

Introduction

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Few social and economic conditions are more compelling or more vexing than inequality. For many, concerns about inequality are largely instrumental. Their unease is focused not on inequality per se but on the possibility that inequality may have troublesome social, economic, and political consequences. For others, the presence of high or increasing levels of inequality raises concerns about equity and justice. These concerns, in turn, prompt questions about whether (or to what extent) public and private institutions function equitably with regard to opportunities, outcomes, or both.

Inequality has long attracted the attention of comparative scholars, especially those interested in studying variation across relatively similar countries. Cross-country comparisons provide a fruitful approach for inequality scholarship, largely because inequality itself varies sharply across countries, even among countries at similar levels of economic development. In addition, many of the institutions widely understood to influence inequality also vary cross-nationally, as do several of the problematic consequences that have been linked to inequality. For these reasons, cross-national comparisons offer a natural framework for inequality research.

This book presents inequality research carried out by 17 established researchers (or research teams), each of which address a different facet of inequality. The collection has several unique features. First, all of the chapters are focused specifically on income inequality. Second, nearly all of the included studies use cross-national research designs; the comparative chapters are complemented by four case studies selected to build upon the explicitly comparative chapters. Third, most of the chapters integrate

into their inequality analyses an assessment of the status of the middle class, in most cases defined in relation to the income distribution. As we argue below, many inequality scholars have long focused on poverty, and recently several have assessed the top of the income distribution; empirical studies that integrate questions about inequality with analyses focused on the middle of the income distribution have been remarkably few and far between.

Fourth and finally, all of the chapters use microdata that are available—or will be available—through LIS (formerly known as the Luxembourg Income Study), a longstanding archive that provides researchers with cross-nationally harmonized income and wealth microdata, mostly from high-income countries. As we describe in more detail below, the use of a common data source provides the methodological backbone of this book, as it maximizes the use of common concepts as well as definitional and measurement practices. It also imposes a degree of both geographic and temporal consistency. The 12 cross-national studies (Chapters 1–12) use data drawn from a common group of 28 countries included in the income and/or wealth databases made available through LIS, and they all focus on the time period from about 1980 to about 2004.

While the common use of the LIS data has numerous conceptual and methodological advantages, it also has at least two disadvantages. One is that this collection is limited almost entirely to assessments of high-income countries (as we discuss in detail later in this Introduction). The other is that the time period covered in the harmonized LIS data ends before the start of the global financial crisis that has, not surprisingly, raised a host of new questions about economic well-being across the affected countries. (The reality of data archives such as LIS that harmonize data *ex post* from a large number of countries is that a lag time of five to seven years is standard.) In this sense, these chapters might be considered as a baseline study that could catalyze a follow-up in a few years.

In the next section, we introduce the focal concept that underlies this book: income inequality. We next offer a brief overview of prior research, discuss measurement and methodological issues, and present empirical snapshots based on the harmonized LIS data. We then introduce the five substantive parts of the book, providing highlights from each chapter. In the Conclusion, we offer a synthesis of findings from across the 17 studies and offer comments about future research directions.

INCOME INEQUALITY

Inequality Matters

In her book on changing U.S. income inequality, Rebecca Blank (2011) identified several claims, primarily instrumental, that should motivate widespread concern about inequality, especially about rising inequality. First, she argued, rising inequality may indicate declining income, and thus decreasing well-being, among individuals and households at the bottom of the income distribution. Rising inequality, more specifically, might signal rising poverty rates. Poverty, in turn, has demonstrably negative consequences for individuals, families, and communities. (For a comprehensive review of the multi-faceted effects of poverty, see the Urban Institute's "Consequences of Poverty" series.¹)

Second, Blank argues, inequality may depress economic mobility, which is generally interpreted as a measure of openness and opportunity in an economy. A substantial and growing literature, much of it cross-national, suggests that high levels of inequality may thwart mobility (see, e.g., Björklund and Jantti 2009). Focusing on the United States, Blank observes that constraints on mobility, in turn, worsen other types of disparities as well: "Since a disproportionate share of low-income families are headed by people of color . . . , children from these families may face particularly reduced economic opportunities in a time of rising inequality, intensifying racial differences as well" (2011, 5).

Third, inequality might harm economic growth, although Blank acknowledges that both the direction and size of this effect are in dispute. Indeed, the claim that high levels of inequality may depress economic growth has been the subject of an extensive debate in recent years, but there is no clear consensus about how this effect operates (see, e.g., Aghion, Caroli, and García-Peñalosa 1999; Forbes 2000; Voitchovsky 2009). Recent scholarship suggests there is no single answer to this question. Voitchovsky (2005), using data from LIS, found that inequality in the upper end of the distribution increases growth, whereas inequality in the lower end is detrimental to growth. This is consistent with the view that the impact of inequality on growth depends on where in the distribution the inequality resides. As Bowles and Gintis (1998, 13) aptly observed, the prevailing view is probably best summed by concluding that "under favorable circumstances egalitarian outcomes are not incompatible with the rapid growth

of productivity and other valued macroeconomic outcomes”; subsequent research has not overturned their observation.

And, in fact, economic growth and trends in income inequality are closely related. Economic growth measures change in aggregate income, while inequality trends capture how that growth accrues differentially to households in different parts of the income distribution. As any change in aggregate income must, by definition, benefit households somewhere in the distribution, economic growth is expected to shift the income distribution. On the assumption that more income growth is beneficial, one reason to be concerned with changing patterns of inequality is that they may indicate differential rates of income growth across the income distribution. If all households’ incomes increase at the same pace, then, by definition, inequality is unchanged. If, on the other hand, incomes grow more rapidly among the affluent, inequality increases. If incomes grow more rapidly among the poor, inequality declines. Assessing inequality trends can illuminate how economic growth is distributed across the income spectrum.

The fourth concern that Blank raised is that inequality may have harmful effects on political processes. A core value in many modern societies is that of democracy. What exactly constitutes democracy is subject to intense debate, but a common interpretation is that all persons should enjoy equal political representation. It is, therefore, worrisome that inequality seems to adversely affect political participation and the nature of political decision making. Whether or not the poor vote may be seen as an exercise of choice. But for those who hold fundamental democratic values, it is of concern that when public opinion varies along the income distribution, policy makers (in the United States, at least) respond much more strongly to views held by the affluent than by the poor (see, e.g., Gilens 2005). Bartels (2009) found that U.S. senators appear to be more responsive to the views of the affluent than to those of the middle class; the views held by the bottom third of the income distribution have no apparent effect on senators’ voting patterns. Also focused on the U.S. case, Stiglitz (2012, 117) argues that one of the main costs of inequality is that “our democracy is being put at peril.” The United States’ high level of inequality, Stiglitz concludes, is causing voter disillusionment, widespread distrust, perceptions of unfairness, and ultimately disenfranchisement.

Other instrumental arguments have received much attention in the literature on the adverse consequences of inequality on non-income outcomes.

In their popular book *The Spirit Level*, Wilkinson and Pickett (2009) argue that large income disparities—within a country—have harmful effects on a multitude of outcomes, including physical and mental health, infant mortality and life expectancy, crime and incarceration, and educational performance. Research is ongoing on the association between income inequality and these diverse non-income outcomes. Thus far, there is little consensus regarding the existence of these effects and/or the nature of any underlying causal mechanisms. However, given the high-stakes nature of these claims, they certainly merit our attention.

Yet another reason that scholars should be interested in inequality is that many people are themselves concerned about inequality, so it should be of concern to those who study public opinion and its consequences. McCall and Kenworthy (2009) presented evidence suggesting that (despite popular perceptions to the contrary) Americans do, in fact, care about inequality of outcomes. According to McCall and Kenworthy, Americans in substantial numbers believe that government should address increased inequality, although not necessarily through traditional processes of redistribution. Likewise, cross-national research on attitudes toward inequality also turns up evidence that the widely held belief that Americans are less concerned with inequality of outcomes than are citizens in other countries may not be true. Osberg and Smeeding (2006), for example, reported that across 27 countries (including most LIS countries), a clear majority agreed with the statement that “income differences are too large.” While a relatively small fraction of U.S. respondents indicated that they strongly agreed with that statement, that fraction was even lower in Germany and Norway. Osberg and Smeeding concluded that citizens in all of the included countries share a general concern for inequality of outcome, specifically with regard to income.

Furthermore, concern about income inequality has risen sharply in several high-income countries since late 2011, when social protests focused on domestic economic issues sprung up in many countries. In the United States, these protests began in September 2011, when a group of activists gathered in lower Manhattan and launched the “Occupy Wall Street” movement, which quickly spread to other U.S. cities and states. Between September and November of 2011, references to income inequality in the American national media increased by a factor of five (Byers 2011). Since then, media coverage about inequality and the declining status of the middle

class has been extensive in the United States and in other countries (see, e.g., Giles 2011).

And, of course, there are ample intrinsic reasons to care about inequality. That said, there is, in fact, no clear line between the instrumental and the intrinsic, as they inform each other. Nevertheless, many regard inequality as inherently undesirable, such that, all else equal, more equality is preferred to less. A well-known exposition of this perspective on equality is that outlined in Arthur Okun's (1975) classic book *Equality and Efficiency: The Big Tradeoff*. To Okun, both equality and efficiency (the latter measured with respect to income levels) are desirable, but the pursuit of greater efficiency comes at the cost of more inequality, so a compromise must be sought between the two. Not surprisingly, this assessment—how much leaking from the famous leaky bucket is too much?—can only be settled on normative grounds. Traditionally, those on the political left tend to place relatively more weight on the value of equality, while those on the political right favor efficiency (and unfettered market outcomes more generally).

Indeed, not everyone agrees that income inequality should be a matter for concern. Feldstein (1998) provided one vantage point on why inequality need not prompt worry. He argues that increases in inequality, measured by (for example) the Gini coefficient, should not necessarily be interpreted as problematic. For Feldstein, many who are concerned with inequality are “spiteful egalitarians”—that is, they regard someone with unchanged real income as being worse off if others experience increased income. According to Feldstein's view, the only real distributional concern should be poverty, to the extent that poverty signals absolute deprivation.

Debates about relative deprivation are by no means new. The question as to whether an individual can reasonably feel relatively deprived has been examined in depth by many scholars, perhaps most prominently by Amartya Sen (see, e.g., Sen 1983). Sen often cites a famous passage from *The Wealth of Nations* (Smith 1776/1976) that states that the ability to “appear in public without shame” required access to quite different goods in, say, the Roman empire than in the Scotland and England of the late eighteenth century, and indeed that even Scotland and England were different in this respect. What counts as making ends meet or having a reasonable standard of living can vary significantly both across time and space (on this point, see Frank 2007). This line of thought raises challenges to the notion that only

real income levels, or absolute deprivation, matter. Concerns about relative deprivation require that we pay close attention to inequality.

Many schools of political philosophy give inequality of resources a prominent role, although exactly what kind of inequality is thought to be problematic varies. For example, the so-called Rawlsian position, following John Rawls's (1971) *Theory of Justice*, focuses on the standard of living of the least well-off (see Roemer 1996). Importantly, however, the utilitarian position is that, all else equal, more equality is preferred to less. But all else may not be equal. In the event that more inequality is associated with greater mean income, the less equal distribution is chosen only if the adverse distributional consequences do not outweigh the increase in mean income. That is, the utilitarian ethical position is very close to the view put forward by Okun.

Measurement of Income and Its Distribution

The chapters in this book mostly rely on a few key income concepts. The chapters on employment and gender (Chapters 7–9 in Part IV) rely heavily on labor market earnings, with Chapter 8 augmented by the imputed value of unpaid work. The chief measure of income in the rest of the book is household disposable income, adjusted for household size. (In the LIS literature, income adjusted for household size is generally referred to as “equivalized.”) Although the chapters on wealth also draw heavily on the concept of net worth (which is defined in detail in Chapter 10), when these authors assess disparities, they generally rely on the income distribution. Only Chapter 5 examines the effects of redistribution per se on inequality; these researchers compare inequality in pre-tax, pre-transfer income with that of post-tax, post-transfer income.

Disposable Income Defined. Using the definition that is standard in the LIS literature, disposable income includes all cash and near-cash earnings, capital income, other private income, public transfers, less direct taxes. This follows closely the international standard for the measurement of disposable income, with the exception of imputed rents, the most important being imputed rents from owner-occupied housing (Expert Group on Household Income Statistics [The Canberra Group] 2001). (See Chapter 12 by Bradbury for more on this.) Other sources of income that may be

important are omitted, including non-cash public transfers (in essence, the value of public services), non-cash private income (such as the value of in-kind employer-provided benefits), and unrealized capital gains.

As Atkinson (1997a, 2003) has pointed out, while the income definition used in this book is a common one, other quite reasonable definitions are possible because money income is obviously only a partial measure of economic well-being. On the other hand, Atkinson (2003) also observed that the distribution of disposable income can be relied on as a gauge on inequality based on the revealed preference of governments, which frequently rely on disposable income when producing public inequality statistics.

The case can be made for studying consumption rather than income. The chief difference between household consumption and household income consists of savings and the consumption value of durables. While it is possible that both cross-country variation and within-country changes in the inequality of consumption are different from those for income, no broadly comparable database of household consumption exists. However, in Chapter 12, Bradbury uses *Luxembourg Wealth Study (LWS)* data to examine how inclusion of housing expenditure changes our assessment of the living standards of the elderly. Furthermore, in Chapter 16, Vanneman and Dubey compare inequality results based on consumption versus income, as do Leibbrandt, Finn, and Woolard in Chapter 17.

The Equal-Sharing Assumption. Most income distribution statistics assume, for lack of better information, that all household members share the same standard of living (Jenkins and O'Leary 1998). Most of the chapters make that assumption, as do we in the empirical work presented later in this Introduction. However, Chapters 7 to 9 do address how inequality is affected by differences in spouses' labor market earnings.

Inequality in an Annual Cross Section Compared with Multi-Year Income. We also rely on annual rather than the more long-run measures of income that many economists would argue are more relevant for gauging well-being (see Burkhauser and Couch 2009). Because incomes tend to fluctuate from year to year, the distribution of annual income tends to overstate inequality in permanent income, which is arguably a more reliable or stable measure of individual well-being. Moreover, inequality of annual income may increase over time because transitory shocks are increasing across time rather than because inequality of permanent income is rising. Likewise,

differences across countries may be driven by differences in transitory shocks rather than in permanent income.

When it comes to cross-country variation, however, the limited evidence that is available on this score suggests that country inequality rankings—that is, cross-country variation in levels of inequality—are largely unaffected by extending the measurement period of income from one to multiple years (Burkhauser and Poupore 1997; Aaberge et al. 2002). It is possible that changes in inequality are driven, to different degrees, by transitory or permanent variation. While there are some cross-nationally comparable data that allow the examination of longitudinal income inequality, they do not allow for as broad a range of countries to be examined as are examined in this book. Using longitudinal data for Germany, the United Kingdom, and the United States, however, Daly and Valletta (2008) found that changes in transitory earnings did not account for the trend in earnings inequality in these three countries in the 1990s. The variance of annual (age-adjusted, logged) earnings followed roughly the same pattern as do their estimates of permanent earnings inequality, at least among prime-aged male household heads.

The Definition of the Middle Class. Many of the chapters in this book concentrate on the middle class. But what exactly is meant by the “middle class”? There is no consensus on the definition of the middle class, even within disciplinary traditions. Sociologists typically invoke definitions that extend beyond income measures, often incorporating educational attainment and/or occupational characteristics, with the overarching aim of capturing power relations. Economists more often identify the middle class with respect to the income distribution (especially in high-income countries) or vis-à-vis the consumption distribution (typically in lower-income countries). The authors in this book have taken this more economic approach, defining the middle class, specifically, relative to each country’s income distribution.² As a result, what we (and many of the authors) refer to as the “middle class” might more accurately be described as those households that fall in the “middle”—that is, in the middle of the income distribution. Nevertheless, throughout this book, the terms *middle* and *middle class* are used interchangeably.

The reliance on income-based definitions has two advantages in the context of this book. First, the common data source—the *LIS* and *LWS*

Databases (discussed in the next section)—are most suited to this approach because the income data are extremely detailed, as well as highly standardized, across countries. Constructing cross-nationally comparable measures of education and occupation is much more difficult in the *LIS/LWS* data and, in fact, in all cross-country databases. Second, using this clearly quantifiable income-based framework enables a high level of comparability across the chapters.

Furthermore, within this income-based framework, the authors generally approach defining the middle class in one (or both) of two ways, both of which are common in the relatively limited comparative literature on the middle class (for a review, see Pressman 2007). One approach identifies a portion of the distribution, generally by defining specific decile groups as the middle class.³ Several chapters use this strategy, in most cases defining the middle class as those households with income between the 20th and 80th percentiles—in other words, “the middle 60.” A second approach establishes an interval defined by percentages of median household income. Several chapters use that method, most often defining the middle class as those households with income between 75 and 125 percent of the national median⁴—although some drew different intervals. For example, Frick and Grabka (Chapter 13) chose 70 to 150 percent (further disaggregating into lower-middle, middle-middle, and upper-middle), and Chauvel (Chapter 4), using a similar framework, selected 75 to 250 percent and also disaggregated the middle class into subgroups. Ólafsson and Kristjánsson (Chapter 15) selected 75 to 150 percent when studying Iceland, while Vanneman and Dubey (Chapter 16) used 50 to 200 percent in their study of India (where the distribution is especially skewed).

These two approaches, of course, enable different questions to be answered. Both approaches allow researchers to compare *characteristics* of the middle class (e.g., absolute income levels, intra-household earnings ratios, wealth holdings, political behavior) across countries, time periods, and/or income definitions. The latter approach also enables analysts to compare the *size* of the middle class, likewise across countries, time periods, and/or income definitions. Both sets of questions are raised in this book.

The Global Distribution of Income. What is the appropriate geographical unit for studying inequality? All of the chapters focus on distributions within countries (or, in the case of the chapter on India, within

sub-national units). In recent years, there has been a vigorous debate about what has been happening to the world distribution of income—that is, the distribution among all persons in the world (see, e.g., Bourguignon and Morrisson 2002; Milanovic 2007). While that debate has yielded valuable insights, in our view, studies on levels and/or trends in economic well-being within countries—such as we present in this book—are warranted for several reasons. In particular, while economies have become increasingly integrated and interdependent, most economic and social policy making still operates at the national (or sub-national) level. Moreover, even if one were to focus on the world income distribution, the central building block for understanding that consists of the distribution within individual countries.

While the analysis of the distribution of income among all persons in the world has considerable merit—every person’s well-being should, after all, matter equally—the examination of income distributions within individual countries is clearly meaningful as well. One reason is that data sources are, almost without exception, national (at least originally), so data definitions and concepts are much more uniform within countries. But importantly, there are relatively few possibilities for, say, UK policymakers to affect the distribution of income in, say, India, although they have a reasonable likelihood of influencing the UK distribution of income. In other words, because policy making is mostly nationally based, it surely makes sense to examine the distribution of economic well-being nationally as well.

Dowrick and Akmal (2005) assessed both inter-country inequality (the inequality of mean income across countries) and global inequality, highlighting problems associated with comparing real incomes across countries. Critiquing both those who use standard estimates of purchasing power parity (PPP)-adjusted exchange rates and current exchange rates, their estimates do suggest a moderate increase in global inequality between 1980 and 1993.

KEY ELEMENTS OF THE BOOK: A SHARED FRAMEWORK AND THE USE OF COMMON DATA

We commissioned the 17 studies that are presented in this book. When we did, we imposed four core requirements. First, a central component of each study had to be income, earnings, and/or wealth inequality—across households, within households, or both. We urged the authors focused on income

inequality to emphasize comprehensive measures of income, especially post-tax and post-transfer (disposable) income (see Chapters 1 to 4). We engaged two sets of authors to assess interactions between income inequality and political outcomes (see Chapters 5 and 6). We invited the authors of three of the commissioned chapters to extend their analyses to gender disparities in employment outcomes and specifically to assess the interplay between gender disparities and income inequality more generally (see Chapters 7 to 9). We asked four researchers (or research teams) to focus their inequality analyses on wealth (see Chapters 10 to 13). Finally, we invited four chapters focused on country cases (Chapters 14 to 17), which we introduce below.

Second, the empirical component of each study had to be cross-national in design. Exceptions to this requirement were made for one of the wealth studies (see Chapter 13, which used single-country data to assess a question that has clear implications for cross-national wealth comparisons) and the four single-country studies that close this book. (We return to these below.)

Third, we asked several of the researchers to include within their inequality analyses some assessment of the middle class. While we did not impose a single definition of the middle class, we encouraged authors to define this group with respect to the income distribution.

Finally, we required that the researchers draw heavily on microdata that are available—or will be available—through LIS, a data archive that provides cross-nationally harmonized income and wealth microdata. We invited the contributors to supplement their use of the LIS data with other datasets as well, including either macro-level data or other microdata, provided that they drew mainly on LIS data to analyze inequality levels and trends and/or to define and assess the status of the middle class.

We imposed the use of this common data source to maximize (across the chapters) conceptual commonality, empirical comparability, and geographic and temporal consistency. Relying on LIS data allowed all of these authors to assess inequality with respect to a shared set of income, employment, and wealth concepts. The use of the harmonized LIS data ensured a high degree of comparability in the contents of key variables, across countries and time periods. Furthermore, the common use of LIS data also enhanced consistency across the chapters in the selection of both countries included and time periods studied.

LIS (the institution) is home to two microdatabases: the *Luxembourg Income Study Database* (also known as LIS) and the *Luxembourg Wealth*

Study Database (known as *LWS*).⁵ (Detailed information is available from <http://www.lisdatacenter.org>.) These two databases contain microdata from several high- and middle-income countries. The LIS staff gathers datasets and harmonizes them, ex post, into a common template; that means they construct a common set of variables and a standard set of rules that determine the placement and treatment of variables from the original datasets. The LIS staff also makes available an extensive catalogue of documentation that provides information on the scope of the datasets included in the databases, characteristics of the original surveys, the rules of variable construction, variable availability (across datasets), and features of the institutions that correspond to the tax and transfer variables.

The *LIS Database* contains harmonized microdata from a large number of mostly high-income countries. The *LIS* datasets contain variables on market income, public transfers and taxes, household- and person-level characteristics, labor market outcomes, and, in some datasets, expenditures. The *LIS Database* currently includes harmonized microdata from 39 countries: 23 European countries; the United States, Canada, and Australia; Israel and Russia; South Korea and Taiwan; 6 Latin American countries (Brazil, Colombia, Guatemala, Mexico, Peru, and Uruguay); and China, India, and South Africa. These data currently span nine time points: (approximately) 1970–1975, 1980, 1985, 1990, 1995, 2000, 2004, 2007, and 2010. (As this book goes to press, some additional *LIS* microdatasets corresponding to 2007 and 2010 have become available.) Over-time data are not available for all of the countries included in *LIS*, because newly participating countries typically provide data from only the most recent time point. When data are available over time, they are available in the form of repeated cross sections.

The *LWS Database*, a new companion to the *LIS Database*, contains harmonized microdata from several high-income countries. The *LWS* datasets include variables on assets and debt, market and government income, household characteristics, labor market outcomes, and, in some datasets, expenditures and behavioral indicators. The *LWS Database* currently includes harmonized microdata from 12 countries: 9 European countries (Austria, Cyprus, Finland, Germany, Italy, Luxembourg, Norway, Sweden, and the United Kingdom), plus Japan, Canada, and the United States. These *LWS* datasets correspond (variously) to years between 1994 and 2006. As with the *LIS Database*, over-time data are not available for all of the

participating countries, and, when available, the data take the form of repeated cross sections. (See the Appendix to this Introduction, Table A1, for a complete list of countries currently included in the *LIS* and *LWS Databases*, with the standardized two-letter abbreviations that are used throughout this book.)

LIS—Expanding Horizons

LIS has traditionally concentrated its data work on high-income countries. According to the World Bank's country classification system (based on per capita income), of the 39 countries currently in the *LIS Database*, 28 are high-income and 11 are middle-income countries. Those 11 countries include 6 from Latin America, as well as China, India, Romania, Russia, and South Africa. The *LWS* datasets are entirely from high-income countries. A current priority at LIS is adding a substantial number of microdatasets from middle-income countries—first to *LIS* and eventually to *LWS* as well. At press time, that effort is well underway.

The chapters address inequality almost entirely in high-income countries. The 12 comparative chapters (Chapters 1 to 12) utilize datasets from high-income countries, with only two exceptions: one chapter includes Mexico and one includes Russia. This is simply because this group of commissioned authors started their work before a recent spate of middle-income datasets (from Latin America, and India and South Africa, thus far) was added to the LIS data archive.

Finally, among the 17 commissioned chapters are 4 (see Part VI) that assess inequality in selected countries for which microdata had not yet been added to the *LIS Database* when the chapters were commissioned. These countries include Japan (Chapter 14), Iceland (Chapter 15), India (Chapter 16), and South Africa (Chapter 17). We selected these four countries for specific reasons. We asked researchers using datasets from Japan and Iceland, both high-income countries, to prepare studies based on them, as they represent two substantively unique and interesting cases with respect to income distribution. In both of these chapters, the authors (using single-country datasets) include some results from after the global financial crisis. We also invited chapters focused on two of the incoming middle-income countries: India and South Africa. These two are included because, like Japan and Iceland, there is widespread interest in their income distributions, especially because rapid change is underway. When this book goes

to press, India and South Africa will also be included in the *LIS Database*, and income datasets from Japan and Iceland are in the pipeline and will be added soon.

INCOME INEQUALITY IN CROSS-NATIONAL PERSPECTIVE: A LOOK AT LEVELS AND TRENDS

The Literature

There is a vast and growing literature that documents cross-country variation in income inequality, as well as trends, much of it using the *LIS* microdata. The contributions of *LIS*-based analyses were summarized by Förster and Vleminckx (2004). Research based on *LIS* data has the advantage of using data that have been harmonized in multiple ways—for example, all *LIS* data have been annualized, and standardized income aggregates have been constructed and made available. Other decisions are left to researchers, but the data allow them to implement common practices across the countries included in their analyses, such as the method for adjusting for household size (i.e., the choice of equivalence scale) or, say, how to treat negative or zero incomes.

In their groundbreaking report prepared for the OECD, Atkinson, Rainwater, and Smeeding (1995) used the *LIS* data from the middle 1980s to establish the first widely accepted cross-country rankings of inequality across high-income countries. Using Gini coefficients to measure inequality, they found that the Nordic countries had the least inequality, followed by continental European countries, Canada, Australia, and the southern European countries, with the United States having the highest (Atkinson et al. 1995).

Many researchers have used the *LIS* data to examine and explain inequality levels and changes. Most recently, Immervoll and Richardson (2011) assess whether, and to what extent, government redistributive policies slowed or accelerated the trend toward greater income inequality over the last two to three decades. Wang and Caminada (2011) analyzed income inequality and the redistributive effect of social transfers; using a simulation approach, they decomposed income inequality into income tax and transfer sources. Grimm and colleagues (2009) examined how indices of human development vary across the income distribution. Cowell and Fiorio (2009) developed decomposition techniques to assess changes in inequality

in the United States and Finland. Scholtz (2008) analyzed whether inequality change between 1985 and 2005 took place near the bottom or top of the distribution. Orgiazzi, Breen, and García-Peñalosa (2008) examined which income sources accounted for cross-country variation in levels and trends in inequality. Mohl and Pamp (2008) assessed links between inequality and redistributive spending, while Checchi and García-Peñalosa (2008) studied links between labor market institutions and income inequality.

While inequality increased in many (but not all) OECD countries in the late 1990s and early 2000s, the broad pattern of cross-country variation identified by Atkinson and colleagues (1995) and again by Förster and Vleminckx (2004) remains in place (OECD 2008). The focus of much of the research on cross-national variation in inequality has been on examining and accounting for *changes* in income inequality (see, e.g., Atkinson 2003; OECD 2008, 2011a; McCall and Percheski 2010). Accounts of the factors underlying changes in income inequality have focused mainly on developments that shift the distribution of labor market income, demographic factors (especially those that affect the sorting of persons with different earnings capacity into different family types), and changes to taxes and transfers.⁶

Many inequality scholars (mostly using data from sources other than *LIS*) have focused their analyses on specific regions. Gasparini and Lustig (2011) reported that income inequality actually declined in most Latin American countries in the 2000s, after having risen earlier. Surveying inequality changes in central and eastern Europe, Heyns (2005) observed that while most of these former state socialist countries experienced increases in overall inequality, the timing, size, and nature of those increases varied substantially.

Arguably, most assessments of inequality trends in high-income countries have focused on the effect of changes in labor markets—importantly, technological shifts, increased international trade, and changes in institutions affecting wage setting. The three explanations need not be mutually exclusive, and, indeed, Atkinson (1997b, 1999, 2003) has made the case that none of them alone can account for the observed trends in earnings inequality. For example, while increased international trade—globalization—is often thought to account for changes in earnings distributions, Atkinson argued that the observed patterns cannot easily be accounted for within a standard economic model of international trade—that is, the Heckscher-Olin model.

McCall and Percheski (2010) reviewed evidence of how changes in family structure and in married women's labor supply (mostly in the U.S. context) have affected income inequality. While the evidence is not clear-cut, it does appear that decreases in married-couple families have tended to increase inequality, while changes in women's employment behaviors and earnings have tended to decrease inequality. Whether or not marital homogamy (i.e., within-couple similarities) increases or decreases income inequality remains open to debate, and, to the best of our knowledge, little is known about how the pure effect of homogamy varies cross-nationally.

Incomes at the very top of the distribution have been increasing in many countries, something observed first in the United States (Piketty and Saez 2003), and later in many other countries as well (Atkinson and Piketty 2007, 2010). As suggested by McCall and Percheski (2010), explanations for the evolution of incomes at the very top should focus on different factors than those that account for overall inequality. In particular, changes in compensation practices for top private-sector officials and the market for top-end jobs are a common focus in this literature.

Furthermore, labor market income can be, and most likely is, affected by changes in capital markets. Atkinson (1997a) reported that the interest rate can affect the skill premium, which affects both the wage differential among persons with different educational qualifications and how the supply of skills reacts to changes in demand. In particular, the premium to higher education increases when real interest rates increase. Compensation of top private-sector officials may depend on returns in the financial sector as well as, for example, differential tax treatment of different types of compensation.

Mahler (2004) found that the evidence that suggests large inequality effects from globalization tends to be weak, a finding that is supported by Roine, Vlachos, and Waldenström (2009). Gustafsson and Johansson (1999), on the other hand, do find some support for the view that imports of manufactured goods are associated with greater inequality.

Public policy can both counteract and reinforce changes in inequality that stem from the market. For example, progressive income taxes can dampen the effects of increased earnings inequality. Rules that lead capital incomes to be taxed at lower rates than labor earnings again provide incentives to convert executive compensation into capital income (rather than labor income) and will thus lead to greater inequality.