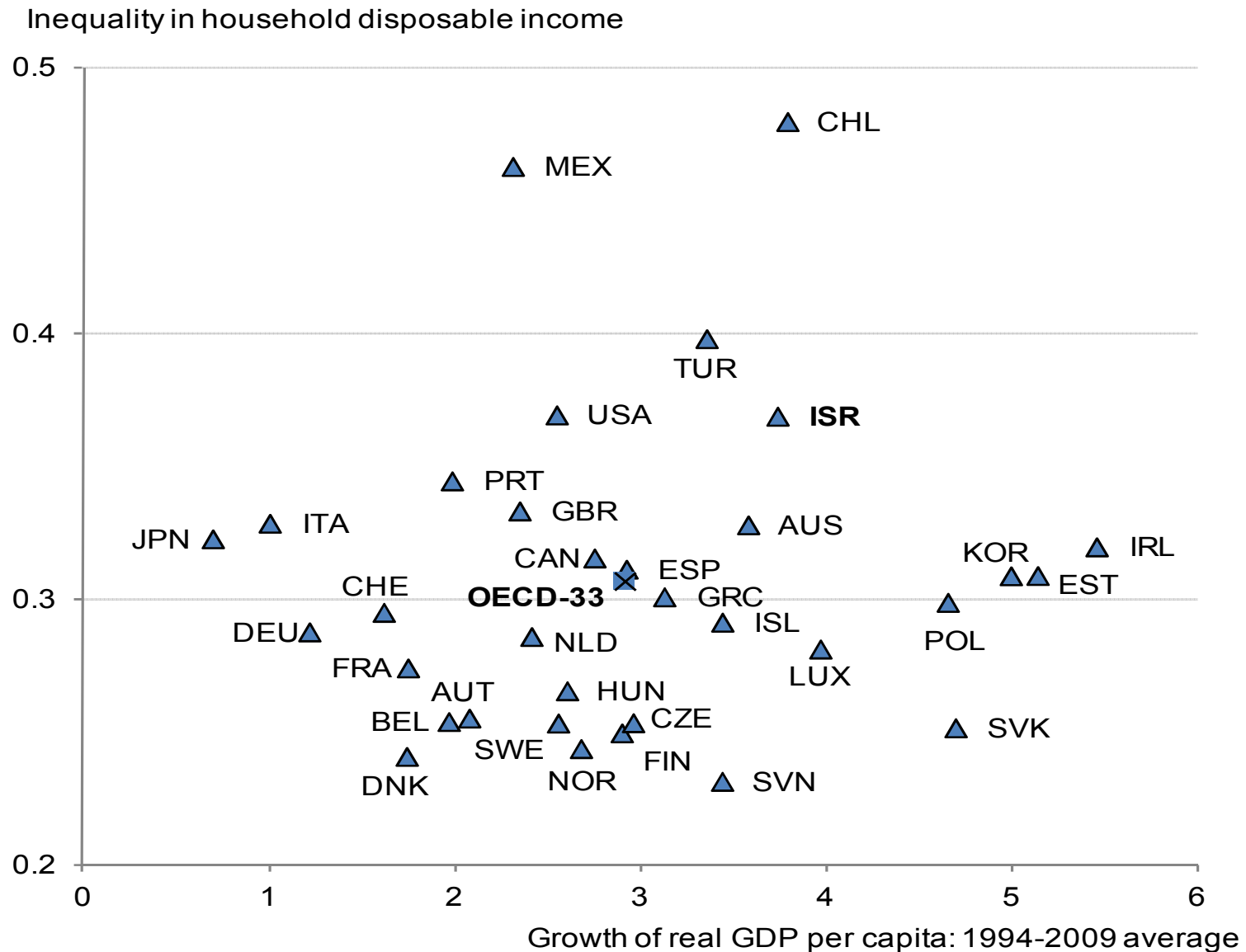


# Reconciling inequality and growth objectives: can it be done?

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OECD, Economics Department  
18 June 2012

# There is no systematic trade-off between inequality and economic growth

Context



# Background of the study

## Context

### **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**

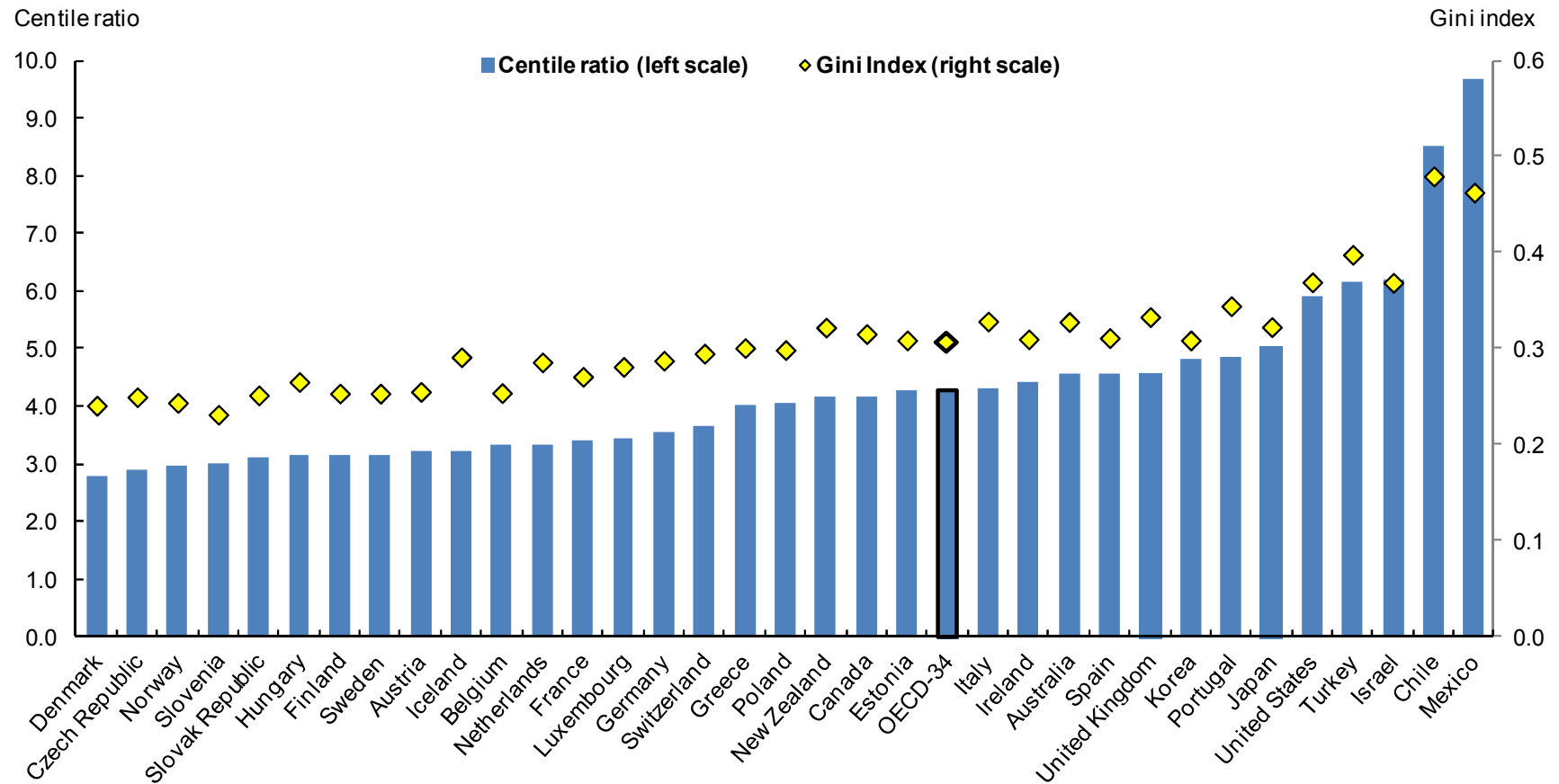
- Cross-country comparisons income inequality and its sources
- Analysis of the impact of policy and non-policy factor on income inequality
- Policy trade-offs and complementarities with respect to growth and distribution objectives

# Inequality in household disposable income varies considerably across countries

Income inequality – an overview

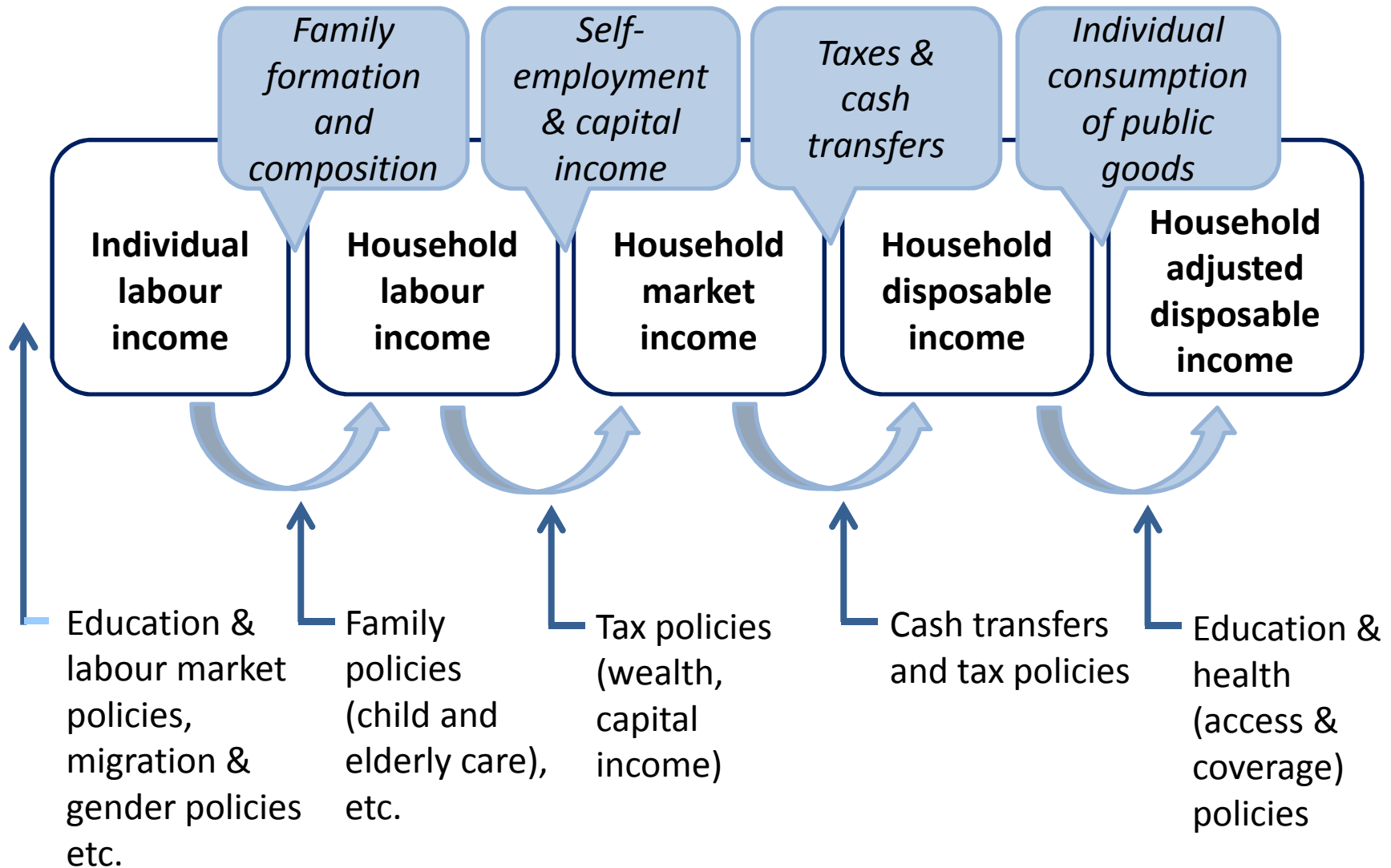
## Gap between the 10th and the 90th centile and the Gini index

Household disposable income in the late 2000s



# Understanding inequality: accounting framework and policy levers

## Income inequality – an overview



# The determinants of labour income inequality: empirical analyses based on macro & micro data

## The distribution of labour income

Two different empirical methodologies:

Quantile regressions  
based on household  
survey data

Macro panel  
regressions using BMA  
to deal with model  
uncertainty

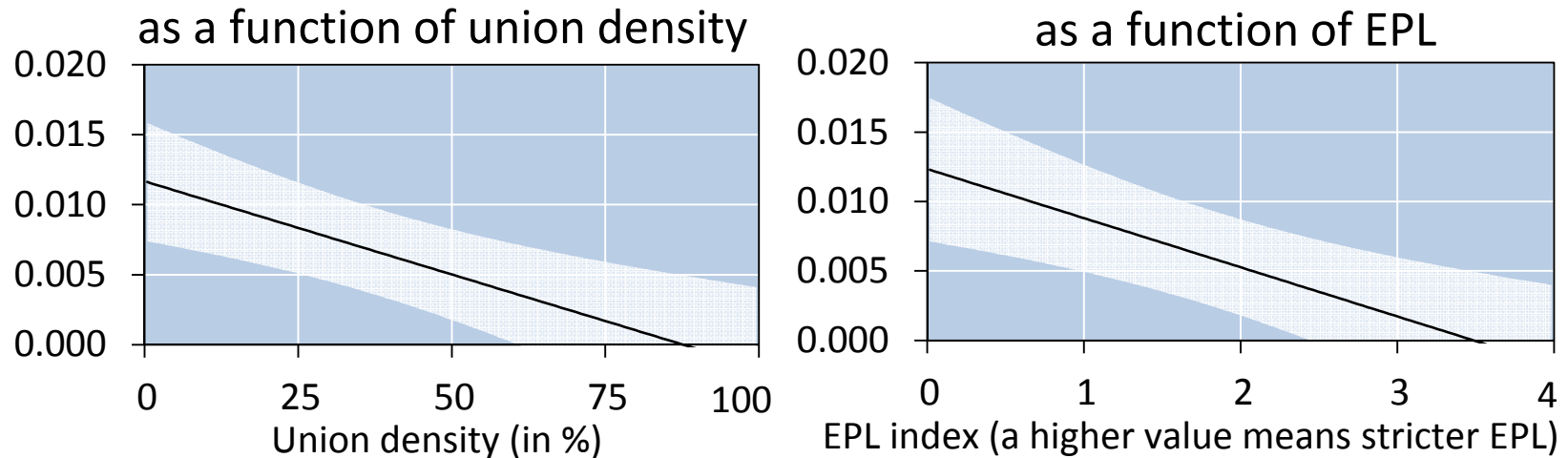
Selected results

Technical change and globalisation	Education policies	Labour market policies	Gender gap
<ul style="list-style-type: none"> <li>• Play an important role but can not fully explain cross-country inequality differences</li> <li>• Inequality effect of trade depends on labour market institutions →</li> </ul>	<ul style="list-style-type: none"> <li>• Policies that boost upper-secondary and tertiary graduation rates reduce inequality →</li> <li>• Policies that promote equity in education reduce income inequality</li> </ul>	<ul style="list-style-type: none"> <li>• Stronger unions compress the earnings distribution →</li> <li>• Higher minimum wages lower earnings inequality but may reduce employment of marginal groups</li> <li>• Dualism raises income inequality →</li> </ul>	<ul style="list-style-type: none"> <li>• Shorter working hours by women are an important explanation</li> <li>• Still, much of the gap remains unexplained →</li> </ul>

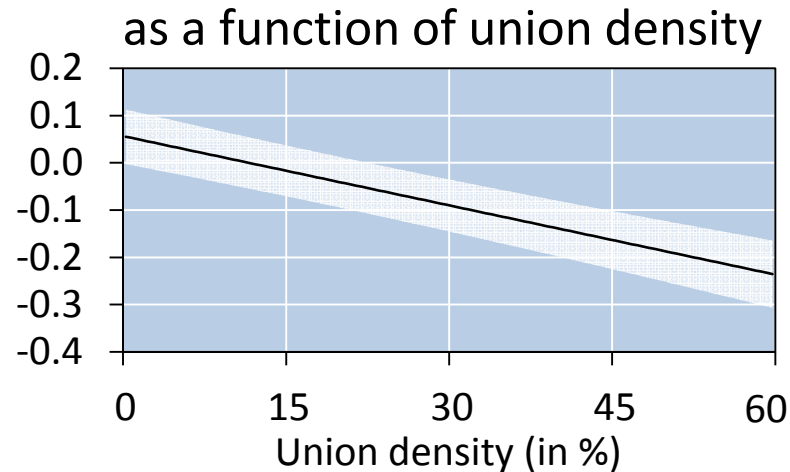
# The inequality effect of trade depends on labour market institutions

The distribution of labour income

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



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



Note: The white shaded areas show the 95% confidence interval.

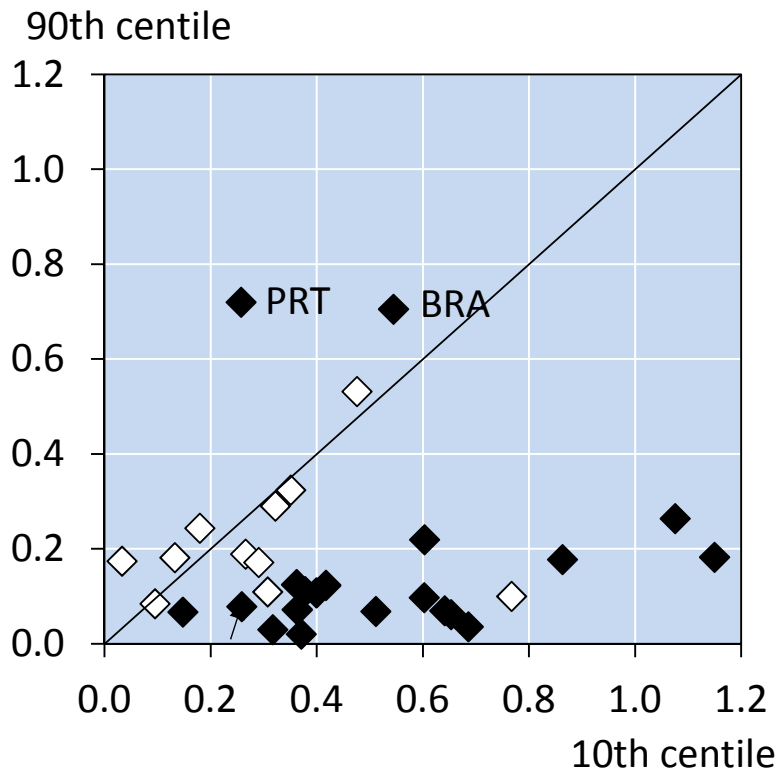


# The effect of a rise in educational attainment on the distribution of earnings

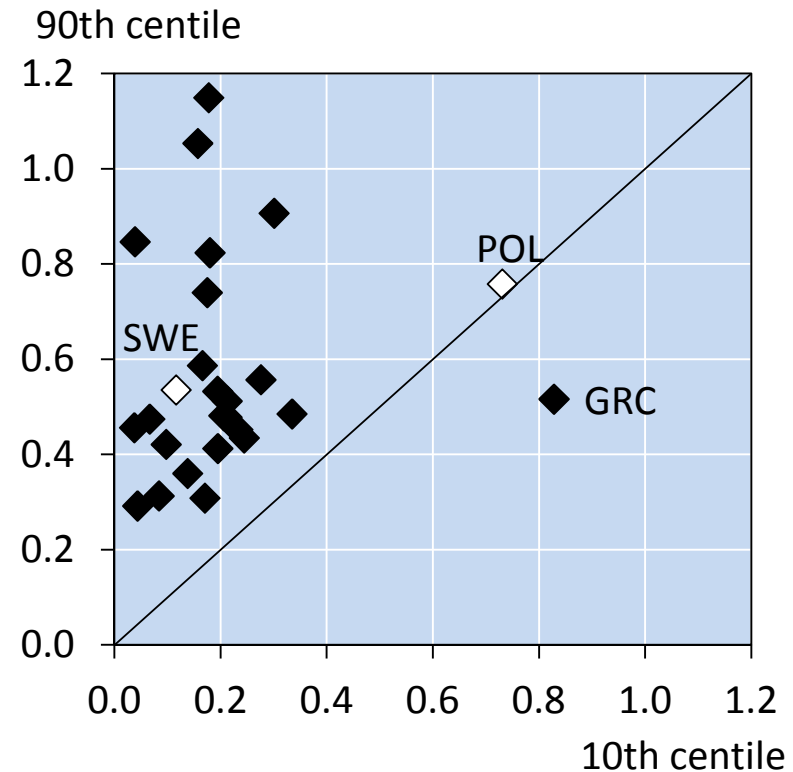
The distribution of labour income

## Earnings impact of raising the share of better-educated workers

Upper-secondary or post-secondary non-tertiary education



Tertiary education



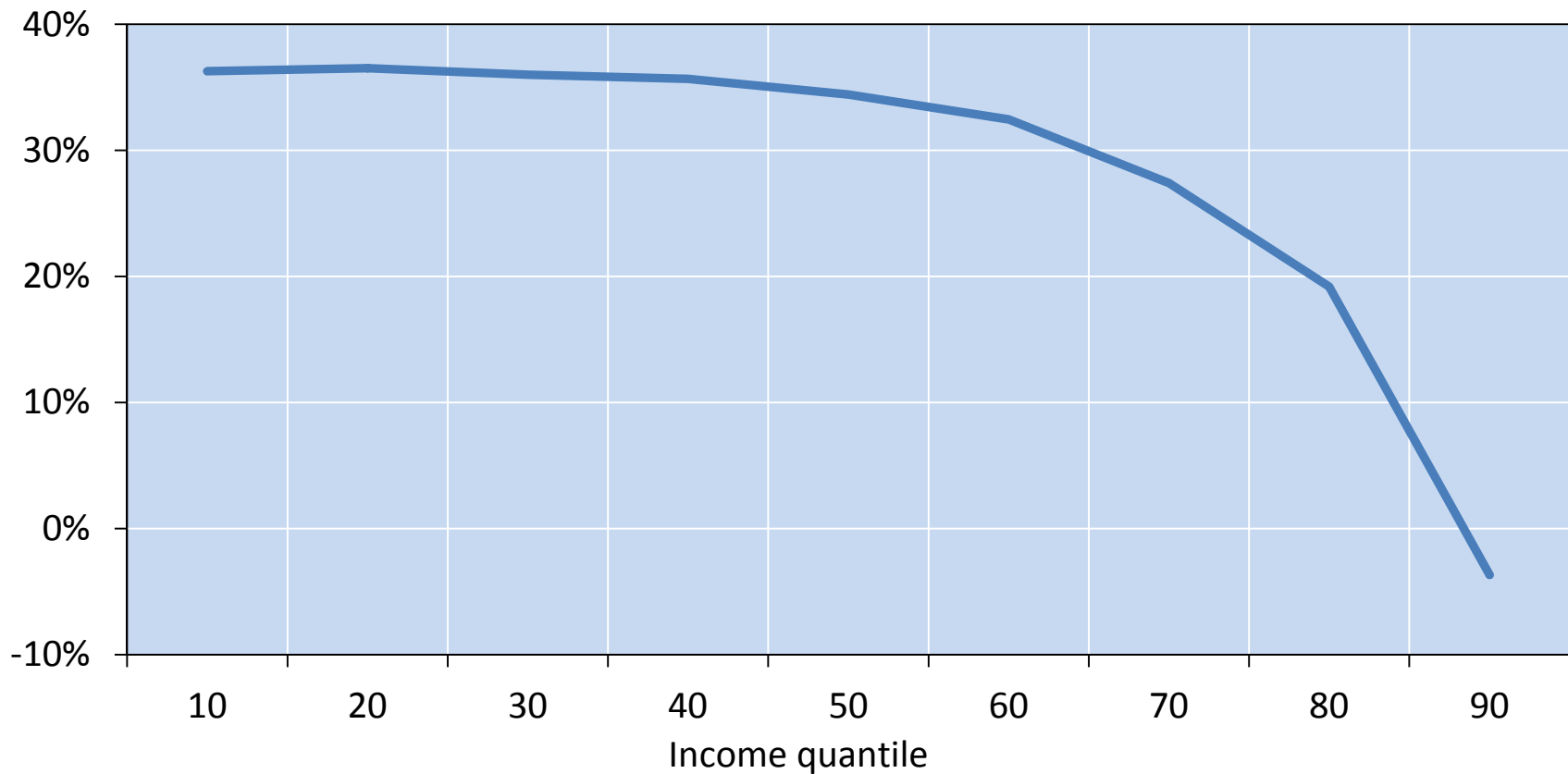


# Higher union membership tends to be associated with lower wage dispersion

The distribution of labour income

## Wage premium of union membership

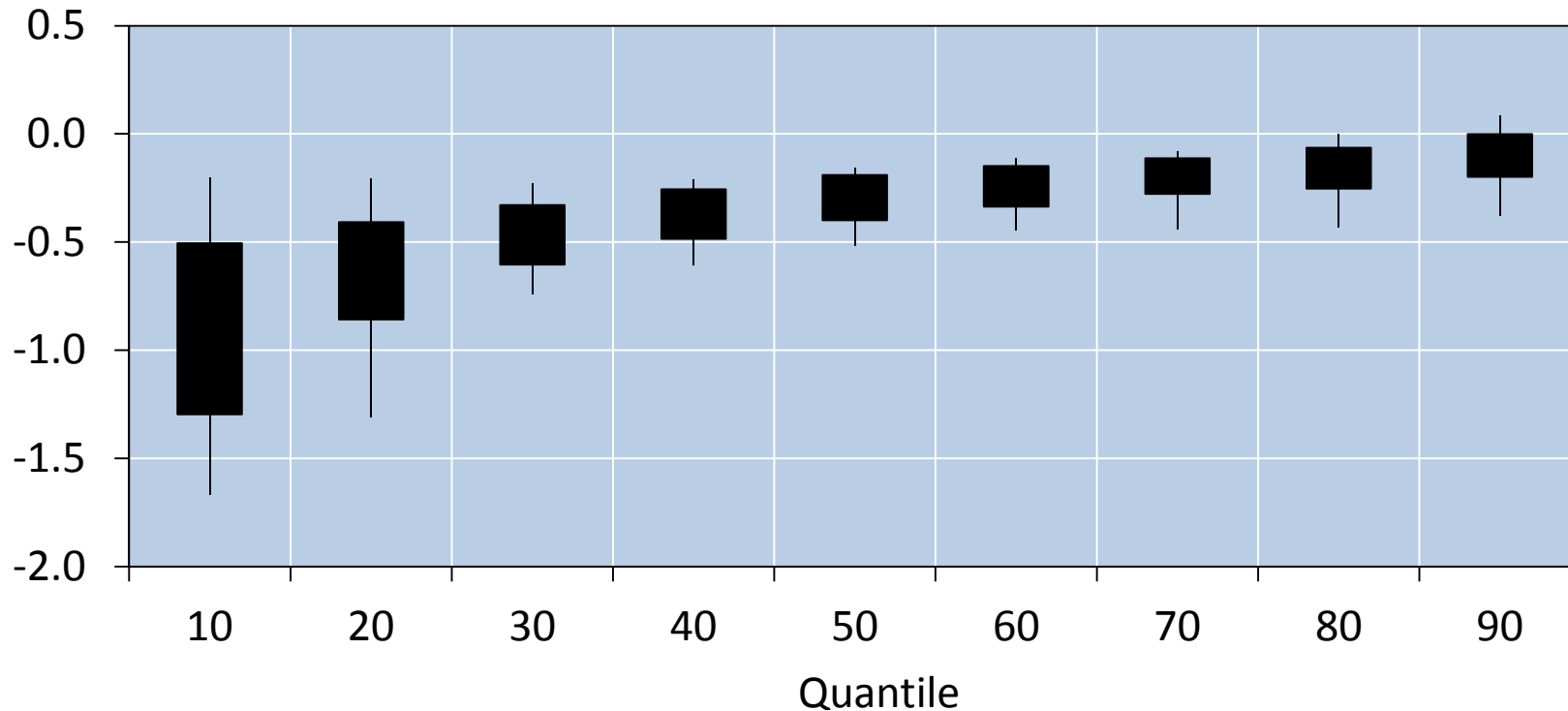
Cross-country average, 2008 or latest available year



# Workers on temporary contracts earn less, particularly those at the bottom

The distribution of labour income

**Effect on log earnings of raising the share of workers with a temporary work contract by one percentage point**  
2008 or latest available year



*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.

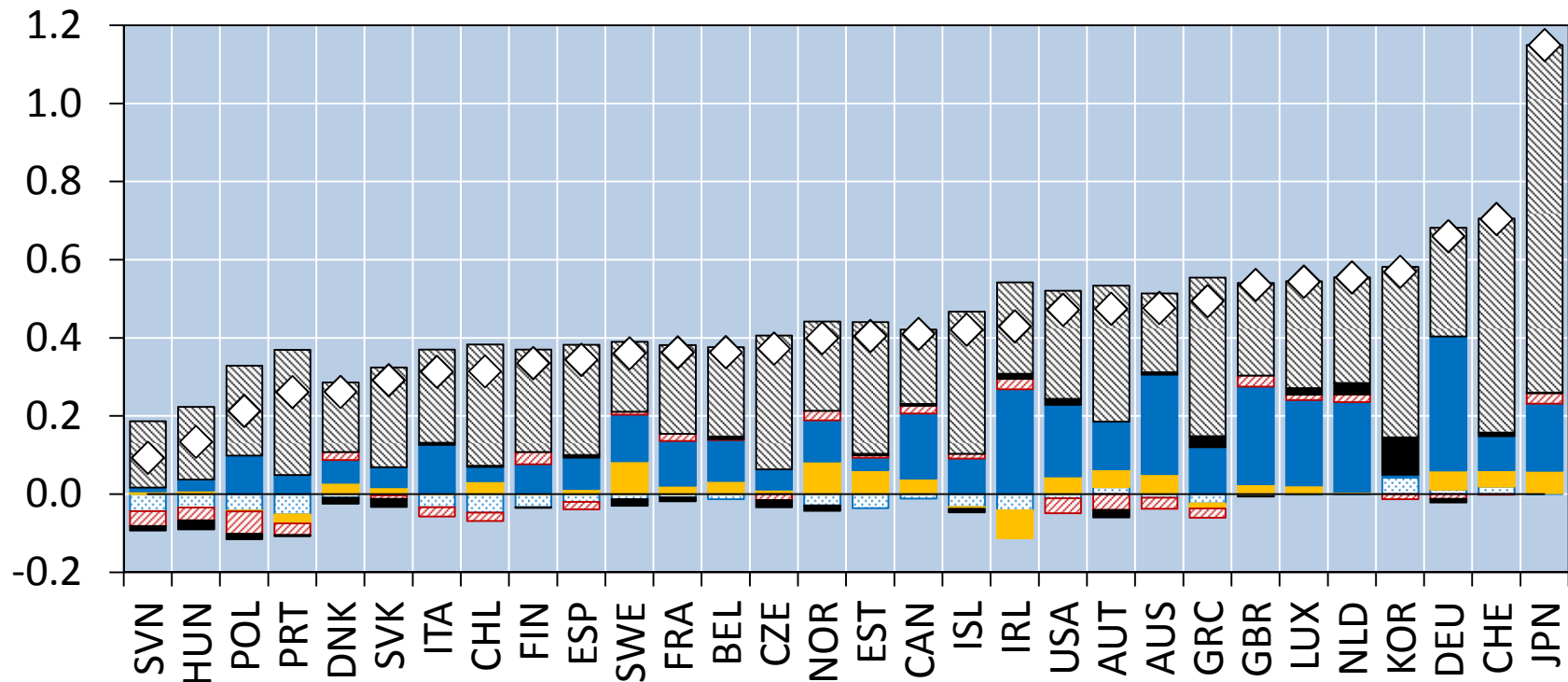


# Women's shorter working hours explain an important part of their lower earnings

The distribution of labour income

## Oaxaca-Blinder decomposition of the gender earnings gap

Full-time and part-time workers, 2008 or latest available year

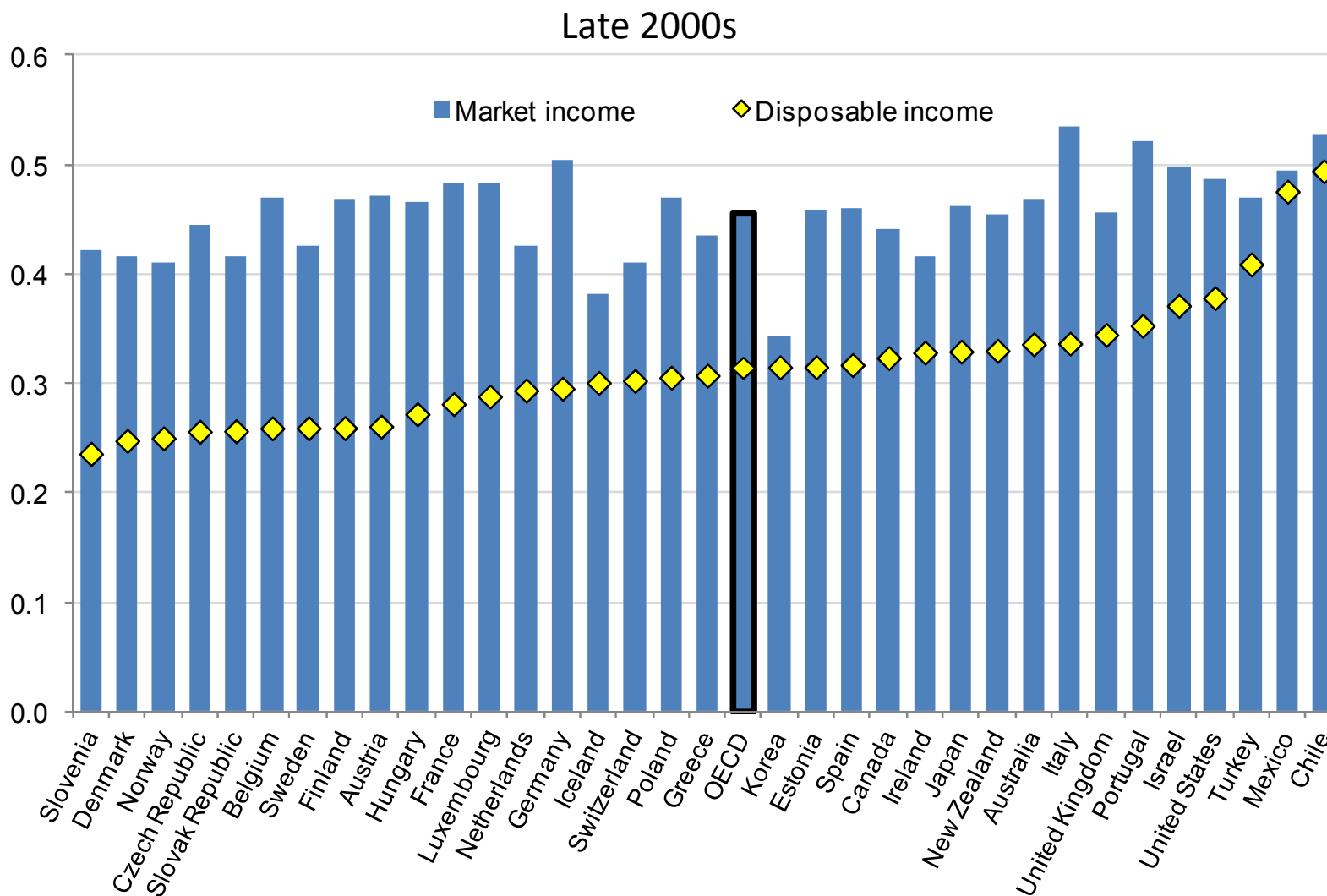


- Composition effects: Education (dotted) Sector (yellow) Hours worked (blue) Occupation (red with diagonal lines) Age (black)
- ▨ Sum of all rate of return effects plus the contribution of the constant
- ◇ Total earnings gap between men and women

# Taxes and transfers reduce market income inequality by about one-fourth

The tax and transfer system

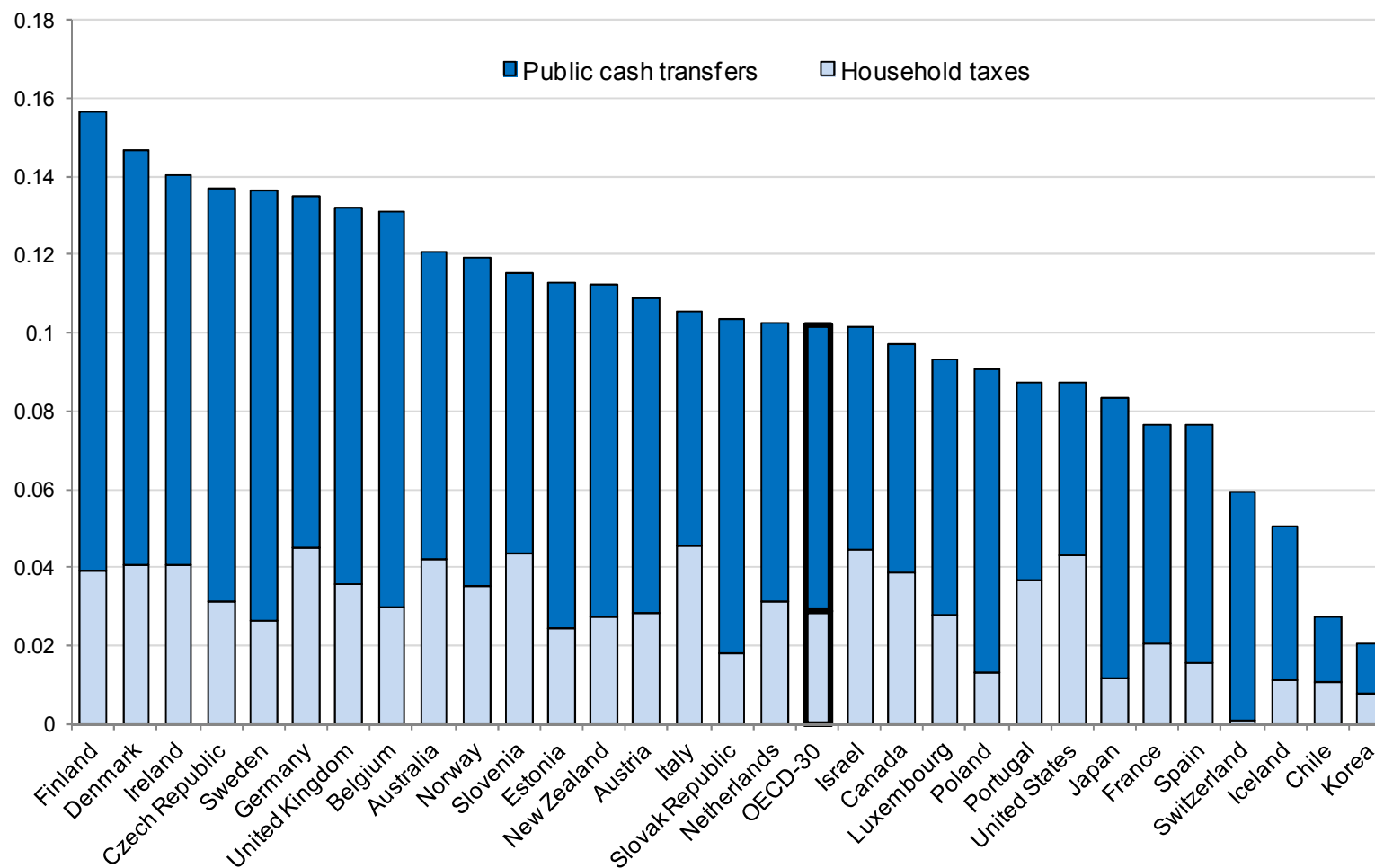
## Gini coefficient of market income and disposable income



# 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



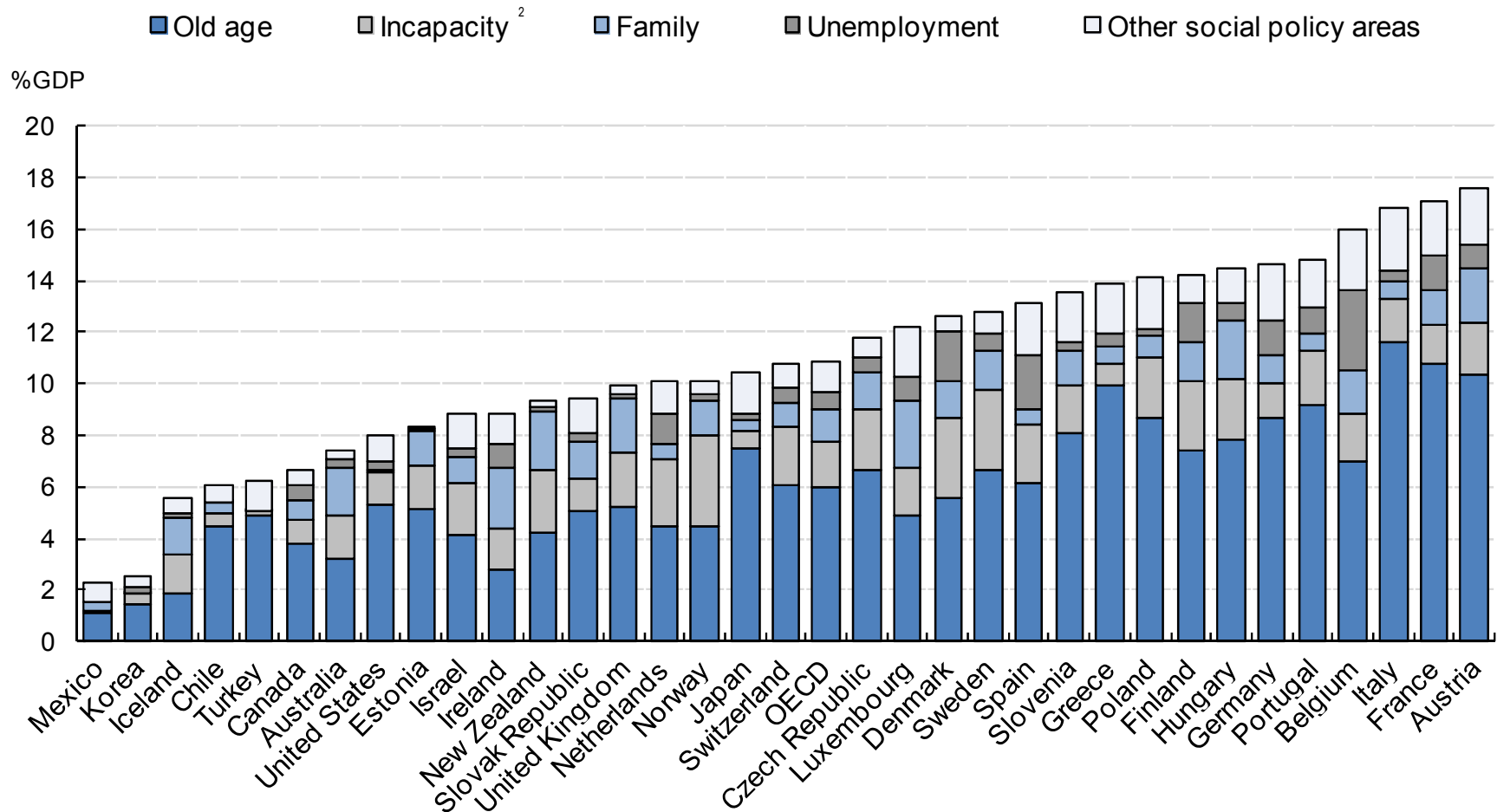
The tax and transfer system

# The size and composition of public cash transfers vary across OECD countries

The tax and transfer system

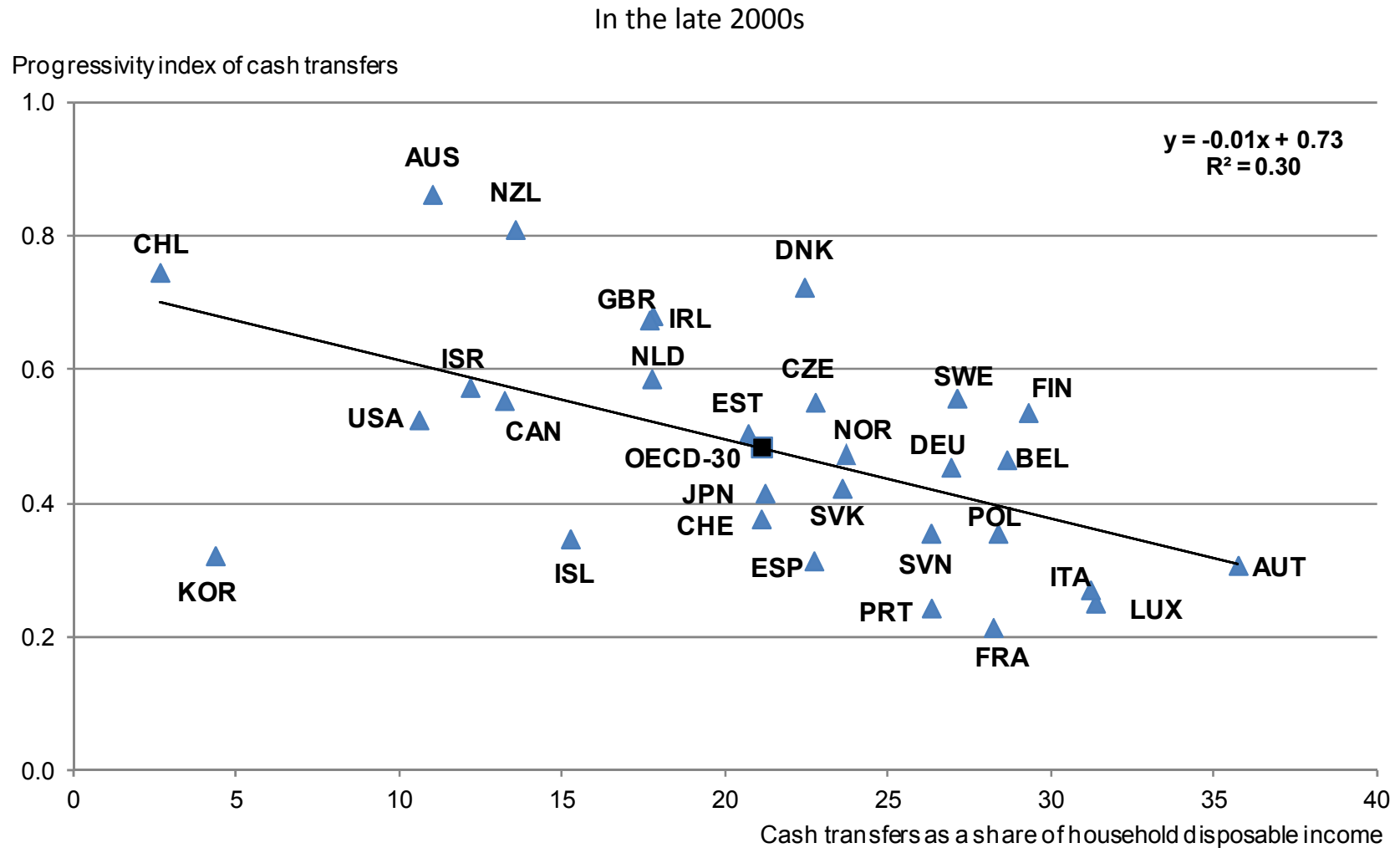
## Public cash transfers to households

Per cent of GDP, 2007



# Countries with large cash transfers tend to have less progressive systems

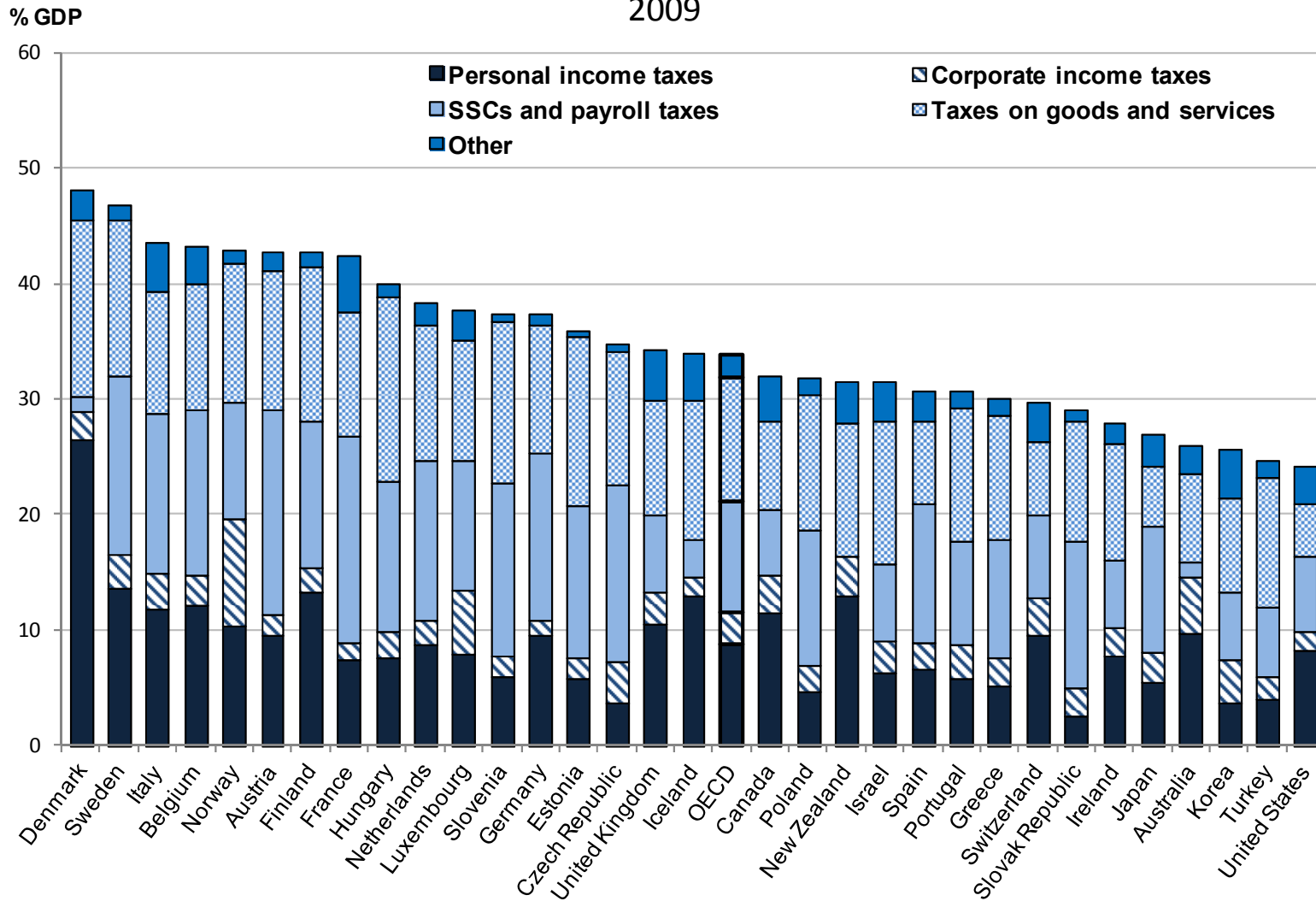
The tax and transfer system



# The redistributive impact of the tax system is a function of its size and its mix ...

## Size and composition of total tax revenues

2009



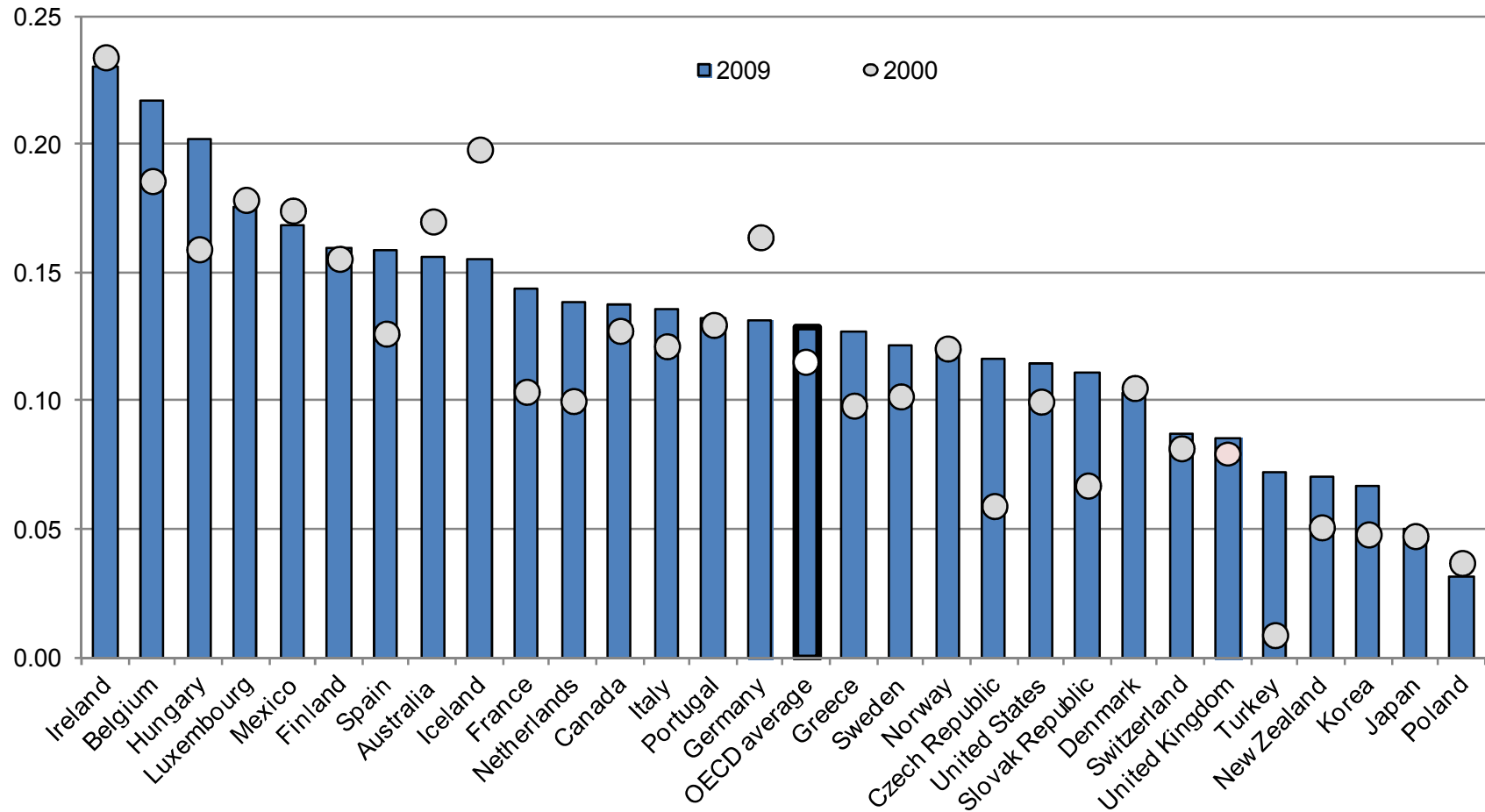
The tax and transfer system



# ... while the progressivity of statutory labour tax schedules has often increased

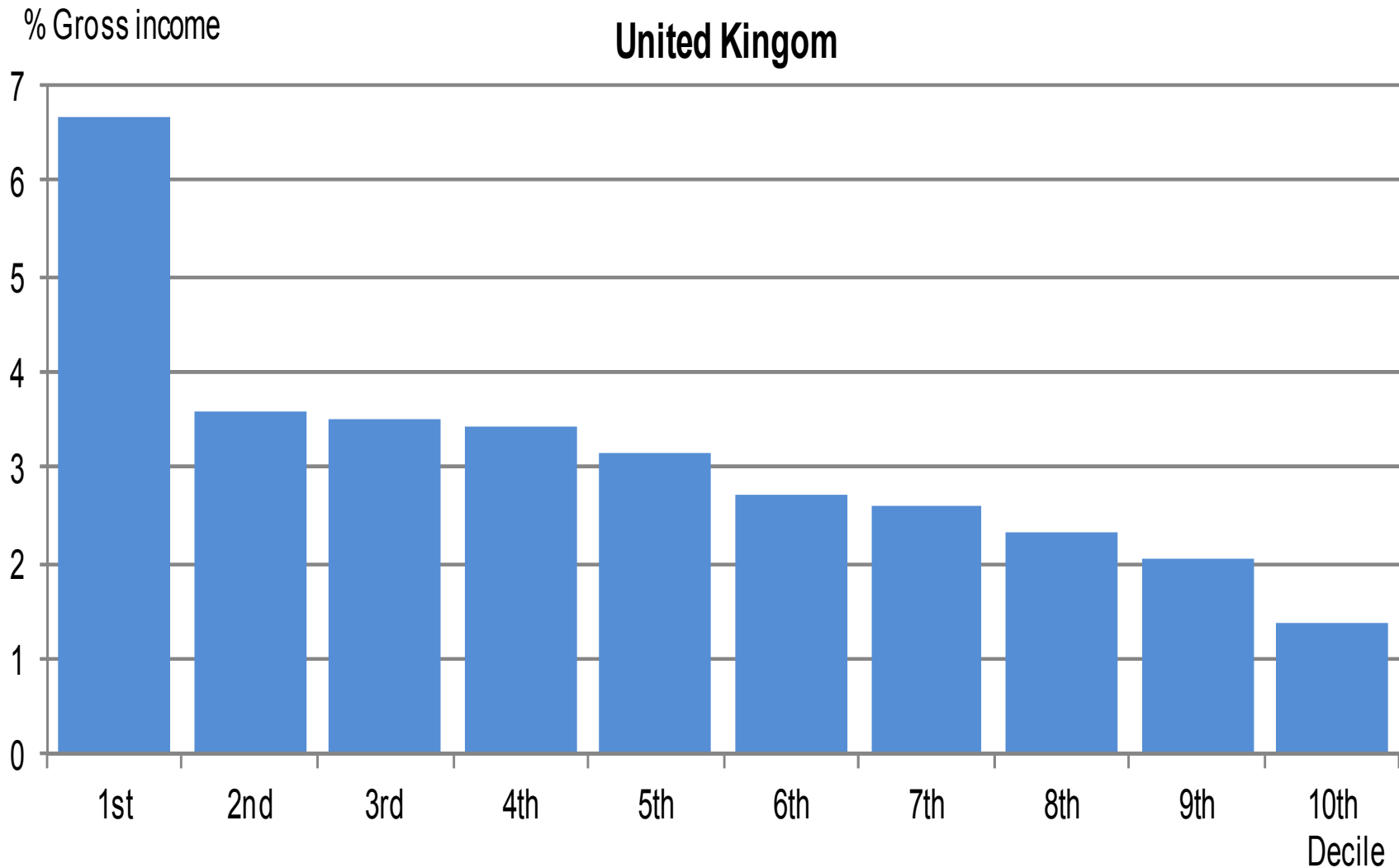
The tax and transfer system

Progressivity indicator based on net personal income tax schedules for single taxpayers without children



## And real estate taxes are often regressive

The tax and transfer system



## Measures to improve human capital are clear win-win strategies

### Impact of policies

A rise in:	Employment rate	Earnings equality	Labour income equality	GDP per capita
Equity in education	?	+	+	+
Upper-secondary and tertiary graduation rates	?	+	+	+
Initiatives to foster the integration of immigrants	+	+	+	+
Initiatives to raise female labour force participation	+	+	+	+
Initiatives to combat discrimination	+	+	+	+

## In the area of labour and product markets, the equality effects depend on the precise measure

### Impact of policies

A rise in:	Employment rate	Earnings equality	Labour income equality	GDP per capita
Minimum wage (relative to median wage)	0/-	+	?	0/-
Unionization	?	+	+	?
Legal extensions of collective wage agreements	-	?	-	-
The gap between protection on regular vs. temporary work	-	-	-	-
Product market regulation	-	0/+	?	-

## Many tax policies imply trade-offs with respect to the growth and distribution objectives

### Impact of policies

Revenue-neutral tax changes:	Disposable income equality	GDP per capita
Change tax mix from income to consumption tax	-	+
Change tax mix from income to real estate tax	-	+
Change tax mix from income to wealth and inheritance tax	?	+
Increasing top PIT rates and tax free allowances	+	?
Cutting tax expenditures and marginal rates	+	+

# Contact information and underlying documents.

## Contact persons

- Isabelle Joumard ([Isabelle.Joumard@oecd.org](mailto:Isabelle.Joumard@oecd.org)) and Isabell Koske ([Isabell.Koske@oecd.org](mailto:Isabell.Koske@oecd.org))

## Webpage

- [www.oecd.org/economy/goingforgrowth/inequality](http://www.oecd.org/economy/goingforgrowth/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

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

- WP 924: Part 1. Mapping income inequality across the OECD
- 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