is the role played by finance?
- What is the role played by “structural” reforms and by weakened LM institutions?
- How has the bargaining power between labour and capital changed? What is the role played by trade unions?
- Has there been an individualization of economic conditions?
- Trends in tax & benefit systems affecting income and wellbeing

Thanks for your attention! 😊