New Approaches to Economic Challenges [B5]
Assessing the transitional costs and distributional consequences of structural reforms

THEME OF THE PROJECT

Growth in GDP per capita has not fully trickled down to household incomes ...

On average across OECD countries and between the mid-1980s and the late 2000s, growth in GDP per capita has not fully trickled down to household incomes. It has also been unequal, as growth in household disposable incomes has been weaker at the lower end of the income distribution. Aside from statistical issues, these trends could be due to economic factors reflected in increasing income transfers from the household to the corporate and public sectors. Measurement limitations include under-reporting of top incomes as well as non-inclusion of capital gains in available survey-based household income data. Economic factors include a trend decline in the progressivity of tax and transfer systems, a rising share of GDP being distributed in the form of profits (as opposed to wages) and a growing share of profits being saved by corporations and re-distributed in the form of capital gains rather than interest or dividends.

... in this respect income distribution effects of pro-growth policies are important

Growth-enhancing reforms can be distinguished according to whether they are found to generate an increase or a reduction in disposable income inequality, in addition to boosting average GDP growth.

RESULTS OF THE WORK STREAM

Many structural reforms have complementary results with regards to growth and equity objectives...

The long-term gains in average household income from reforms are generally close to those in GDP per capita. This reflects the fact that GDP per capita is a key driver of average household disposable income in the long term. There is little evidence of policy trade-offs between efficiency and equity in the long run, and even relatively frequent occurrences of policy synergies. These results may reduce concerns associated with potential negative reform effects on household material living standards and inequality.

... but some reforms present short term trade-offs between growth and income distribution especially at the lower end

A number of reforms have a differential impact on household income and GDP per capita – especially those at the lower end of the distribution. Short-run effects may deviate from long-run complementary equilibrium effects identified in this project, which calls for assessing the dynamic effects of reforms on household disposable incomes and income inequality. In the short-run, some reforms are likely to increase income inequality even if this would vanish or even revert in the long-run. Associated welfare implications may need to be taken into account in the reform process.

NEW APPROACHES

Considering distributional effects represents a fundamental shift in thinking about the effects of structural reforms .

The central income concept used throughout the project has been that of household real disposable income, as this is the best proxy of households' economic resources comparable internationally and across the income distribution. Broadening the policy perspective from GDP per capita to household incomes allows for tracing the distribution effects of structural policies on households incomes, in addition to their economic growth enhancing properties. This represents a fundamental shift in thinking about and assessing the outcomes of structural policies.

POLICY IMPLICATIONS

Complementarities exist when policies deliver returns to the poor and middle class that are higher than average economic growth ...

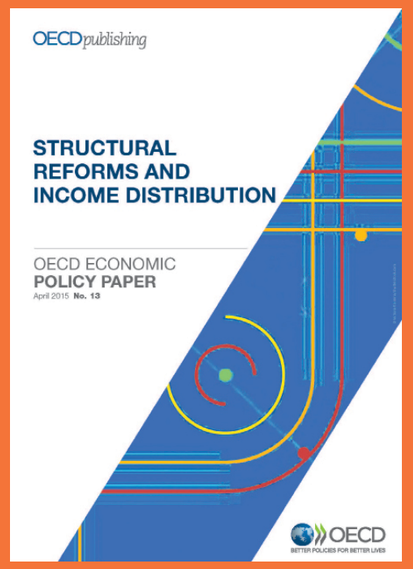
The project results point to several cases of long-term policy synergies between the growth and equity objectives, such as reducing regulatory barriers to domestic competition, trade and FDI, stepping-up job-search support and activation programme. These structural reforms are indeed found to deliver stronger income gains for households at the lower end of the distribution compared with the average household and can thus be viewed as helping to narrow inequality in disposable incomes.

... while policies with trade-offs achieve the opposite and may result in higher inequality

Shifting from income taxation to property and consumption taxes, boosting ICT investment and tightening unemployment benefits for the long-term unemployed are found to lift incomes of the lower-middle class by less than GDP per capita – the latter reform is even found to reduce disposable incomes of the lower-middle class, a clear indication that it may raise inequality. Reducing minimum relative to median wages could also raise concerns as it is found to depress disposable incomes on average and for the median household, though not for households at the lower end of the distribution.

PROJECT PAPERS

- **Causa, O., A. de Serres and N. Ruiz, (2015)** "Structural reforms and income distribution", OECD Economics Policy Papers, No 13



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