Why should inequality researchers care about the rich?

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1. Introduction

In recent years, interest in understanding the evolution of top incomes and top wealth has increased markedly among economic inequality researchers. A number of studies by Thomas Piketty, Anthony B. Atkinson and Emmanuel Saez, followed by many others, have provided new and intriguing insights into the long-run links between development and inequality.[2] The recent literature uses data on personal income tax returns from the beginning of the twentieth century to create comparable estimates of top income shares for the entire period up until today. This has yielded for the first time a consistent set of really long series of economic inequality which are also reasonably comparable across countries. While limited in their coverage of the population, the series are sufficiently detailed and rich, in particular in terms of income composition, to address the theories of Kuznets (1953, 1955) and others about changes in inequality over the path of development.

This short paper has three objectives. First, it highlights some of the main arguments for analyzing top wealth and incomes in inequality research. Second, it presents recent empirical evidence over the long run in the case of Sweden. And third, it suggests some considerations for future work.

2. Why should inequality researchers care specifically about the rich?

There are a number of reasons why researchers into income and wealth should take notice of the income and wealth of the rich in society.

First, there is a pragmatic fact concerning the availability of historical data. At least before World War II, only high income earners paid income tax in most countries (the same is true for wealth taxes). This means that inequality estimates based on top income or top wealth shares promise considerably longer homogeneous time series than any other of the common inequality measures used.[3]

Second, the available empirical evidence suggests that there is great heterogeneity between different groups within the top of the distribution. Such detailed knowledge about the top is crucial for distinguishing between different explanations of what drives inequality – for example, to differentiate between theories which, on the one hand, focus on changes in the relative wages of skilled and unskilled workers and those that, on the other hand, stress the importance of savings and capital formation.

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2 See, e.g., Piketty (2001, 2003), Piketty and Saez (2003), Atkinson (2004, 2005), and the new volume of Atkinson and Piketty (2007) presenting evidence from ten Western countries.

3 In fact, it was dissatisfaction with the scattered data points in most inequality datasets that spurred Thomas Piketty to write his book on French inequality (Piketty, 2001) which started this new wave of research.

Third, the income and wealth of the very richest are important components of the variation in broader measures of inequality, especially the Gini coefficient, and, obviously, in decile- or quintile-based analyses. In practice, this means that when analyzing trends using the Gini one should control for the impact from variation in the top shares, not least to see if this has varied over time (which is likely) – in particular as the coverage of the rich in household income and wealth surveys is likely to be imperfect, either because of an underreporting of wealth or because of selective non-response (Johansson and Klevmarken, 2006 suggest the latter after having double-checked with tax-based registries). Whatever the reason, this has a potentially huge impact on measured inequality.

Fourth, the rich are an important group in society, possessing a disproportionate share of economic influence, forming a large part of the tax base and often being owners of the corporate sector, with direct or indirect political influence. Hence, in order to fully understand the forces of economic and political change one needs to carefully characterize the status of those with the highest incomes and wealth holdings.

3. Income and wealth concentration in an egalitarian society: Sweden

This section provides some of the most important findings from recent empirical investigations of top incomes and wealth in Sweden, allegedly one of the world's most extensive welfare states.

3.1 Top incomes in Sweden over the twentieth century

Roine and Waldenström (2008) study the evolution of Swedish top income shares over the twentieth century. Figure 1a shows how the share of the top income decile declined secularly up to the early 1980s, with most of the decrease taking place before 1950, i.e., before the expansion of the welfare state. After 1980, the top shares increase when one includes realized capital gains, making Sweden's experience resemble that of the U.S. and the U.K. with their sharp increases in top incomes. Excluding capital gains, Sweden looks more like the continental European countries, where top income shares have remained relatively constant.

The Swedish evidence is in line with previous studies in finding a notable heterogeneity between groups within the top income decile. In Figure 1b, the long-run trends of the lower half (P90–95) and the next four percentiles (P95–99) appear to be basically flat whereas the top percentile (P99–100) decreased in much the same way as the whole top decile (Figure 1a).[4]

The heterogeneity within the top is also seen in the composition of top incomes. Capital income (interest earnings and dividends) matters most in the top percentile whereas wages are almost all of the income in the bottom half (P90–95).[5]

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[4] Taken seriously, this result suggests that some commonly used inequality metrics, in particular P90/P10 and P90/P50, do a poor job in capturing the relative incomes of "the rich". A more informative analysis would be achieved if they were to be accompanied by similar measures of the very top, such as P99/P50 or even P99.9/P10.

[5] Notably, the increasing share of capital incomes in the level of total income is not uniform across countries. For example, Piketty and Saez (2003) find that today's top income earners in the U.S. are primarily represented by high wage earners.

3.2 Long-run trends in Swedish wealth inequality

The distribution of wealth in Sweden has been the subject of several studies.[6] Recent work includes that of Ohlsson, Roine and Waldenström (2008). They analyze the long-run trends in wealth inequality and their determinants over the twentieth century, with a specific focus on comparing multiple wealth concepts.[7] Their main series are displayed in Figure 2.

The long-run trend in wealth concentration in Sweden over the twentieth century is that the top decile has seen its wealth share drop substantially, from around 90 per cent in the early decades of the century, to around 53 per cent around 1980, then recovering slightly to a level around 60 per cent in recent years. Looking just at this general trend is, however, incomplete if one is to really comprehend the evolution of wealth concentration. As in the case of income, decomposing the top decile and looking separately at the top per cent (P99–100) and the nine per cent below that (P90–99), we see that the majority of the top decile actually experiences substantial gains in wealth shares over the first half of the century. The overall drop in the top decile share is explained by such dramatic decreases in the top percentile share that this outweighs the increase for the P90–99 group. In the period 1950–80 both groups experience declines in wealth shares but the decrease is larger for the top percentile; after 1980 the trend is again the same for both groups, but now the gains in wealth shares are somewhat larger for the top percentile.

4. Some suggestions for future top income and wealth data collection

Based on the empirical results from recent studies of the long-run evolution of income and wealth concentration in Sweden, the following lessons for the future work are worth emphasizing:

The top income decile is quite heterogeneous in terms both of trends over time and of the com-position of incomes. It is important to draw distinctions when making statements about the rich in society. For example, P90/P50 and P99/P50 will most likely give entirely different answers to the same question concerning the relative income of "the rich".

- The role of (realized) capital gains deserves more attention in research on economic inequality. In particular, since 1980 there has been a surge in asset prices in both housing and financial markets. Understanding the determinants of inequality, not least in the top of the distribution, depends on the collection of good data on capital gains.
- Wealth data from wealth tax returns has no future since wealth taxation is disappearing throughout the developing world (the Swedish government decided in April 2007 to abolish the tax from the following year). If one wishes to use official registries for the construction of micro-data evidence on personal wealth, the main remaining source that is available in most countries is estate data (as is already used in the U.K.). Another good aspect of this source is that estate records are available for a long period in history, and indeed have already been used by

[6] See, e.g., Spånt (1979), Statistics Sweden (2000) and Klevmarken (2004).

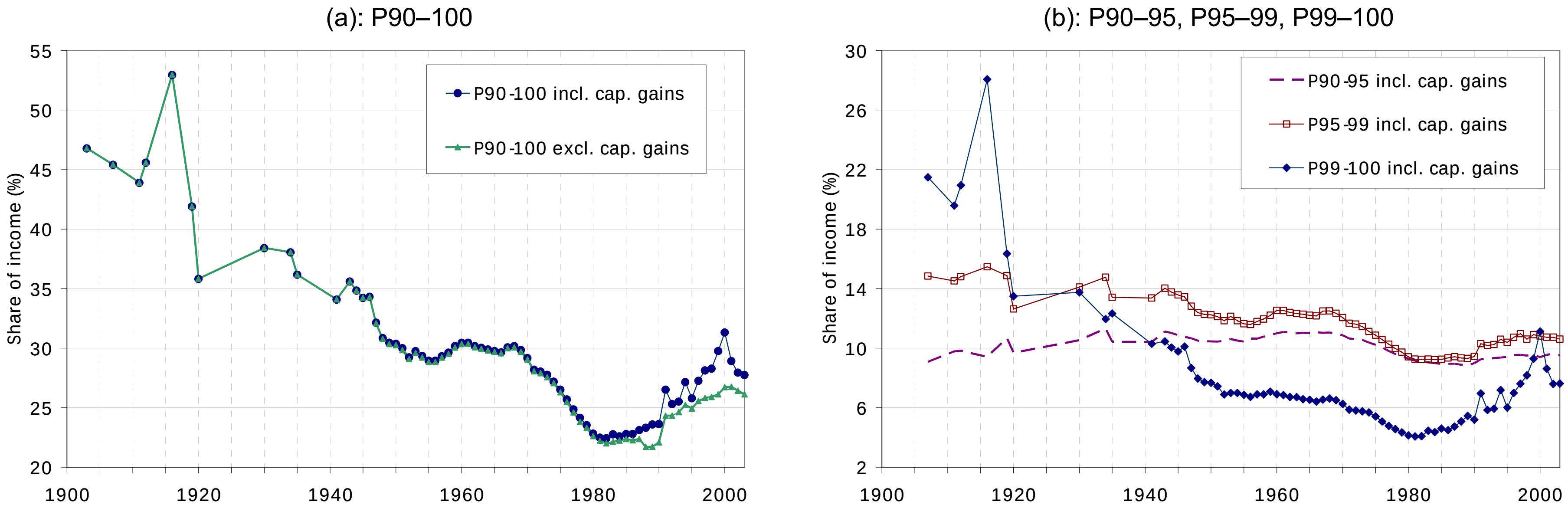
[7] They use three different measures of wealth inequality: tax-assessed values of net worth from wealth tax returns, market values of net worth in wealth tax returns (only since 1975) and estate tax material for 1873–77, 1906–08, 1954/55, 1967, and 2002–03. Previous comparisons of the effect of different definitions and sources of wealth on measured inequality were undertaken by, e.g., Atkinson and Harrison (1978), Davies and Shorrocks (2000) and Sierminska, Brandolini and Smeeding (2006).

researchers to construct long-run series of wealth inequality (e.g., Kopzcuk and Saez, 2004 for the U.S. and Piketty, Postel-Vinay and Rosenthal, 2006 for France).

- The coverage of top wealth data in household surveys depends on efforts to ensure the rich respond. Where they do, recent estimates from Sweden indicate that they disclose fairly accurate numbers (Johansson and Klevmarken, 2006).
- Pension wealth may be notoriously difficult to measure for a number of reasons. However, it is too large in relation to people's other personal assets and, more importantly, it differs systematically across countries in ways that invalidate comparative analyses of cross-country wealth inequality if left unaccounted for. Hence, those responsible for collecting personal wealth data should always aim at collecting the broadest measures of pension wealth possible.

Figure 1

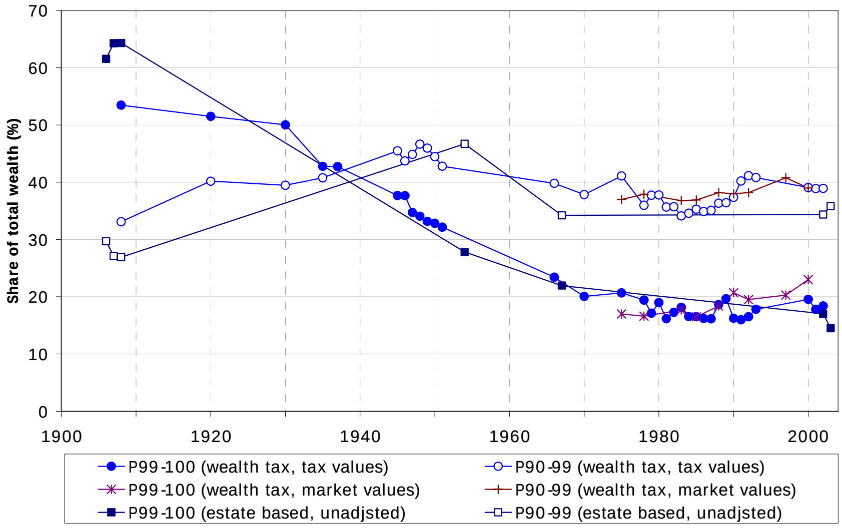
Swedish top income shares (incl. and excl. realized capital gains), 1903−2004



Source: Roine and Waldenström (2008).

Figure 2

Wealth concentration in Sweden 1906–2002



Source: Ohlsson, Roine and Waldenström (2008).

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