
INCOME INEQUALITY TRENDS: CAUSES AND CONSEQUENCES

Irma Đidelija Čolaković

Faculty of Economics, University “Džemal Bijedić” of Mostar, Bosnia and Herzegovina,
irma.djidelija@unmo.ba

Taleb Hamme Taleb

Transilvania University of Brasov, Romania, taleb-taleb@student.unitbv.ro

Abstract: Economic inequalities are found in all societies and as such seem inevitable and necessary for economic and social development. Most research on inequalities focused on inequalities arising from income distribution (implies the way in which the income generated in economy is distributed to households. The method of calculating this indicator is most often at the household level, by adding up the incomes of all members households and then weighted by the number of members household and their age). The reason for the above is that total wealth is more difficult measure accurately (in some countries, income inequality is not great, however, wealth inequality is increasing in last years. Wealth is generally more unevenly distributed compared to income due to the possibility of inheritance and rising real estate prices.). The aim of this paper was to examine the causes and consequences of economic inequalities. Several broad factors are identified as drivers of rising income inequality: technological change, globalization and trade, labor market institutions and policies, concentration of capital and rents, demographic and social factors. Economic inequalities lead to a number of negative social, economic and other consequences: it erodes middle-class share, reduces mobility, and can weaken political and social cohesion. Due to the consequences of economic inequalities, addressing this problem has become increasingly important in recent years. The constant, inevitable, downward phases of economic cycles have reversed long-term trends in convergence of living standards, and have significantly burdened social protection systems. Inequality is thus generally increasing in most EU member states, but also in other countries in the world, raising concerns about the sustainability of growth and social cohesion. The possibility of inclusive growth has also been called into question. Namely, if the income of a country (measured on the basis of GDP) grows faster than the income of households in that country, then the conclusion is that growth is not inclusive, i.e. the benefits of growth are not felt by all households in the country under consideration. For example, official statistics show that GDP growth in the USA in recent years has almost exclusively benefited households with the highest incomes. Also, too much inequality can threaten growth. The above applies in particular to inequality which cause is the increase in poverty at the bottom of the income distribution scale. Namely, if people at the bottom of the income distribution scale do not have enough funds to invest in their education and skill development, then such people will probably not be able to realize their full potential, which further threatens overall growth. Another way in which too much inequality threatens growth is that redistribution of income can encourage demand in the economy, and households as a rule, those with low incomes spend more.

Keywords: economic inequalities, causes, consequences of inequality

1. INTRODUCTION

Income inequality is the uneven distribution of income among individuals or households in an economy (OECD 2024.). It is measured by summary indices such as the *Gini coefficient* which ranges from 0 (perfect equality) to 1 (perfect inequality) (OECD, 2024). In recent years, inequality has become a big issue for policymakers and researchers as high inequality has been linked to social unrest, political polarization and institutional distrust. This article looks at recent trends in inequality, reviews the theoretical frameworks that explain these trends and analyses the drivers and effects of inequality. We also present a *case study of inequality in the European Union* using data from Eurostat and OECD to illustrate key points. The paper is structured as follows. Section 2 reviews the literature on inequality, classic theories (e.g. Kuznets' curve) and modern perspectives (Piketty's $r > g$ hypothesis, Milanovic's global inequality). Section 3 looks at the main drivers and consequences of inequality with empirical evidence and figures. Section 4 is the case study of inequality in the EU. Finally, Section 5 summarises findings, notes limitations and suggests future research. Throughout we cite sources in APA style.

2. LITERATURE REVIEW

The first influential theory is *Kuznets' curve*, proposed by Simon Kuznets (1955), which says that income inequality will rise and then fall as an economy grows. Kuznets argued that in the early stages of industrialization (shift from agriculture to manufacturing) inequality increases, but over time education expands, technology diffuses and public

transfers reduce inequality. Indeed Kuznets documented a post WWII decline in income inequality in many Western countries, due to more schooling, narrowing wage gaps and strong redistributive policies. But the Kuznets hypothesis fell out of favour after the late 20th century as most developed countries saw *rising inequality* not continued decline.

Building on this history Thomas Piketty (2014) revived the analysis of inequality with a new framework. Piketty's central insight is the relation $r > g$: when the rate of return on capital (r) exceeds the economy's growth rate (g), wealth accumulates faster for the owners of capital than for wage earners. This amplifies any existing disparities. In theory if capital owners reinvest their returns while workers' wages grow only at the economy's growth rate the ratio of wealthy to non-wealthy grows at $r-g$. So Piketty predicts that high returns on capital will drive up wealth inequality and by extension income inequality (through capital income and inheritance) unless checked by taxes or other policies. In his historical analysis Piketty shows that $r-g$ was unusually small or even negative during the mid 20th century (due to world wars, inflation and taxes) which corresponded to lower inequality but has reopened in recent decades suggesting a secular rise in inequality.

Branko Milanovic (2016) emphasizes both Kuznetsian waves and globalization. He notes that the recent surge in inequality can be seen as a "second Kuznets wave" driven by technological revolutions and the migration of labor from manufacturing to more heterogeneous services and by globalization of markets. These forces tend to hollow out middle class incomes in rich countries and give more weight to high skilled and capital incomes. Importantly Milanovic highlights the *global dimension* of inequality: overall world inequality depends on between-country and within-country disparities. He and others have shown that while within-country inequality has risen in many countries since the 1980s between-country inequality (the income gap between rich and poor nations) has fallen in the late 20th and early 21st century largely due to fast growth in populous nations like China and India (Qureshi, 2023) As a result measures of *global inequality* (among all individuals worldwide) actually declined modestly after 2000 since lower between-country inequality offset the rise within countries(Qureshi, 2023).

Empirical research confirms that income inequality has *increased markedly* in many countries. For example OECD data shows that in advanced economies the share of income going to the top10% went from around 1/3 in 1980 to over 40% in 2020 (Qureshi, 2023). Top income shares have risen while bottom and middle have stagnated or grown slowly. Statistical research also shows that countries with growing technology or trade integration tend to see widening wage gaps between skilled and unskilled workers (e.g. Autor, Katz, & Kearney, 2008). In summary the literature agrees on the trend of rising inequality in many places but disagrees on the causes and long term effects.

3.DRIVERS OF INCOME INEQUALITY

Based on the aforementioned literature review, it can be concluded that the following are the reasons for the growth of income inequality:

- Technological change (skill-biased innovation): Rapid advances in information technology and automation have increased demand for highly skilled workers while reducing demand for routine low- and middle-skill jobs. This leads to more unequal labor income. Brookings researchers note that tech-driven shifts have made labor income more unequal and have enabled a higher share of income to flow to capital owners through increased productivity and automation.
- Globalization and trade: Liberalization of trade and offshoring has exposed low-skill workers in high-income countries to competition from abroad. Evidence suggests that globalization has depressed wages for less-educated workers in manufacturing and tradable sectors in advanced economies(Qureshi, 2023). In emerging economies, increased exports have sometimes been offset by automation and higher skill intensity, so the net effect on inequality has been mixed. Overall, globalization has tended to raise within-country inequality in many places, even while it reduced global inequality between nations.
- Labor market institutions and policies: Declines in unionization, weakening of labor standards, and erosion of minimum wages have also contributed to larger wage dispersion. Similarly, reductions in progressivity of taxes and trimming of social transfers have meant less redistribution. For instance, the Brookings analysis points out that deregulation and financialization have concentrated incomes and that many countries' tax-and-transfer systems have become less aggressive at reducing inequality. Horowitz, J. M., Igielnik, R., & Kochhar, R. (2020) likewise highlights the decline of unions and minimum wage erosion as key factors in the U.S. context.
- Concentration of capital and rents: Rising concentration of business and financial capital can increase inequality. Large corporations with market power generate economic rents (excess profits) that accrue primarily to their owners or top executives. As Milanovic and others note, higher capital income shares (with a Gini above 0.9 for capital income) mean the rich capture growing portions of total income. When

capital income is taxed lightly or inherited across generations, wealth inequality begets income inequality (consistent with the $r > g$ mechanism).

- Demographic and social factors: Trends in household composition and assortative mating also play a role. For example, the tendency for high-income individuals to partner (homogamy) increases inequality of household income. Aging populations can have mixed effects: older retirees often have lower labor income but may have accumulated wealth. Immigration can affect average incomes if migrants are disproportionately low- or high-skilled.

These drivers interact with national policies. Countries that maintained strong redistributive policies (e.g. progressive taxes, generous social programs) saw smaller inequality rises than those that cut back on redistribution. In summary, technological innovation, trade, institutional shifts, and public policy choices all combine to explain recent inequality trends.

4. CONSEQUENCES OF INCOME INEQUALITY

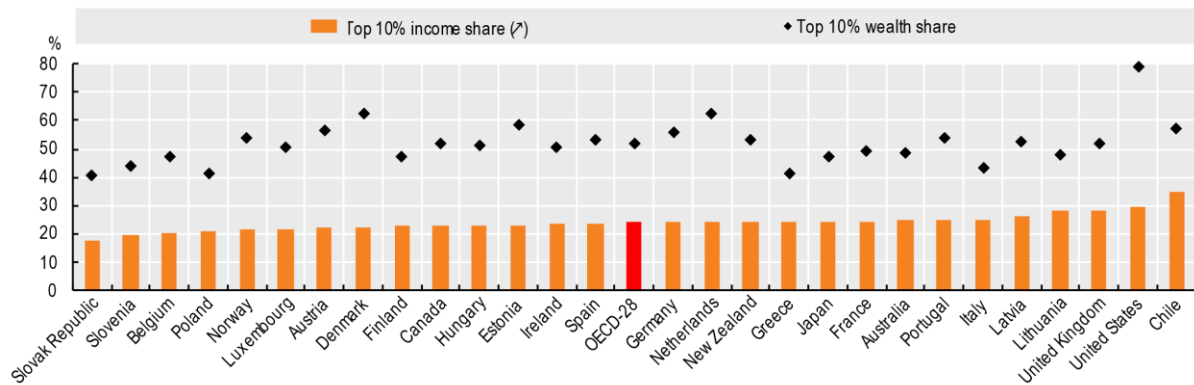
High income inequality has many economic and social effects. Scholars have linked rising inequality to slower growth and underinvestment in human capital. For example, when the bottom half of society loses share of income, aggregate demand may weaken (since the wealthy save more of their income), and growth may slow (cf. Saint-Paul & Verdier, 1993). But the empirical effect of inequality on growth is contested: some studies find a slightly negative effect once inequality is high, while others find that moderate inequality can stimulate innovation (the consensus is to be cautious with too much inequality).

Socially, inequality is associated with less mobility and social cohesion. The “Great Gatsby Curve” suggests that countries with higher inequality have lower intergenerational mobility (Qureshi, 2023). In practical terms, this means that children born into low-income families face more barriers to climbing the income ladder in high-inequality societies. Horowitz et al. (2020) note that rising inequality worries the public because of its impact on mobility and fairness. Brookings (2023) says that high inequality erodes the middle class and sharpens divisions within society.

Political consequences are also documented. When income is concentrated, the rich may have more political influence than the poor, and public policy may skew in their favor (Qureshi, 2023).. Wilkinson and Pickett (2009) and others argue that high inequality is associated with worse outcomes in health, crime and social trust. For example, societies with large income gaps often report lower trust in institutions, higher incarceration rates and worse public health on average (Qureshi, 2023).. Some of these correlations are debated, but there is broad concern that very high inequality can break social cohesion.

Figure 6.2 from OECD below shows that *wealth inequality* is even more extreme than income inequality. In most countries, the top 10% of households own more than 10% of total wealth (often 50% or more), while their share of income is much lower (as shown by orange bars vs black diamonds). Wealth is the “capital stock” for the rich and generates future income, so high wealth concentration can perpetuate high income inequality over time.

Figure 1: In OECD countries, the share of income going to the top 10% (orange bars) is much lower than the share of net wealth held by the top 10% (black diamonds)(20). For example, in the United States the top 10% hold roughly 33% of income but over 70% of wealth; in Chile the disparity is similar



Source: OECD Wealth Distribution Database.

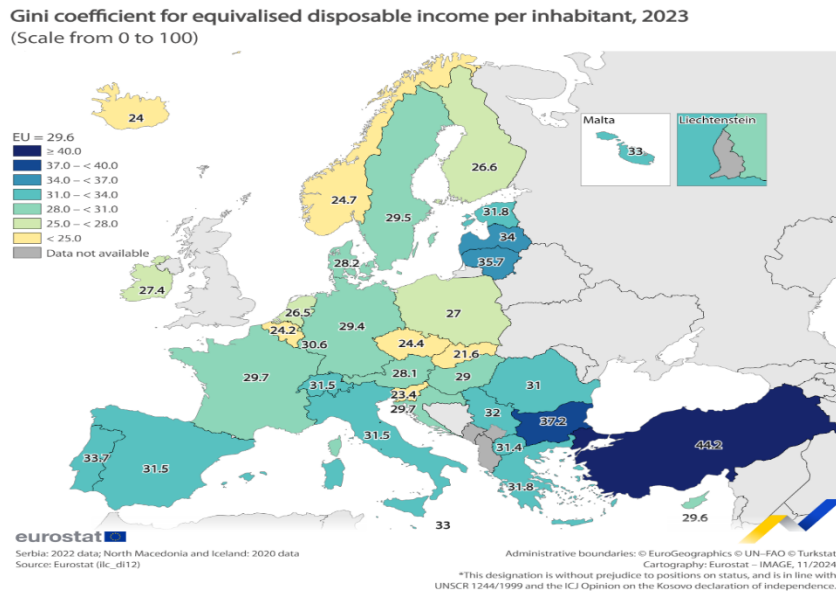
In short, the effects of rising inequality include slower growth and human capital accumulation, erosion of middle-class stability, reduced mobility and strains on political and social stability (Qureshi, 2023).

5. CASE STUDY: INCOME INEQUALITY IN THE EUROPEAN UNION

To illustrate these trends with data, consider the *European Union*. According to Eurostat data in 2023 the EU had a median annual disposable income of about 19,955 purchasing-power-standard (PPS) units per person. Notably, social transfers (including pensions and other government benefits) accounted for roughly 27.7% of that median (5,538 of 19,955 PPS), highlighting the role of redistribution in the EU. The at-risk-of poverty rate (households with incomes below 60% of the national median) was 14.3% in 2023, down from 16.5% in 2019, showing some poverty reduction in recent years.

Despite progress, income inequality in the EU remains significant and varied across countries. The Gini coefficient for disposable income was 29.6 (out of 100) on average. However, there is large heterogeneity: Bulgaria (37.2), Lithuania (35.7) and Latvia (34.0) have the highest Gini values in 2023, whereas Slovakia (21.6), Slovenia (23.4), Belgium (24.2) and Czechia (24.4) had the lowest. This pattern is visible in the Eurostat map below, where darker shading indicates higher inequality.

Figure 2: Gini coefficient for equivalised disposable income per inhabitant (2023) in EU and neighboring countries. The EU average is 29.6; values range from about 22 (green) up to 44 (Turkey)



Source: Eurostat (2023)

Several factors help explain these differences. Eastern and Southern European countries tend to have higher inequality partly due to relatively low social spending and larger informal economies. Western and Northern European countries have stronger welfare systems and more progressive taxes, which compress incomes. For example, the Czech Republic and Slovenia have lower Gini because generous social benefits and collective bargaining keep incomes relatively equal. In contrast, Baltic states and new member countries inherited more unequal structures after transition and have gradually increased redistribution. Over time, most EU countries have seen moderate increases in Gini since the 1990s, although not as steep as in the US. Between 2008 and 2023, EU-average inequality was relatively stable thanks to automatic stabilizers (e.g. pensions) during the crisis and recovery. Compared to non-EU OECD countries, the EU's top 10% income shares are generally lower. For instance, OECD data show the United States has a Gini of about 0.43 (that is higher than any EU country) and a much larger top-income share (Horowitz et al., 2020). By contrast, many EU nations (Germany, France, Scandinavia) have Gini around 0.28–0.33. Thus, the EU case illustrates how social policy and economic structure can moderate inequality. However, the diversity within the EU also underscores that policy choices matter: countries with weaker redistribution experience higher inequality and poverty.

6. CONCLUSION

This review finds that income inequality has trended upward in many countries since the 1980s, after decades of stability or decline in the mid–20th century (Kuznets, 1955; Qureshi, 2023). The traditional Kuznets hypothesis of an inevitable decline in very rich countries no longer holds in the face of rising inequality in nearly all advanced economies. Piketty’s insight ($r > g$) and analyses by Milanovic and others help explain why capital-rich and globalized economies see growing inequality. Our analysis identified multiple drivers: technological change, globalization, weakened labor institutions, and policy retrenchment, that together have pushed inequality higher. In the European Union, robust social transfers have dampened inequality, yet significant gaps remain across countries (Eurostat, 2023).

The evidence also confirms that high inequality has serious consequences: it erodes middle-class share, reduces mobility, and can weaken political and social cohesion (Qureshi, 2023). While there is still debate about the precise impact on economic growth, most researchers agree that very high inequality is socially undesirable and can create feedback loops that perpetuate poverty and exclusion.

This study’s objectives were met: we have outlined key theories and summarized recent empirical findings on inequality’s causes and consequences. However, there are limitations. Income inequality is measured in various ways (market vs disposable income, pre- vs post-tax), and data gaps remain, especially for wealth and the very top of the distribution. Cross-country comparisons must be interpreted with care due to different survey methods and welfare systems. Future research should improve measurement of wealth and capital income, investigate inequality’s impact on health and environmental outcomes, and analyze recent shocks (e.g. COVID-19) on income distribution. Developing models that link inequality to long-term growth and social stability remains an important agenda. Policymakers will need rigorous analysis to design tax, education, and social policies that balance growth with a more equitable income distribution.

REFERENCES

- Atkinson, A. B., & Lakner, C. (2014). Top incomes and the measurement of inequality. *Journal of Economic Literature*, 52(3), 635-656.
- Eurostat, F. (2023). *Living conditions in Europe-income distribution and income inequality* (Statistics Explained).
- Garbinti, B., & Goupille-Lebret, J. (2019). Income and wealth inequality in France: Developments and links over the long term. *Economie et Statistique/Economics and Statistics*, (510-511-512), 69–87.
- Horowitz, J. M., Igielnik, R., & Kochhar, R. (2020). Trends in income and wealth inequality. *Pew Research Center*, 9.
- Qureshi, Z. (2023). Rising inequality: A major issue of our time. In *Brookings*. Retrieved
- Kuznets, S. (1955). *Economic growth and income inequality*. *American Economic Review*, 45(1), 1–28.
- Milanovic, B. (2016). *Global inequality: A new approach for the age of globalization*. Harvard University Press.
- Organisation for Economic Co-operation and Development OECD (2024), *Society at a Glance 2024: OECD Social Indicators (income and wealth inequalities chapter)*, OECD Publishing, Paris
- Piketty, T. (2014). *Capital in the twenty-first century*. Harvard University Press.
- Pinkovskiy, M. L. (2015). *A Discussion of Thomas Piketty's Capital in the Twenty-First Century: By How Much Is r Greater than g?* (No. 20150713b). Federal Reserve Bank of New York. Retrieved from
- Polacko, M. (2021). Causes and consequences of income inequality—an overview. *Statistics, Politics and Policy*, 12(2), 341-357.
- Sintos, A. (2023). Does inflation worsen income inequality? A meta-analysis. *Economic Systems*, 47(4), 101146.
- Stiglitz, J. E. (2012). *The price of inequality: How today's divided society endangers our future*. WW Norton & Company.
- Topuz, S. G. (2022). The relationship between income inequality and economic growth: are transmission channels effective?. *Social Indicators Research*, 162(3), 1177-1231.
- Wilkinson, R., & Pickett, K. (2011). *The spirit level: Why greater equality makes societies stronger*. Bloomsbury Publishing USA.