

Box 2.2. Income inequality and economic growth in OECD regions

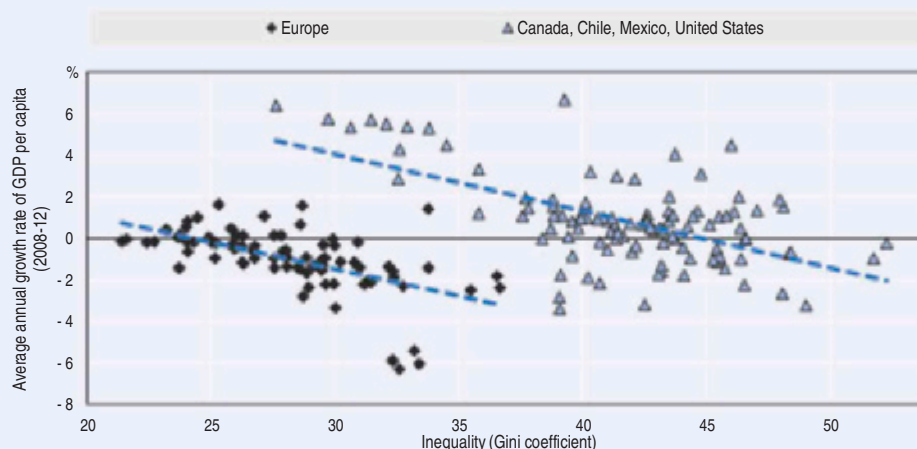
The OECD recently undertook an extension of its collection of standardised income distribution indicators to the regional level. The data show that, on average, the within-country variation in inequality is large, and comparable to that observed across countries (OECD, 2014a). Regional differences are particularly high in all large OECD countries and in some small countries with a dominant urban centre. The data show that income inequalities increase with city size. This has several possible explanations. First, large cities host the most productive firms, which pay the highest rewards to observable skills and attract talented individuals (Behrens and Robert-Nicoud, 2014). In addition, large cities may also have, on average, workers with higher unobserved skills, since there is evidence that the increase of inequality with city size occurs also within skill groups (Baum-Snow and Pavan, 2013). Finally, large cities are places of greater opportunities that attract poor people, thus contributing to greater wage dispersion.

Importantly, the data allowed addressing the relationship between income inequalities and economic growth at the sub-national level (Royuela et al., 2014). The analysis considers 15 OECD countries, covering three continents, over the period 2004-12.

A clear negative correlation was observed between income inequality and economic growth in OECD regions, especially when the patterns followed by European, and North and South American countries were considered separately. In both continents, more unequal regions experienced a subsequent slower growth rate of GDP per capita, on average (see figure below). Econometric results confirmed this negative relationship, which was stronger after 2008, suggesting that higher equality might represent an element of regional resilience against economic shocks.

The negative inequality-growth relationship was also found to be sensitive to the type of urban structure. After having controlled for the effect of urbanisation on economic growth, higher inequality seems to be more detrimental for growth in large cities, where inequality is already relatively higher on average.

Income inequality and growth in OECD regions, 2008-12



Source: Royuela, V., P. Veneri and R. Ramos (2014), "Income Inequality, Urban Size and Economic Growth in OECD Regions", *OECD Regional Development Working Papers*, Vol. 2014/10, OECD Publishing, Paris, <http://dx.doi.org/10.1787/5jxrcmg88l8r-en>.

StatLink  <http://dx.doi.org/10.1787/888933207870>

Redistribution

If inequality has a negative impact on long-term growth, a relevant policy question is how to promote a win-win process to reduce inequality and boost growth. The main,