MEETING OF THE OECD COUNCIL
AT MINISTERIAL LEVEL, PARIS
6-7 MAY 2014

REPORT ON THE OECD
FRAMEWORK FOR

INCLUSIVE GROWTH

KEY FINDINGS

OECD
BETTER POLICIES FOR BETTER LIVES

This document was prepared by the OECD Secretariat. Main contributors: Romina Boarini, Luiz de Mello, Alain de Serres, Fabrice Murtin and Paul Schreyer. It benefitted from inputs by Henrik Braconier, Orsetta Causa and Nicolas Ruiz.

Corrigenda to OECD publications may be found on line at: www.oecd.org/publishing/corrigenda.

EXECUTIVE SUMMARY

Economic growth is not an end in itself; more is needed to address multidimensional challenges.

Pro-growth policy analysis and advice have conventionally focused on options for improving the population's income and consumption possibilities. Emphasis is placed on supply-side instruments, or policy actions that can lead to an increase in the per capita output of goods and services over the longer term, with progress measured essentially at the level of an "average" individual. Pro-growth policies have the potential for making all citizens better off materially, generating resources that can be used to achieve social goals and ensure that growth is maintained over the long term. Appropriate combinations of policies and institutional settings are identified to improve the performance and long-term output potential of economies, taking into account country-specific needs and circumstances, including the level of development and institutional capacities.

However, there is growing awareness of the importance of recognising the effects of policies on different social groups. Widening income disparities over the last three decades in most OECD countries have drawn attention to the need for going beyond the "average" individual or household when gauging the success of pro-growth policies among population groups that can be highly heterogeneous (Box 1). Indeed, persistent unemployment among certain socio-demographic groups, such as women, youth and immigrants, as well as rising relative poverty since the crisis, have underscored a multitude of policy challenges that need to be addressed. Also, rising inequality of opportunities suggests that policies that aim to address inequality of outcomes will fail unless they ensure more equal access to high-quality education, health care and infrastructure, which remain unevenly spread among social groups and across regions and places within many countries.

Box 1. Trends in inequalities

Income disparities have been widening in most OECD countries, including in traditionally egalitarian ones. The average income of the richest 10% is now about 9.5 times that of the poorest 10% on average in OECD countries, up from 7 times 25 years ago (OECD, 2013a). In Germany, Norway and Sweden, the gap between rich and poor has expanded from less than 5 to 1 in the 1980s, to more than 6 to 1 today (OECD, 2013a).

However, income gaps are narrowing, albeit from very high levels, in some developing countries and -market economies. This is the case in Mexico and Chile; but the ratio between the richest 10% and poorest 10% still stands at approximately 27:1 in these countries. Brazil considerably reduced the rich-poor income gap but it is still 50:1. And in South Africa, inequality has continued to rise and now it is over 100:1 (OECD, 2011a).

Income gains have accrued to top earners. Over 1976-2007 the top 1% of the income distribution has benefitted disproportionately from greater income growth. In the United States 47% of total income growth over 1976-2007 went to the top 1%, in Canada it was 37%, and the figure stood at around 20% in New Zealand, Australia and the United Kingdom (OECD, 2014a, forthcoming).

Inequality goes beyond income, and better educated people live longer. Data from 15 OECD countries show that on average people with better education live 6 years longer than their poorly educated peers (OECD, 2013d)

Access to jobs is also unequal, perpetuating income discrepancies. Non-standard work arrangements make up 33% of total employment across OECD countries (OECD, 2014b). In-work poverty now affects 8% of the workforce in OECD countries (www.oecd.org/social/income-distribution-database.htm).

Increases in income and consumption do not necessarily translate themselves into sustained improvements in well-being. Indeed, OECD work shows that a host of non-income dimensions matter for people's subjective perception of life satisfaction, despite differences across countries in levels of income of the population as a whole and institutional settings. Health and educational status, employment conditions and other aspects of life can affect subjective well-being more than income. Non-income dimensions are important because they also stand for opportunities and choices that matter for people's participation in economic life and society. For instance, good health improves subjective well-being but is also a pre-condition for participating in the labour market and benefiting from social relationships. Similarly, being well integrated in the job market provides a sense of accomplishment and contributes to life satisfaction over and above financial rewards. Pro-growth policy actions that can deliver improvements in outcomes along all these dimensions, as well as raising material living standards, would therefore go a long way in fostering economic performance and enhancing the well-being of the population.

Multidimensionality, attention to distributional considerations and policy relevance are therefore the three key pillars of a policy framework for Inclusive Growth. For the reasons highlighted above, and while still regarding economic growth as an important means to an end, the policy debate can place increasing emphasis on the drivers of subjective well-being and the policies that can create opportunities for all segments of the population and distribute the dividends of increased material prosperity fairly across society. This policy framework can build on OECD work on: (*i*) well-being, which highlights the importance of multidimensionality in policy analysis; (*ii*) income distribution, which identifies the policies levers for dealing with income inequalities; and (*iii*) pro-growth structural reforms, which point to areas where growth-friendly and pro-inclusiveness policies can reinforce each other. In doing so, this framework can better inform the policy debate about the synergies, trade-offs and unintended consequences of policy actions on the basis of a richer, broader panoply of policy indicators and dimensions of well-being. The framework also allows for gauging policy impacts for different social groups, such as households with average, median or low incomes.

Multidimensional living standards have improved faster than GDP per capita, despite widening income inequality

Measures of "multidimensional living standards" can be used to complement GDP per capita when assessing the outcomes of pro-growth policies. For example, attention can be placed on changes in unemployment and longevity to capture key non-income dimensions that matter for people's well-being: jobs and health. Together with household disposable income, a measure of "multidimensional living standards" can be computed, aggregating these three dimensions. In particular, when applied to OECD countries over the period 1995-2007, calculations show that:

- Multidimensional living standards rose faster than GDP per capita in the decade running up to the crisis. For the average household in the OECD area, living standards rose by 3.9% per year compared to a 2.3% rise in average GDP between 1995 and 2007. This is due to rising household incomes, as a result of robust GDP growth in the run-up to the crisis, but also falling unemployment and improvements in health conditions (rising longevity), which are important for well-being.

- The rise in multidimensional living standards was somewhat weaker for median households (those with income at the middle of the distribution) and for the poor (those households with income at the lowest decile of the distribution), at 3.8% and 3.6%, respectively, than for the "average" (mean) household. These findings show that widening income inequality affected the poorest households most adversely.

- The trend of rising multidimensional living standards changed significantly as the crisis set in. In the most affected countries, such as Spain, Greece or Ireland, the multidimensional living standards of the median household dropped by a significant margin more than GDP per capita during 2007-10, reflecting in particular a loss in welfare due to rising unemployment and income inequality.

Does inequality matter?

Inequality of opportunity, rather than outcomes, is particularly detrimental to growth and well-being. Rewarding hard work and skills entails a certain degree of income inequality, but it may be good for economic growth, as long as all citizens have equal access to high-quality education, health care, and other public goods and services, as well as finance and other drivers of entrepreneurship. In this case, some level of inequality of outcomes is not only economically inevitable but also politically acceptable. However, inequality of opportunities can be particularly damaging, because it locks in privilege and exclusion, which undermines intergenerational social mobility and weakens incentives to invest in knowledge and, in turn, holds back potential growth. Indeed, taking into account cross-country differences in social attitudes towards income inequality, continually rising inequality cannot be disregarded, especially if it is associated with rising barriers to full participation in economic and social life by the most disadvantaged members of society.

Structural reforms can indeed have different effects on GDP and household income, as well as for different social groups

The effects of policies on multidimensional living standards have yet to be fully gauged, but preliminary analysis regarding the income dimension of well-being points to different impacts on GDP per capita and household disposable income. GDP per capita and average household disposable incomes tend to move in parallel, at least over sufficiently long periods. But specific pro-growth structural policies affect GDP per capita and household disposable incomes differently, with different effects for different social groups along the distribution of income. Evidence for OECD countries and selected structural reforms over the period from the mid-1980s to 2010 illustrates these different effects. For example:

- Reforms to reduce regulatory barriers to domestic competition, trade and inward foreign direct investment can lift the incomes of the lower-middle class by more than it does GDP per capita or average household income.

- Conversely, a tightening of unemployment benefits for the long-term unemployed, if implemented without accompanying measures, such as a strengthening of job-search support and other activation programmes, may lead to a decline in the income of the lower-middle class, even if it boosts average income.

A full analysis of policy packages for Inclusive Growth requires going beyond income and assessing the effects of structural policy on non-income dimensions

It is possible to gauge the effects of structural policies on multidimensional living standards. As noted above, it is important to gauge the effects of structural policies on different social groups, such as the middle class ("median" households) and the poor (households with incomes in the low deciles of the income distribution). But it is also important to inform the policy debate by providing evidence on the policy determinants of multidimensional living standards, including the effects of specific actions on jobs and the population's health status. Certain structural policies may not be immediately beneficial for GDP growth and possibly median household income (for instance, increased tax-financed health care expenditure), but they may yield health benefits that ultimately contribute to productivity and economic

growth. Other structural policies that have an immediate bearing on the income and employment prospects of a majority of households are particularly desirable, as they positively affect two important dimensions of well-being: income and jobs. These multi-dimensional effects remain to be worked out more systematically. Their assessment is crucial for valuing trade-offs and synergies from structural policies.

Options can be considered for gradually strengthening the policy framework for Inclusive Growth. They include broadening the range of non-income dimensions that are known to affect subjective well-being and better understanding the linkages between policies and outcomes along the various dimensions that matter for the computation of multidimensional living standards. Indeed, several "policy transmission channels" are already well known, including how changes in tax-benefit systems affect GDP per capita and household income through their effects on labour force participation. Likewise, the growth effects of innovation policies are well understood through their impact on labour productivity, but the effects of these policies on health, for example, deserve further investigation. It is also important to complement the analysis with sector-specific insights and to reflect the circumstances and needs of specific countries, including developing countries and emerging market economies.

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

OECD INITIATIVE ON INCLUSIVE GROWTH

The OECD Initiative on Inclusive Growth is a multidimensional project which aims to identify and better understand policies that can deliver improvements in living standards and in outcomes that matter for people's quality of life (e.g. good health, jobs and skills, clean environment, efficient institutions). It contributes to the OECD initiative on "New Approaches to Economic Challenges" (NAEC), an organisation-wide reflection process that was launched at the 2012 OECD Ministerial Council Meeting (MCM) with the objective to catalyse a process of continuous improvement of the organisation's analytical frameworks and advice.

www.oecd.org/inclusive-growth

OECD WEEK 2014

OECD

BETTER POLICIES FOR BETTER LIVES