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INCOME DISTRIBUTION IN OECD COUNTRIES

Report on a meeting of trade union experts
held under the OECD Labour/Management Programme

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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INCOME DISTRIBUTION IN OECD COUNTRIES

Report on a meeting of trade union experts
held under the OECD Labour/Management Programme
(Paris, 9-10 May 1994)

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Foreword

Under the OECD Labour/Management Programme for 1994, a meeting of trade union experts on "Income Distribution in OECD countries" was held in Paris on 9-10 May 1994. The meeting was prepared in collaboration with the Trade Union Advisory Committee to the OECD (TUAC).

Below is an overall report of the discussions of the meeting of experts, prepared by Professor Timothy M. Smeeding who was designated as General Rapporteur for this activity.

A list of the participants in the meeting is given in the Annex.

THE OPINIONS EXPRESSED AND ARGUMENTS EMPLOYED IN THIS REPORT ARE THE RESPONSIBILITY OF THE AUTHOR AND DO NOT NECESSARILY REPRESENT THOSE OF THE OECD.
1. INTRODUCTION

Personal income distribution, relative low incomes, and income inequality in general, are increasingly important subjects for economic and social policy-makers in OECD countries, particularly as they become more interdependent. In the study of these issues, there is now great interest in the comparison of the experience of different countries. Interest in cross-national income distribution research did not come about by accident; comparable cross-national data on distribution allow for comparisons of similarities and differences across countries and over time. Such comparisons help us understand how market forces, demographic forces, and public policy affect the relative economic status of various groups. The topic is particularly interesting at the present time on account of the economic, social and political forces which have coincided to produce a widening in the income distribution in several OECD nations. It is of interest to know how far this has been a general trend and what differences there are in country experience.

Since the late 1970s, there have been considerable changes in major factors that influence the distribution of income in OECD countries. In part, these have resulted from broad economic developments in output, the price level, industrial structure, and the numbers of those employed and unemployed. In part, they have arisen from the changes that have taken place in the structure of employment -- by age, sex and occupation -- and in the age and family composition of populations. Some of these changes have occurred spontaneously, without conscious design, while others have been affected by the directions which government policies have taken.

Among the most important factors in creating these changes one might list the following: (1) A widening of inequality in the distribution of earnings in most OECD countries; (2) differential experiences with macroeconomic performance (job creation, unemployment, real economic growth) across nations and continents, particularly in the 1980s, with unemployment rising to unacceptable levels in many nations by the early 1990s; (3) declining male labour force participation, generally, and particularly increasingly early retirement, juxtaposed with increasing female labour force participation and rising female wages relative to male wages in most countries; (4) a general ageing of the population which has created, and is expected to continue to create, severe budgetary pressures on central governments’ social retirement and health care finance systems; (5) the growth of single parenthood with important implications for distributional outcomes; (6) shifts in taxation policy toward indirect taxation; (7) changes to income transfer policy which have generally included lowering the top income tax brackets, and reductions in benefit levels and coverage in response to the budgetary pressures noted above; and, (8) an increase in the returns to capital and changes in the distribution of ownership of assets, including privatisation of former social retirement schemes. This list is not intended to be exhaustive and there are many other elements which could be included, such as decline in unionisation and labour’s bargaining power, immigration and technological change.
The distributional implications of these changes have not as yet been fully documented and analysed. Indeed, to do so is a task of considerable difficulty. The mechanisms linking macro-economic variables to personal income are now complex, not least because of the existence of intervening institutions. The categories of national income do not map directly into incomes received by households, making comparisons of real or absolute living standards hazardous. Traditionally the extended family has been a major intermediary for income redistribution across and within generations and households. However, structural changes in the corporate sector and the role of financial intermediaries, as well as the significant ownership of assets by pension funds and assurance companies, all mean that changes in interest payments, profits and rent have implications for personal incomes which are not immediately apparent. While the State is the single most important intermediary, it is far from the only intermediary and the direct and indirect effects of the State on income distribution are often difficult to measure. For instance, it is far from easy to trace through the consequences of a program of privatisation, with the proceeds used to reduce income or payroll taxation.

At the present time, it is not therefore possible to account separately for the distributional impact of each of the different factors outlined above. However, the OECD has recently financed a major study to compare the distribution of personal income in OECD countries and the changes in distribution during the 1980s. This report made use both of national studies and a major new multinational database, the Luxembourg Income Study (LIS), to present a coherent picture of the evolution of the income distribution. A summary paper which reviewed the main findings of this study and the policy issues which it suggests served as a basis for the meeting which is the subject of this report.

The meeting first reviewed the empirical findings, with particular emphasis on the proportion of the population with relatively low or falling incomes. Comparative data on relative inequality between countries were discussed, as were trends within individual countries in the 1980s. The influence of the major components of income were assessed -- in particular, income from employment and property income -- and the impact of government taxes and transfers on income inequality was analysed. Methodological issues, terminology and data quality were addressed, followed by a discussion of substantive sources of inequality and their variance across nations. Policy implications of these findings were the last item discussed.

The introductory discussion indicated that the timeliness of this study was seen as an important first step at systematically investigating the multiple dimensions of income inequality. There was widespread support for the suggestion that it should be updated in the near future when the next "wave" of income distribution studies from the LIS data base became available.

2. BASIC FINDINGS

The rapporteur reviewed the basic findings of the study. As regards the level of overall income inequality in the mid-to-late 1980s, certain groupings could be made. There are, first of all, a group of Northern European countries which have distinctly less income inequality than other OECD nations. These include: Finland, Belgium, Sweden, Norway, Luxembourg, the former West Germany, and the Netherlands. The highest inequality was found in the United States and Ireland. In between come two groupings: the commonwealth countries (Canada, New Zealand, the United Kingdom, and Australia) and Southern Europe (France, Italy, Spain, Portugal).
As for the trend in income inequality, the study indicates that for the nations which we can study for two periods using LIS (one period around 1980 and the other in the mid-to-late 1980s), inequality rose in the majority of the nations studied and particularly in the United States and in the United Kingdom. The supplementary information from national studies supported the LIS-based findings and indicate that we can also add Japan and the Netherlands to the list of nations experiencing rising income inequality during the 1980s. The results in other nations were more mixed. Several nations appear to have experienced little trend or conflicting evidence, albeit for different periods of time (Austria, Canada, Finland, France, Germany, Italy, Norway). At least one nation (Portugal), seems to have experienced small declines in income inequality during the 1980s. Thus, the overall evidence suggests increasing inequality, but it was somewhat mixed and certainly not universal during the early and mid-1980s.

The discussion turned to the results of the study as they pertain to the level and trend in earnings (or primary income). Particularly striking was the finding that on average more than 25 percent of all households received less than half of their total incomes from market sources. On average, a full 18 percent of all households had no income whatsoever from earnings, and as unemployment grows in most OECD nations, these numbers can be expected to increase. Clearly a large fraction of households in every nation rely heavily on non-market income sources. Moreover, in most countries there seems to be a trend toward increasing inequality of primary and market incomes over the 1980s. These findings are consistent with other LIS-based studies and non-LIS based studies covering OECD nations. The rapporteur suggested that these trends were not cyclical but structural in nature, with rising unemployment and/or falling wages systematically undercutting the primary and market incomes of the least skilled, least educated and youngest workers in most OECD nations.

Finally, the rapporteur reported the study’s findings concerning the role of taxes, and government transfers on income distribution. While the impact of direct tax payment was generally progressive, the impact of transfer payments was not so straightforward. The results show marked divergences across countries not only in the level of transfers but also in the degree to which transfers are targeted to the lower income groups. As expected, government transfers are the major source of income for older persons in many, but not all, countries. They play less of a role for households with younger heads, but here too the range is wide, with transfers making up a quarter of income in some countries and well under 10 percent in some others. And, the relationship between the pattern of transfers and the share of the population who have low incomes was not particularly clear among households with heads under age 60. Here the role of earnings seems dominant, but other forms of social income -- child allowances, unemployment and disability benefits, etc. -- are also important in determining the family income package. As expected, there is a strong relation between average transfers to below median older persons and the low income rate.

In reacting to this summary, several participants argued that in more recent years the pattern of increased inequality in earnings, wages and incomes has almost certainly intensified in all OECD nations represented at the meeting. And further, it was argued that present trends will continue into the future. The rise in long-term unemployment in these nations since the 1980s is unprecedented and shows little sign of abatement. Participants argued that while a report such as the one being reviewed is very useful, it would be even more useful if it included later years data and focused on three additional items: (a) disentangling the various economic, demographic and political
forces which affected inequality; (b) differentiating country behaviour in terms of market induced changes in incomes (e.g., falling wages and relatively low transfer payments and unemployment in the United States) versus government responses to changes in market incomes (e.g., higher wages and unemployment and higher transfer payments in Europe); and (c) the efforts of government interventions on labour markets and market incomes, e.g., minimum wages, wage subsidies, employment related payroll taxes, and changes in collective bargaining and employment protection measures.

3. METHODOLOGICAL ISSUES

A discussion of the methodological underpinnings of the report was the next issue of discussion. The rapporteur began by summarising the choices of income accounting units, adjustments for family size and differences in data quality across countries. The rapporteur argued that the same basic findings emerge regardless of choice of income measure, type of family size adjustment, or measure of inequality employed. The issues of absolute versus relative measures of poverty and the possibility of using purchasing power parities to transfer incomes into real terms were also discussed at length.

There was general agreement on several points of discussion. First of all, there is a need to further standardise income survey data and definitions across nations. Projects such as LIS could in time create a set of standards for measuring earnings and income distributions to which all countries could adhere. With greater standardisation and greater international support for LIS, the timeliness and speed of updating these reports could be greatly improved. The likelihood that inequality in earnings is growing in the 1990s adds import to the findings of this study.

The quality of the data reported in these surveys varies according to the source of income. Using national accounts aggregates as the yardstick, wages and salaries tended to be better reported than property income or self-employment income. Because macroeconomic data show that property income and self-employment incomes rose faster than wages and salaries during the 1980s, the results of studies based on LIS-type data might actually understate the trend toward greater poverty and inequality. Second, absolute measures of well-being are important, particularly as they are used to measure poverty. When real living standards are changing over time, relative measures cannot always be relied upon to show the impact of changes in living standards. The rapporteur argued that the authors sought to use purchasing power parities in order to establish comparable cross-country poverty levels but were unable to do so to their satisfaction and did not report these results. During the discussion it was suggested that OECD experts might be able to help the authors to derive appropriate purchasing power parity indicators, though the trade union participants noted the difficulties in calculating such indications. It was agreed that at a minimum it should be possible to establish inter-temporal comparisons for individual countries by establishing an initial relative poverty line for each country, say 50 percent of average or median income in 1980, which could then be applied in subsequent years after having been adjusted for inflation. Following such a methodology it would be possible to make statements about the change in absolute poverty rates. Finally, it was suggested that reports such as this would be more useful if they added estimates of indirect taxes and their incidence to the estimates of direct taxes which are already included in the study. The existence of widespread differences in levels of indirect taxes levied on employers and on consumer purchases, and differences in the trends in these taxes, across OECD countries were noted by conference participants. Depending on assumptions regarding
their incidence (e.g., on consumers, on labour earnings, or in profits),
patterns of income inequality found in the study might be biased.

4. **SUBSTANTIVE ISSUES: COUNTRY DIFFERENCES AND EXPLANATIONS**

The discussion turned to the issue of sources of inequality growth
across countries and their relative importance. These include three general
categories: (a) market driven changes in inequality, e.g., cyclical and
structural changes in earnings and employment patterns and in the return to
capital; (b) demographically driven changes such as the ageing of the
population, the growth of single parent families, and increased market work by
married women; and (c) public policy changes such as those affecting
macroeconomic performance, employment protection and collective bargaining,
income tax rates, and transfer program generosity. The complicated nature of
such decompositions as these were immediately pointed out. For instance,
increased market work by married women might have displaced low skill men, thus
raising the incomes of one group (married couples) and lowering the earned
incomes of another already hard-pressed group and thereby triggering
differences in both tax collections and transfer outlays. Alternatively,
increased part-time market work by married women with low wage husbands might
create a widening in the distribution of earnings, but a reduction in overall
income inequality.

There was widespread agreement among outside participants on several
points. First of all, the "trickle down" phenomenon was not successful.
Participants felt that lowering top income tax rates to induce higher rates of
investment and economic growth produced no real gains in jobs or incomes among
the lower classes during the 1980s in any of the OECD nations present. Second,
it was argued that modern economies face a sort of Hobson's choice between more
jobs at lower wages or fewer jobs at higher wages, and that no economy at
present seemed able to provide enough jobs at high wages.

A discussion of various country experiences pointed to a wide ranging
set of institutional differences across nations. For instance, while only
about 15 percent of all wage earners bargained collectively in the United
States, this figure was nearly 85 percent in Sweden. Most trade union
participants felt that while institutional differences were helping to drive
the widening of the earnings distribution in OECD nations, they were not the
major force at work. They argued that while the political and institutional
drive to "deregulate" the economy in the 1980s might have contributed to
growing inequality in wages, other more basic forces such as technological
change, the internationalisation of financial markets, and job exporting to
developing nations were helping to reduce former high wage jobs in OECD
countries. The discussion of the issue of the replacement of manufacturing by
services suggested a two-edged sword, because there were both good and bad jobs
in both sectors. To the extent that technological change creates more jobs
based on higher skills, thus allowing for increased returns to human capital
investment, then better trained workers to fill these jobs will enhance
employment stability and real wage growth through time within the OECD area.
Clearly no one expected that there could be a major shift in demand which would
provide good jobs for the large numbers of less skilled, jobless, younger
workers in major OECD nations.

There was also some discussion of the hollowing out of the middle of
the income distribution in many nations. In the United States and the United
Kingdom, there appears to be a movement from the middle class to either
permanent high or low income status and the rest of Europe might also
experience this phenomenon, e.g., via the growth of long-term unemployment and
dependency on transfers amongst the working classes, as opposed to steady real income growth among the more skilled, particularly families with two working adults. If this hollowing out were to occur, political and economic struggles between the "haves" and the "have-nots" could create serious social problems in most OECD nations.

5. POLICY IMPLICATIONS

In order to avoid the choice of fewer good jobs versus more bad jobs countries needed to pursue a consistent policy strategy if they wanted to have both more and better quality jobs. For instance, nations could decide not to compete at low wage jobs, but to concentrate on high wage jobs. Such a decision has implications for wage setting policies and other labour market policies, and for tax and transfer policy. Other choices sometimes involve tradeoffs between economic growth and price stability. Accelerated growth can bring about full employment but at times only at a higher rate of inflation than would otherwise exist at lower rates of employment growth. An interesting implication of the increasing numbers in OECD countries who rely on non-market sources of income is that political pressure from some quarters for measures to reduce inflation may impinge on policies to bring about full employment. Another possibility that might appeal to some countries would involve choosing an industrial structure strategy which involved business-government cartels to promote and market specific industries (e.g., airplanes, shipping, electronics) at the expense of others within a nation. Clearly the income transfer systems of OECD countries were heavily stressed by high unemployment, low growth, rising health care costs, and ageing populations. Solutions would have to involve some re-thinking of the balance between private and public responsibilities for income stability, economic growth, education, and training.

At the microeconomic level, policy choices were also seen as crucial. For instance, linking job training to good jobs whether by means of public subsidy or lower training wages was seen as worthwhile. Similarly the lowering of non-wage labour costs especially payroll taxes in some nations (e.g., Spain, France) was felt to be worthy of consideration. On the other hand, reduced taxes to cover public budgets meant increased pressure on governments to meet social program budget obligations which they were already hard-pressed to absorb. Other specific strategies such as work-related benefits targeted to low wage/low income households (e.g., the earned income credit in the United States; subsidised child care) and inventive use of unemployment insurance benefits (e.g., as a worker directed subsidy for new employment) were also seen as worthy of experimentation.

6. CONCLUSIONS

The study under discussion and the issues paper prepared for this meeting chart the widening distribution of earned and total incomes in most OECD countries. Trade union participants felt that policy changes in addition to wider economic forces could explain much of this and that on present policies these trends were set to continue. Improvements in the quality, focus, and timeliness of studies such as this should be high on OECD’s agenda. Documenting emerging patterns of wage change, the nature of employment, and the effectiveness of government tax transfer policy in reducing market driven inequality were seen as very useful. While the proper policy response to high and rising unemployment and slow rates of job creation in major OECD nations was open to debate, it was felt that studies such as the one reviewed here provided an important service by providing a factual basis to inform future debate on economic and social policy to combat these occurrences.
# ANNEX

## LIST OF PARTICIPANTS

### Trade Union Experts

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NOTES


3. Market incomes include property income (interest, rents, dividends), occupational pensions and private transfers (e.g., alimony), as well as earnings.
