Yes, finance fuels income inequality

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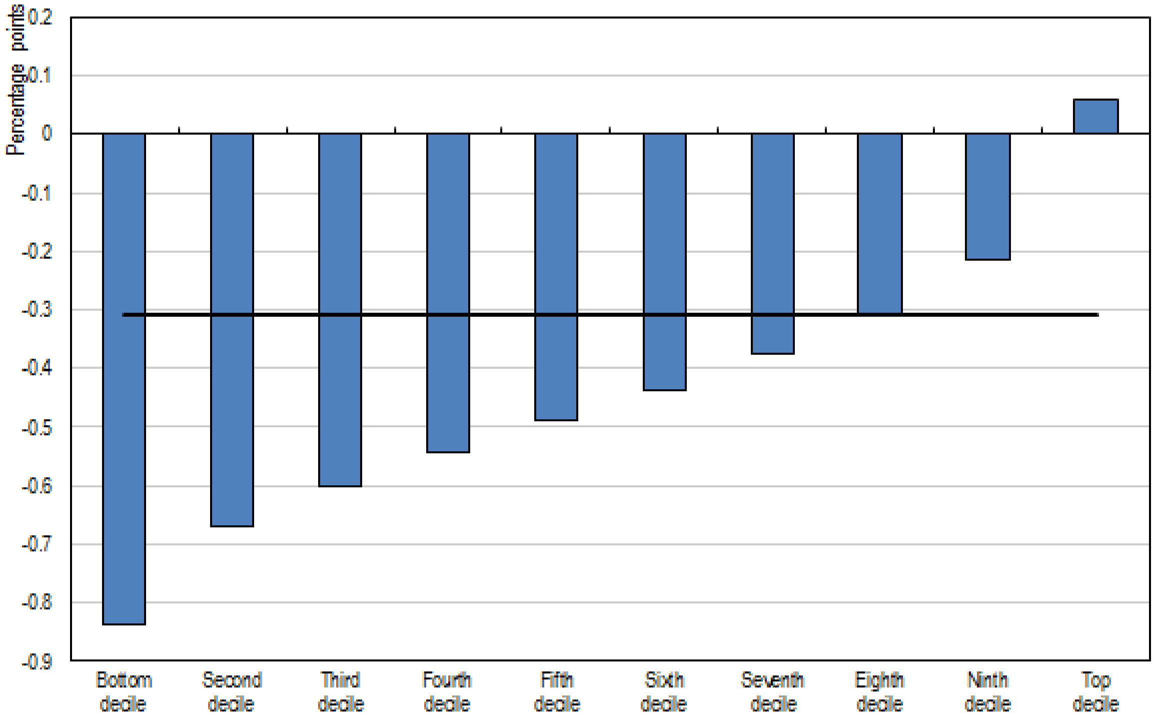
The Great Financial Crisis has prompted a lively debate, where the financial sector has been accused of not only triggering crises but also concentrating income in the hands of a few. The Occupy Wall Street movement in New York coined the slogan "we are the 99%", that is to say the bottom 99% in the income distribution. The OECD in Paris has extensively probed the data to examine how finance influences the distribution of income.

The main conclusion is that, indeed, financial expansion exacerbates income inequality. Econometric investigations uncover that more finance, in the form of more bank credit or larger stock markets, goes hand in hand with higher income inequality across OECD economies (see Chart). Further expansion in bank credit from the levels observed in OECD countries is associated with slower household income growth, but the negative effects are particularly acute at the bottom of the distribution, while simulations suggest that the top 10% benefit. Stock market expansion is linked with stronger household income growth, but the benefits are concentrated at the top and the very bottom of the income distribution is simulated to lose out. These effects, which have been identified on average across OECD countries, might not apply at lower levels of development.

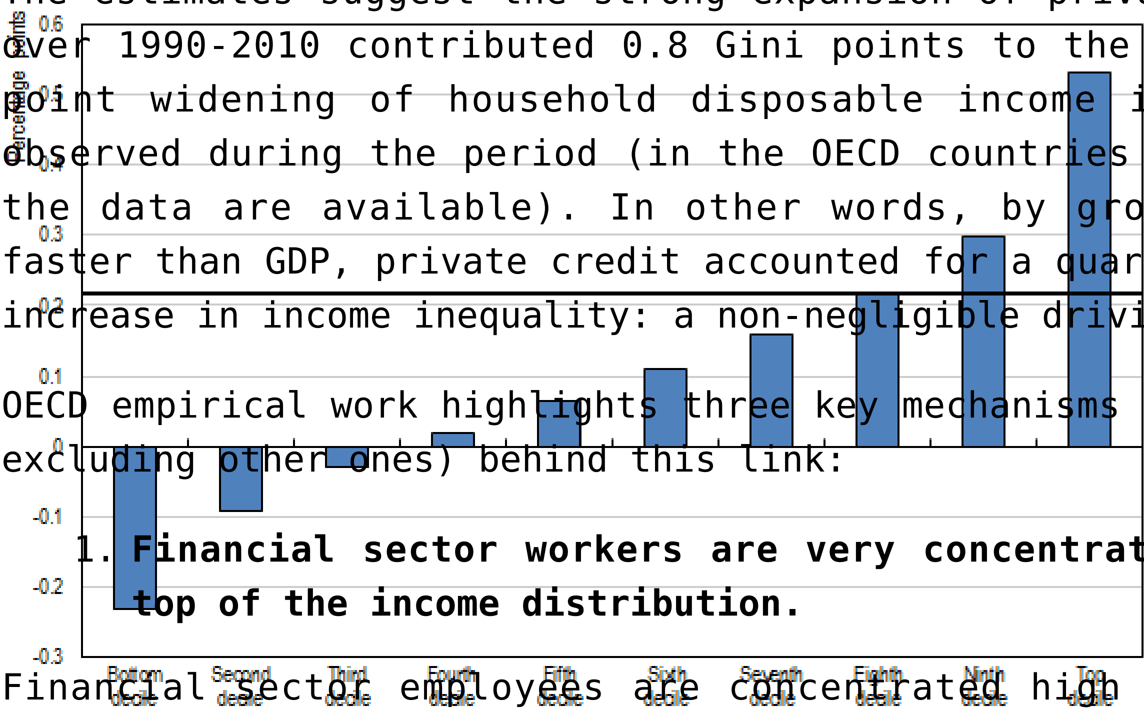
The effects of credit and stock market expansion vary a lot across income levels

A. Simulated effect of a 10% of GDP expansion of financial sector credit on household income growth



B. Simulated effect of a 10% of GDP expansion of stock market capitalisation on household income growth

Note: Household income growth is household disposable income growth per capita. Stock market capitalisation is the value of all shares listed in a stock market. The horizontal line indicates the change in household income growth for the economy as a whole.



The estimates suggest the strong expansion of private credit over 1990-2010 contributed 0.8 Gini points to the 3.1 Gini-point widening of household disposable income inequality observed during the period (in the OECD countries for which the data are available). In other words, by growing much faster than GDP, private credit accounted for a quarter of the increase in income inequality: a non-negligible driving force.

OECD empirical work highlights three key mechanisms (while not excluding other ones) behind this link:

1. **Financial sector workers are very concentrated at the top of the income distribution.**

Financial sector employees are concentrated high up in the income distribution. In Europe, financial sector employees make up only 4% of the workforce but 20% of the top 1% earners. In Luxembourg and the United Kingdom, more than 30% of employees in the top 1% work for financial firms. The high number of financial sector workers among top earners is justified as long as very high productivity underpins their earnings. However, detailed econometric investigations find that financial firms pay wages well above what employees with similar profiles earn in other sectors. Even worse, the premium is especially large for top earners.

2. **High income earners can and do borrow more.**

The distribution of credit is twice as unequal as the distribution of household income in euro area countries (where detailed, internationally comparable data are available). More than 45% of total household credit goes to the top 20% of the income distribution in Austria, Finland, France, Germany and Italy. Credit expansion fuels income inequality, because the well-off gain more than others from the investment opportunities that they can identify.

3. **Much of the benefits of stock market expansion go to affluent households.**

Stock holdings are disproportionately concentrated in the hands of high-income people. In the euro area, stock market wealth is four times more unequally distributed than household income. As a consequence, larger stock markets, which generate more dividends and capital gains, widen the income distribution.

As a result, more finance means more income inequality.

Find out more:

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Denk, O. and A. Cazenave-Lacroutz (2015), "Household Finance and Income Inequality in the Euro Area", OECD Economics Department Working Papers, No. 1226, OECD Publishing, Paris.

Denk, O. and B. Cournède (2015), "Finance and Income Inequality in OECD Countries", OECD Economics Department Working Papers, No. 1224, OECD Publishing, Paris.