STRUCTURAL POLICIES AND THE DISTRIBUTION
OF THE GROWTH DIVIDENDS

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The dividends of economic growth have not been shared equally across OECD countries over the last two decades.

In number of countries, the income of rich households has grown disproportionately while that of poor households stagnated, resulting in rising inequalities.

Some structural policies increase earnings dispersion by accelerating the adoption of SBTC.

Other policies increase labour participation and job creation, especially among low-income households, but at the same time tend to widen wage dispersion, with an ambiguous overall effect on earnings inequality.

One final group of policies unambiguously reduce inequality, especially by promoting equality of educational opportunities, upskilling and a better matching between jobs and individuals.

There is a case for countries facing widening income inequality to pursue structural reforms that ensure a wider distribution of the growth dividends.
Economic growth in OECD countries over the last two decades has on average been mostly beneficial to rich households.

Average annual growth of GDP per capita and household disposable income (1995-2011): weighted average over 26 OECD countries


The average income of the 26 OECD countries is calculated from income data expressed on a per consumption basis in USD 2011 constant prices and 2011 constant PPPs with Purchasing Power Parities for private consumption. The OECD average is calculated using population weights.

Source: OECD, Income Distribution Database.
But this masks cross-country heterogeneity in the distributional profile of the growth dividends.

Growth in household incomes across the distribution between the mid-90s and late 2000s: selected OECD countries

A. Sweden and Turkey

B. United States and Belgium

C. Spain

Note: Household incomes across the distribution are measured by the full range of income standards, i.e. from top to bottom-sensitive income standards. (See Causa et al., 2015)

The data show cumulative growth rates and refer to the period 1995-2009. Income data are expressed in USD, constant prices and constant PPPs (OECD base year 2005) with Purchasing Power Parities for private consumption of households.
Did pro-growth structural policies contributed to income inequality? Hard to say.

Structural reform and change in Gini coefficient of household disposable income

Selected OECD countries, 2000-11

Change in Gini coefficient (in percentage points)

Source: Going for Growth (2015) and OECD Income Distribution Database.
The impact of policies is likely to vary depending on income measurement and population covered

- Extending the scope of population to the whole working-age population (including the non-employed)
- Extending the scope of income to non-labour income and population to all households
- Incorporating taxes and public transfers

Wage dispersion among the employed
Earning inequality among working-age population
Inequality in household market income among the whole population
Inequality in household disposable income among the whole population

Source: Going for Growth (2015) and Divided We Stand (2011)
Empirical evidences suggests that some policies increase wage and earnings dispersion through SBTC

<table>
<thead>
<tr>
<th>A pro-growth change in:</th>
<th>Wage dispersion</th>
<th>Employment</th>
<th>Overall earnings inequality</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Innovation and Technology</strong></td>
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<tr>
<td>Technical progress (Higher MFP)</td>
<td>+</td>
<td>=</td>
<td>+</td>
</tr>
<tr>
<td>Higher R&amp;D intensity</td>
<td>+</td>
<td>=</td>
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<tr>
<td><strong>Globalisation</strong></td>
<td></td>
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<tr>
<td>Deeper trade integration</td>
<td>=</td>
<td>=</td>
<td>=</td>
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<tr>
<td>Higher FDI openness</td>
<td>=</td>
<td>=</td>
<td>=</td>
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<tr>
<td><strong>Education / Human capital</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Higher share of skilled workers</td>
<td>-</td>
<td>+</td>
<td>-</td>
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<tr>
<td><strong>Product market competition</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Lowering regulatory barriers to entry</td>
<td>+</td>
<td>+</td>
<td>=</td>
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Source: Going for Growth 2015, Chapter 2
Labour market reforms increase wage dispersion but also employment, leading to an ambiguous overall effect on earnings inequality.

<table>
<thead>
<tr>
<th>A pro-growth change in:</th>
<th>Effect of change on:</th>
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<tbody>
<tr>
<td></td>
<td>Wage dispersion</td>
<td>Employment</td>
<td>Overall earnings inequality</td>
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<tr>
<td>Labour Market Policies</td>
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<tr>
<td>Easing Employment Protection Legislation (EPL) (overall protection)</td>
<td>+</td>
<td>= / +</td>
<td>= / +</td>
</tr>
<tr>
<td>Easing EPL (reducing duality)</td>
<td>-</td>
<td>+</td>
<td>-</td>
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<tr>
<td>Lowering minimum wage</td>
<td>+</td>
<td>= / +</td>
<td>=</td>
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<tr>
<td>Lowering unemployment benefit replacement rate</td>
<td>+</td>
<td>+</td>
<td>=</td>
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<tr>
<td>Strengthening active labour market policies (ALMPs)</td>
<td>=</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>Lowering labour tax wedges</td>
<td>+</td>
<td>+</td>
<td>- / =</td>
</tr>
<tr>
<td>Removing barriers to female labour force participation</td>
<td>-</td>
<td>+</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Going for Growth 2015, Chapter 2
1. Human capital
   - Ensuring equality of educational opportunities and up-skilling throughout working lives (vocational training, life-long learning)

2. Product Markets
   - Reducing entry barriers in service sectors with large pent-up demand and low entry costs (therefore a large room for job creation such as e.g. retail distribution)

3. Job Protection
   - Reducing labour market duality by shifting protection from job to workers.

4. Tax-benefits
   - Reducing fiscal disincentive for labour force participation, especially among women and the low-skilled
   - Cutting back regressive tax expenditures
1. Policies to increase labour force participation:
   • Reducing UB benefits can increase wage dispersion quickly while increasing employment only slowly, especially so during economic downturn. Such reform should be coupled with targeted protection and activation of the unemployed with least prospect of being hired.

2. Reducing job protection on regular workers
   • Such reform is likely to increase lay-offs in the short-run. It should be coupled with an enhanced social protection and ALMPs (i.e. shifting protection from jobs to workers).

Structural policies should be tailored in a way to maximise the synergies with income equality while minimizing trade-offs.
Putting « people first »: the policy focus is shifting from maximising growth to maximising the growth dividends for society at large

GDP growth is essential but not enough: the benefits must be broadly shared to generate sustained improvements in living standards

Ongoing ECO work is developing a consistent analytical framework allowing to move from GDP per capita to household material living standards, focusing on the income dimension and explicitly addressing distributional concerns

This work should deliver a new diagnostic tool for identifying Going for Growth priorities, based on an extended set of policy objectives
The analysis moves from income generated at the macro level to income distributed at the micro, household-based level, which decomposes along two steps:

1. From income generated by domestic production to income received by the household sector taken as a whole: does every point of GDP growth trickles down to the average household?

2. From income received by the household sector to income distributed within the household sector, i.e. how aggregate income is distributed across households.
Preliminary insights: the household income share

• Step 1 has been largely unexplored so far on the prior that income of the household sector and GDP are the same.

• We introduce the concept of “household income share” with a view to assessing to what extent the typical household enjoys the fruits of GDP growth over a given time.

• While GDP growth is found to trickle down to the household sector in the long-run, this is far from true in the short to medium term: deviations can persist for a relatively long period of time, resulting in declining household income shares.
Preliminary results: the evolution of the household income share of GDP across OECD countries, 1995-2013
Should the policymaker care about the household income share? Yes:

- A disjuncture between macroeconomic performance and economic progress from the perspective of the average household does not only raise equity and fairness issues...
- ...this may ultimately drag on growth, for instance by spurring political instability and undermining the consensus for growth-oriented reforms.

When the typical household does not enjoy the dividends of growth, the policymaker could put more emphasis on reforms that accelerate the “pass-through” from productivity to household incomes..

- ....to the extent that it is possible to identify such reforms...
- which requires disentangling policy and non-policy drivers of the household income share
- ...(to come)...

The way forward: preliminary results & issues for discussion