Reconciling inequality and growth objectives: can it be done?

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There is no systematic trade-off between inequality and economic growth
Background of the study

Economic context
• Income inequality was high and rising in many OECD countries even before the crisis
• The crisis has eroded GDP per capita levels
• A key question: how to achieve a more equitable distribution of income while returning to solid growth

Aim of the study
• Identifying win-win policies that help foster growth and reduce income inequality and those that entail trade-offs between the two objectives

Components of the study
• Cross-country comparisons income inequality and its sources
• Analysis of the impact of policy and non-policy factor on income inequality
• Policy trade-offs and complementarities with respect to growth and distribution objectives
Inequality in household disposable income varies considerably across countries.

Gap between the 10th and the 90th centile and the Gini index
Household disposable income in the late 2000s

Income inequality – an overview

Centile ratio

Gini index

Countries included: Denmark, Norway, Slovenia, Hungary, Finland, Sweden, Austria, Iceland, Belgium, France, Germany, Ireland, Greece, Poland, New Zealand, Canada, Israel, Mexico.
Understanding inequality: accounting framework and policy levers

- **Family formation and composition**
- **Self-employment & capital income**
- **Taxes & cash transfers**
- **Individual consumption of public goods**

**Income inequality – an overview**

- **Individual labour income**
- **Household labour income**
- **Household market income**
- **Household disposable income**
- **Household adjusted disposable income**

- Education & labour market policies, migration & gender policies etc.
- Family policies (child and elderly care), etc.
- Tax policies (wealth, capital income)
- Cash transfers and tax policies
- Education & health (access & coverage) policies
The determinants of labour income inequality: empirical analyses based on macro & micro data

Two different empirical methodologies:
- Quantile regressions based on household survey data
- Macro panel regressions using BMA to deal with model uncertainty

Selected results

Technical change and globalisation
- Play an important role but can not fully explain cross-country inequality differences
- Inequality effect of trade depends on labour market institutions

Education policies
- Policies that boost upper-secondary and tertiary graduation rates reduce inequality
- Policies that promote equity in education reduce income inequality

Labour market policies
- Stronger unions compress the earnings distribution
- Higher minimum wages lower earnings inequality but may reduce employment of marginal groups
- Dualism raises income inequality

Gender gap
- Shorter working hours by women are an important explanation
- Still, much of the gap remains unexplained
The inequality effect of trade depends on labour market institutions.

**ppt change in the 90/10 ratio due to a 1% rise in the trade-to-GDP ratio**

- As a function of union density
  - The white shaded areas show the 95% confidence interval.

**ppt change in the employment rate due to a 1% rise in the trade-to-GDP ratio**

- As a function of union density
  - The white shaded areas show the 95% confidence interval.

Note: The white shaded areas show the 95% confidence interval.
The effect of a rise in educational attainment on the distribution of earnings

Earnings impact of raising the share of better-educated workers

Upper-secondary or post-secondary non-tertiary education

Tertiary education
Higher union membership tends to be associated with lower wage dispersion

**Wage premium of union membership**
Cross-country average, 2008 or latest available year

The distribution of labour income

Income quantile

-10%  0%  10%  20%  30%  40%  50%  60%  70%  80%  90%
Workers on temporary contracts earn less, particularly those at the bottom

Effect on log earnings of raising the share of workers with a temporary work contract by one percentage point

2008 or latest available year

The distribution of labour income

Quantile

Note: The thick bars depict the cross-country mean of the estimated effect +/- 1 standard deviation across countries, while the thin bars depict the cross-country maximum and minimum of the estimated effect.
Women’s shorter working hours explain an important part of their lower earnings

Oaxaca-Blinder decomposition of the gender earnings gap
Full-time and part-time workers, 2008 or latest available year

Composition effects:
- Education
- Sector
- Hours worked
- Occupation
- Age

Sum of all rate of return effects plus the contribution of the constant
Total earnings gap between men and women
Taxes and transfers reduce market income inequality by about one-fourth

Gini coefficient of market income and disposable income

Late 2000s

The tax and transfer system
The redistributive impact of transfers is higher than that of taxes in most countries.

The redistributive impact of taxes and transfers

Point reduction in concentration coefficients, late 2000s
The size and composition of public cash transfers vary across OECD countries.

**Public cash transfers to households**

Per cent of GDP, 2007

The tax and transfer system

<table>
<thead>
<tr>
<th>Country</th>
<th>Old age</th>
<th>Incapacity</th>
<th>Family</th>
<th>Unemployment</th>
<th>Other social policy areas</th>
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Countries with large cash transfers tend to have less progressive systems

In the late 2000s

The tax and transfer system

Progressivity index of cash transfers

Cash transfers as a share of household disposable income

$y = -0.01x + 0.73$

$R^2 = 0.30$
The redistributive impact of the tax system is a function of its size and its mix ...
... while the progressivity of statutory labour tax schedules has often increased

Progressivity indicator based on net personal income tax schedules for single taxpayers without children
And real estate taxes are often regressive
Measures to improve human capital are clear win-win strategies

<table>
<thead>
<tr>
<th>A rise in:</th>
<th>Employment rate</th>
<th>Earnings equality</th>
<th>Labour income equality</th>
<th>GDP per capita</th>
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<tbody>
<tr>
<td>Equity in education</td>
<td>?</td>
<td>+</td>
<td>+</td>
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<tr>
<td>Upper-secondary and tertiary graduation rates</td>
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<td>Initiatives to foster the integration of immigrants</td>
<td>+</td>
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<td>Initiatives to raise female labour force participation</td>
<td>+</td>
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<td>Initiatives to combat discrimination</td>
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In the area of labour and product markets, the equality effects depend on the precise measure

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<tr>
<td>Minimum wage (relative to median wage)</td>
<td>0/-</td>
<td>+</td>
<td>?</td>
<td>0/-</td>
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<td>Unionization</td>
<td>?</td>
<td>+</td>
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<td>Legal extensions of collective wage agreements</td>
<td>-</td>
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<td>The gap between protection on regular vs. temporary work</td>
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<td>Product market regulation</td>
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<td>0/+</td>
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Many tax policies imply trade-offs with respect to the growth and distribution objectives.

<table>
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<tr>
<th>Revenue-neutral tax changes:</th>
<th>Disposable income equality</th>
<th>GDP per capita</th>
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<tbody>
<tr>
<td>Change tax mix from income to consumption tax</td>
<td>-</td>
<td>+</td>
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<td>Change tax mix from income to real estate tax</td>
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<tr>
<td>Change tax mix from income to wealth and inheritance tax</td>
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<td>+</td>
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<tr>
<td>Increasing top PIT rates and tax free allowances</td>
<td>+</td>
<td>?</td>
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<td>Cutting tax expenditures and marginal rates</td>
<td>+</td>
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</table>
Contact information and underlying documents.

Contact persons
• Isabelle Joumard (Isabelle.Joumard@oecd.org) and Isabell Koske (Isabell.Koske@oecd.org)

Webpage
• www.oecd.org/economy/going forgrowth/inequality.

Going for Growth 2012
• Reducing income inequality while boosting economic growth: can it be done?, Chapter 5

OECD Economics Department Policy Notes Series
• Policy Note No. 8: Inequality in labour income – What are its drivers and how can it be reduced?
• Policy Note No. 9: Income inequality and growth – The role of taxes and transfers
OECD Economics Department Working Paper Series

Working Paper Series on “Less income inequality and more growth – Are they compatible?”

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- WP 925: Part 2. The distribution of labour income
- WP 926: Part 3. Income redistribution via taxes and transfers across OECD countries
- WP 927: Part 4. Top incomes
- WP 928: Part 5. Poverty in OECD countries
- WP 929: Part 6. The distribution of wealth
- WP 930: Part 7. The drivers of labour earnings inequality – An analysis based on conditional and unconditional quantile regressions
- WP 931: Part 8. The drivers of labour income inequality – A review of the recent literature