

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

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# Background of the study

## **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**

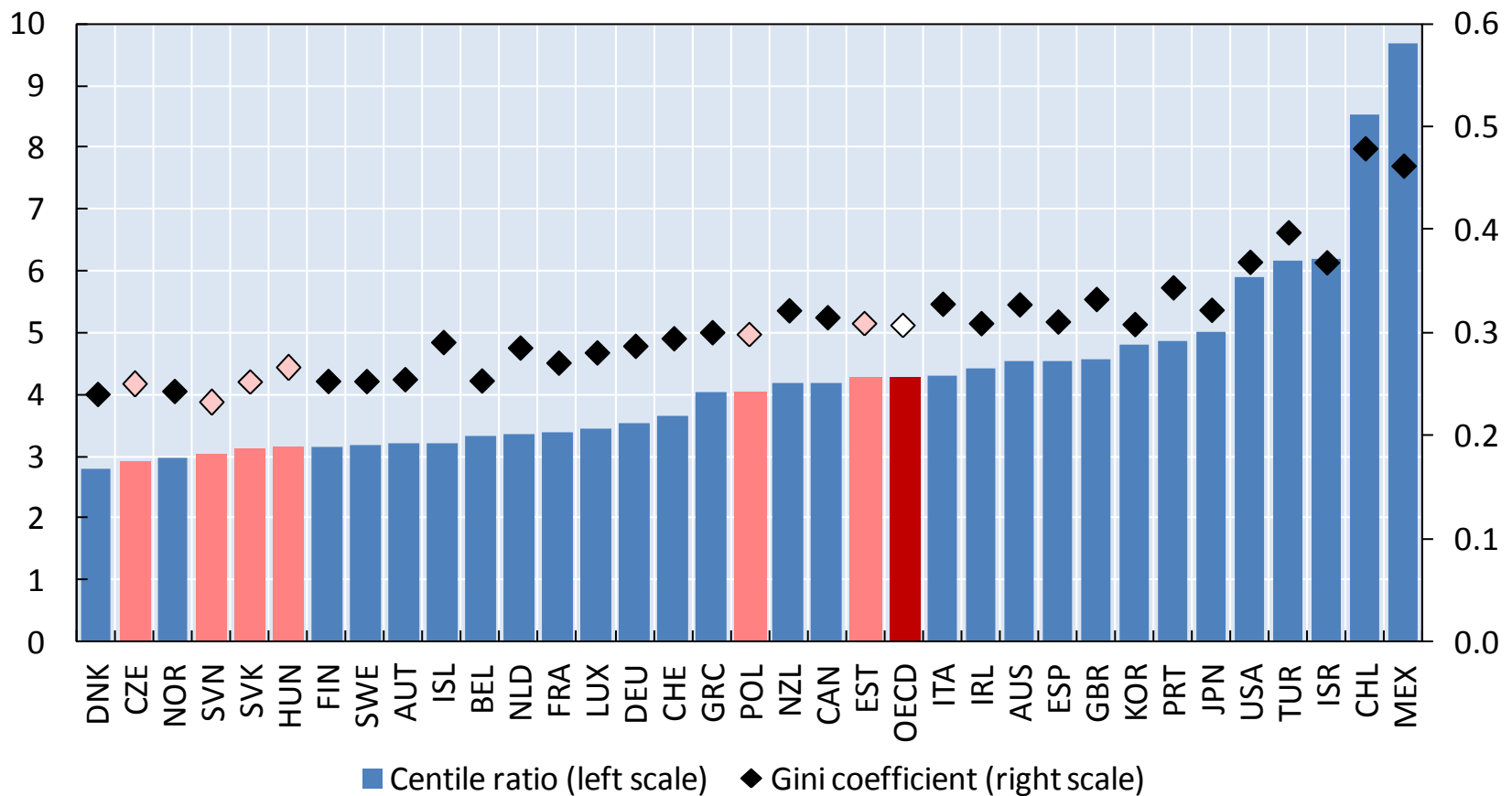
- Cross-country comparison of income inequality and its sources
- Analysis of the impact of policy and non-policy factor on income inequality
- Policy trade-offs and complementarities with respect to growth and distribution objectives

# Inequality in household disposable income varies considerably across countries.

Income inequality – an overview

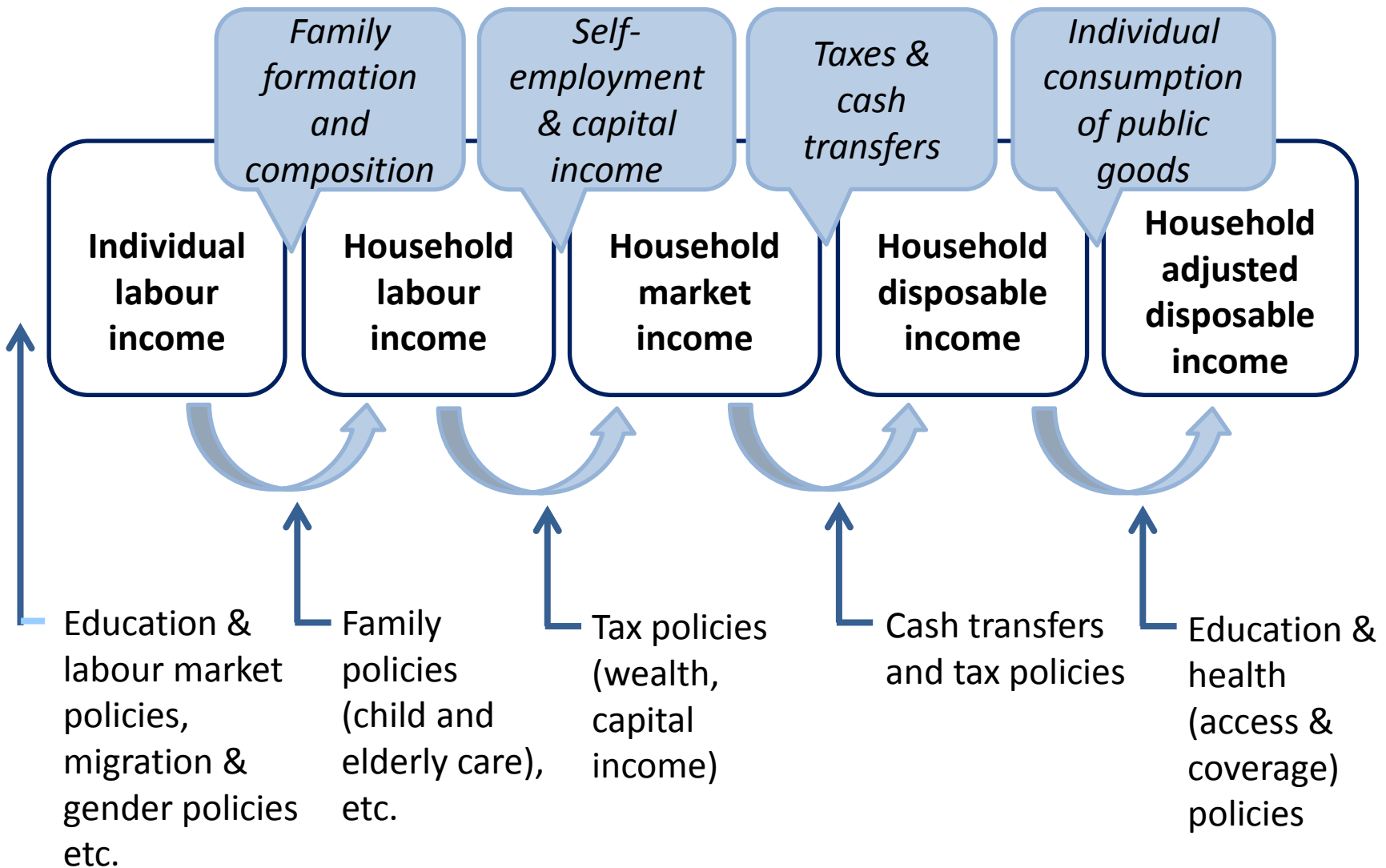
## Gap between the 10th and the 90th centile and the Gini index

Household disposable income in the late 2000s



# Understanding inequality: accounting framework and policy levers

## Income inequality – an overview

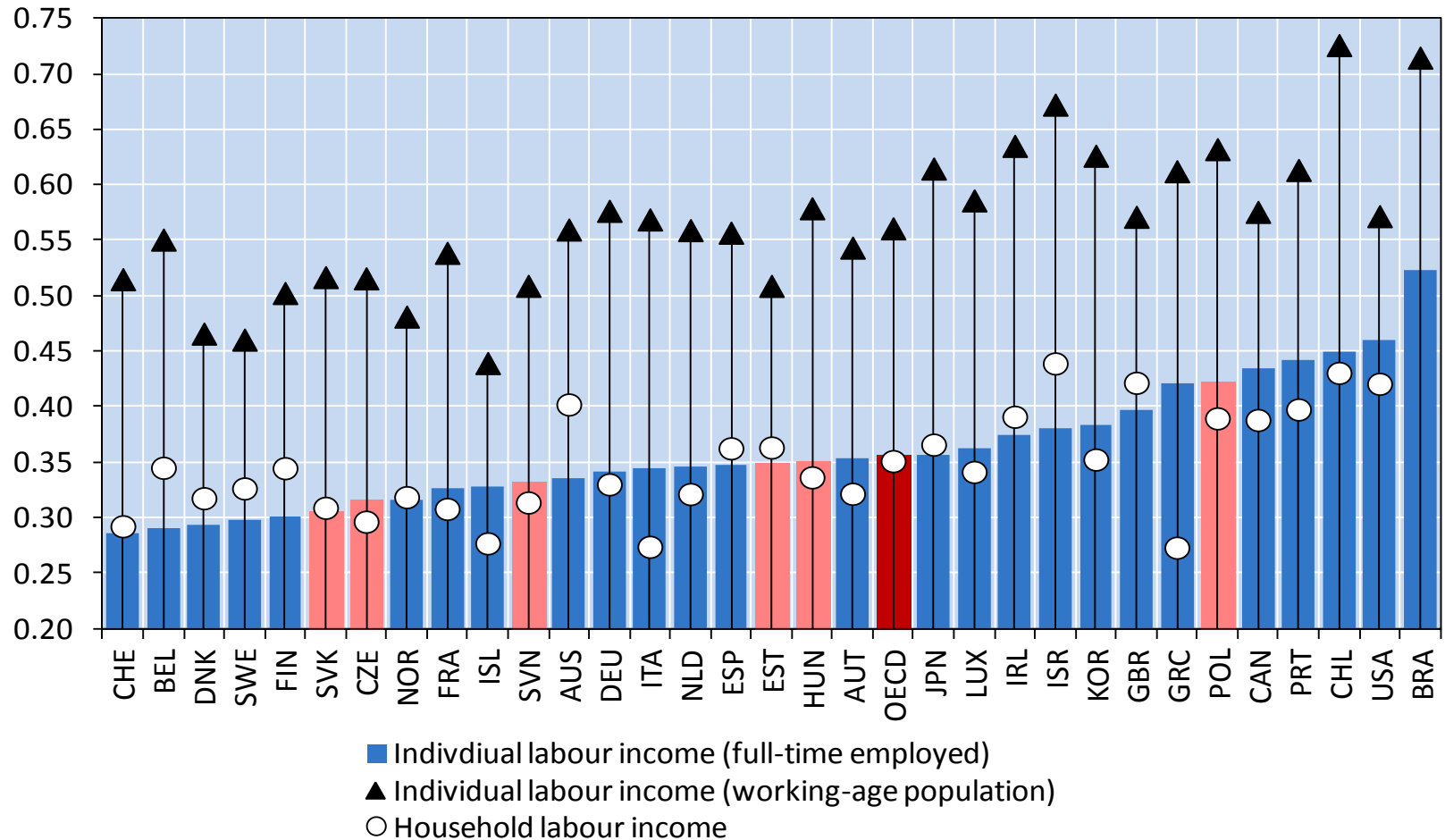


# The sources of inequality in household labour income vary across countries.

## Labour income inequality in the OECD

Gini coefficients, late 2000s

The distribution of labour income



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

Two different empirical methodologies:

Quantile regressions  
based on household  
survey data

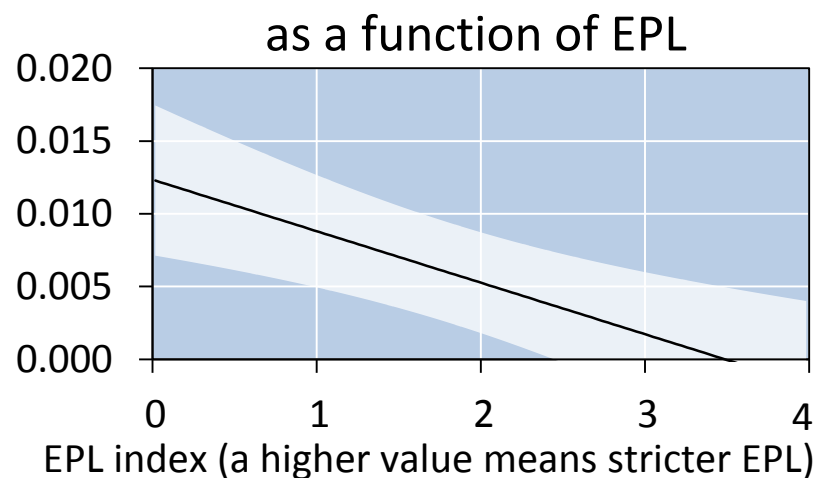
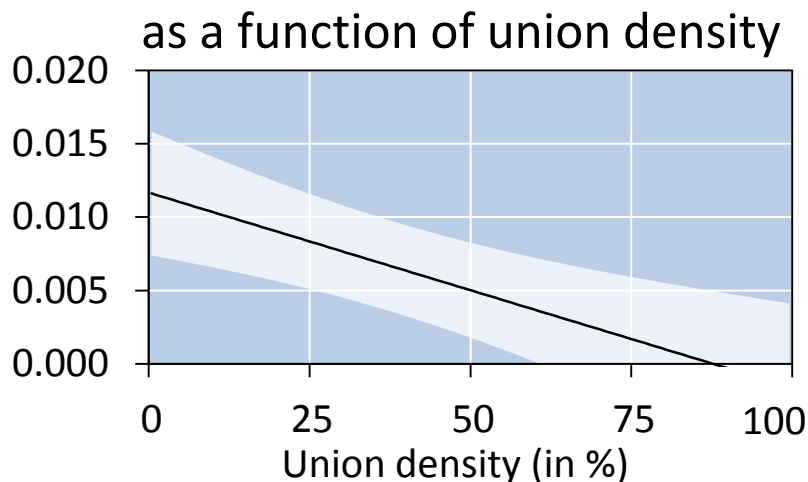
Macro panel  
regressions using BMA  
to deal with model  
uncertainty

Selected results

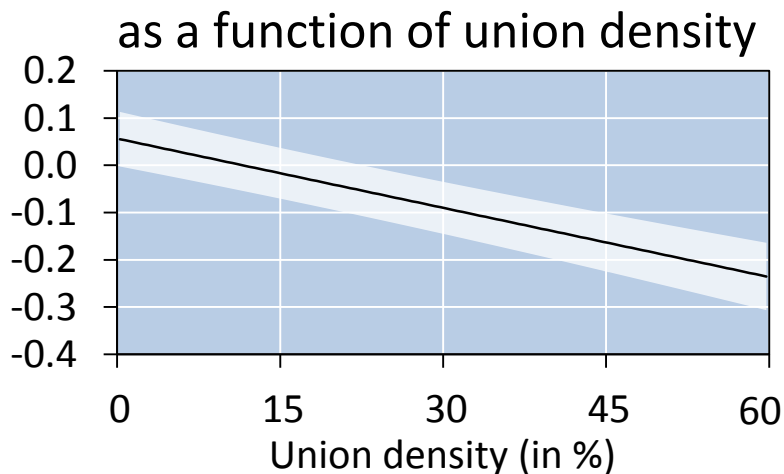
Technical change and globalisation	Education policies	Labour market policies	Gender gap
<ul style="list-style-type: none"> <li>• Play an important role but can not fully explain cross-country inequality differences</li> <li>• Inequality effect of trade depends on labour market institutions →</li> </ul>	<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

**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**

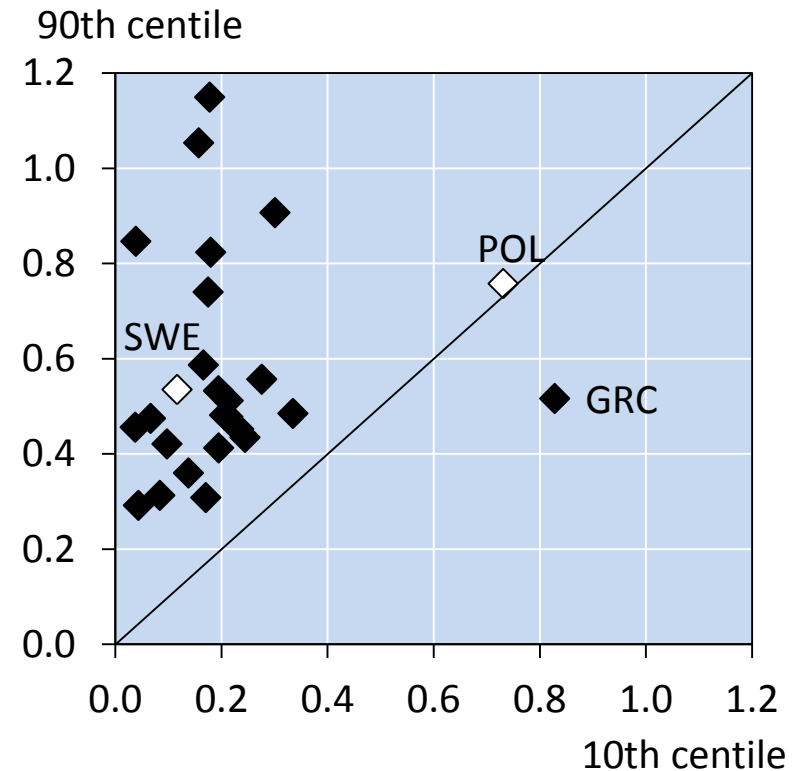
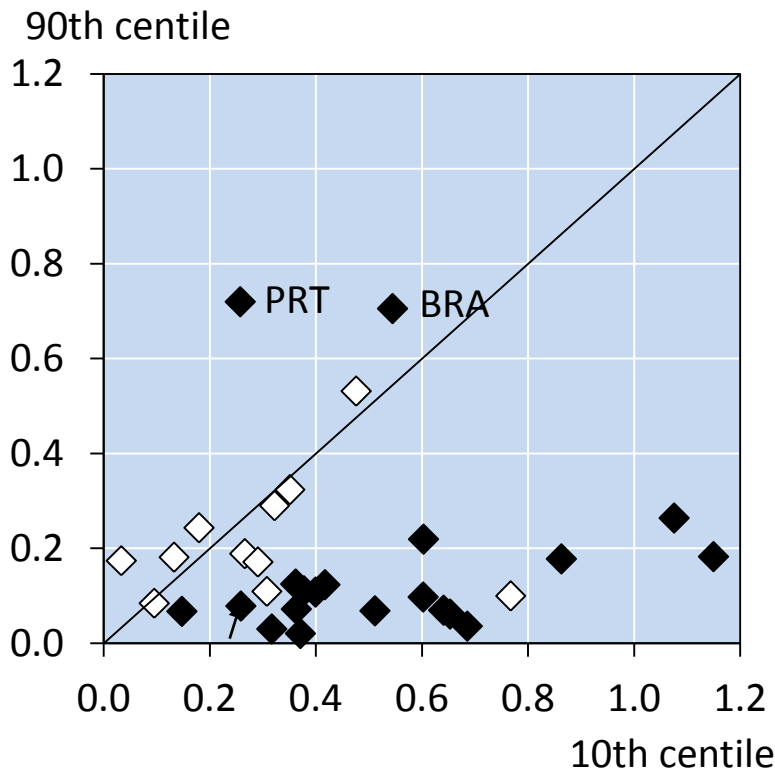


# The effect of a rise in educational attainment on the distribution of earnings

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

Upper-secondary or post-secondary non-tertiary education

Tertiary education

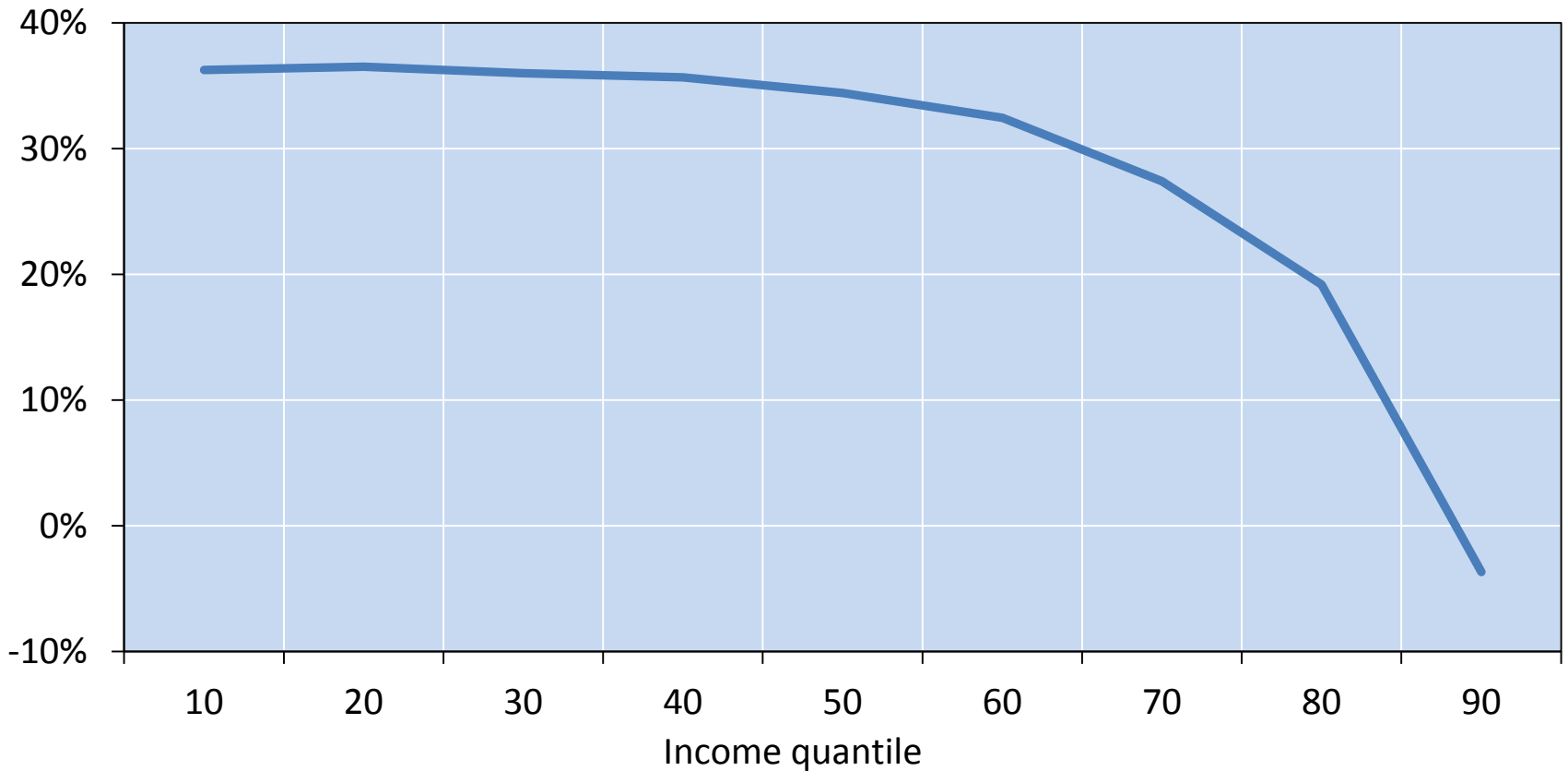




# Higher union membership tends to be associated with lower wage dispersion

The distribution of labour income

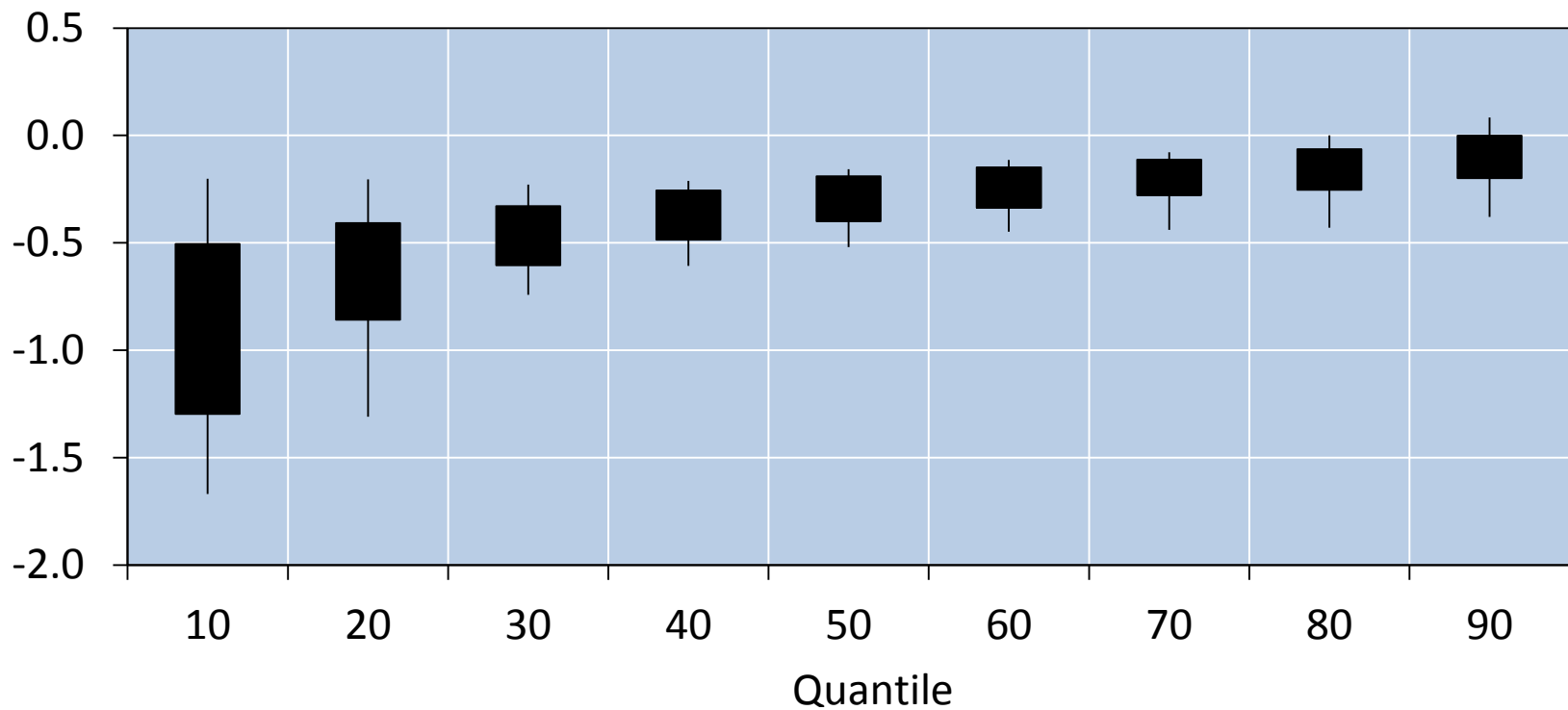
**Wage premium of union membership**  
Cross-country average, 2008 or latest available year



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

**Effect on log earnings of raising the share of workers with a temporary work contract by one percentage point**

2008 or latest available year



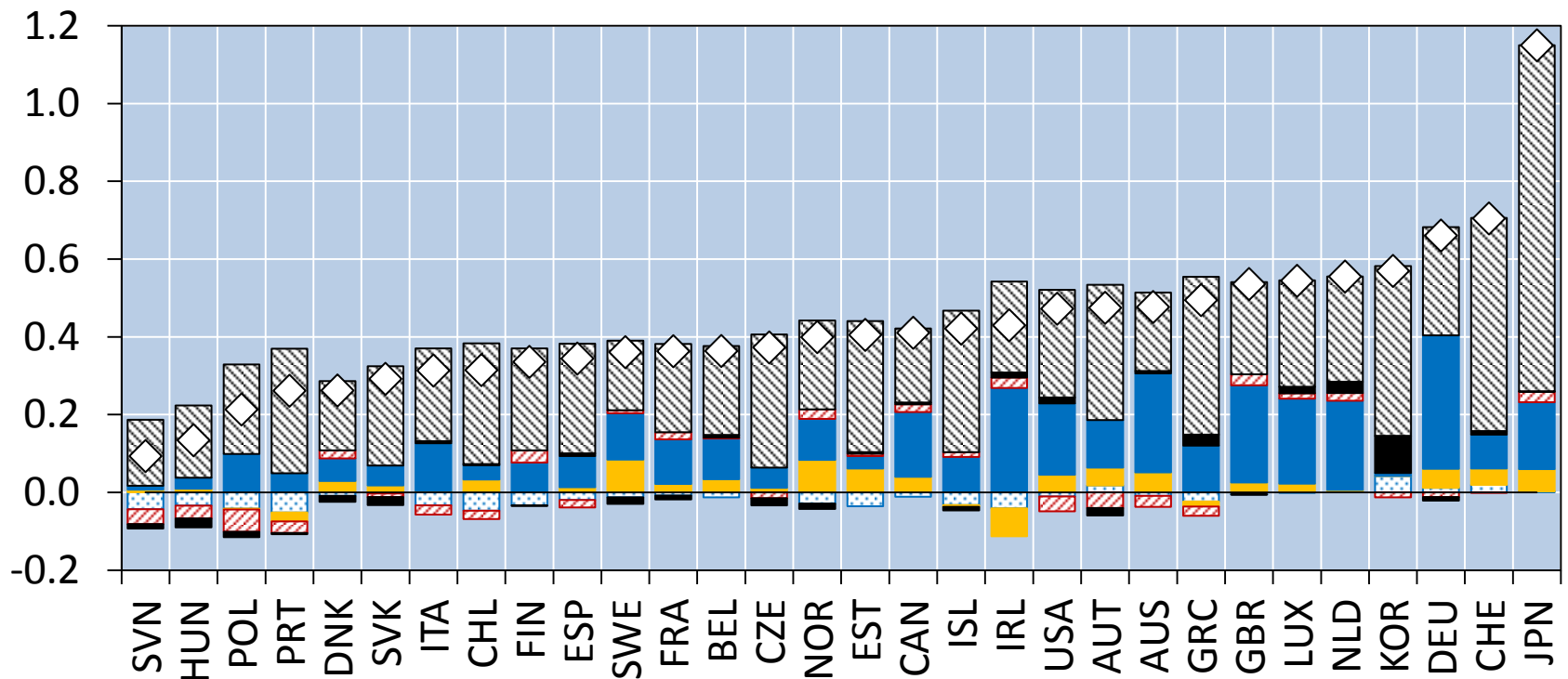
The distribution of labour income

*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

**Oaxaca-Blinder decomposition of the gender earnings gap**  
Full-time and part-time workers, 2008 or latest available year

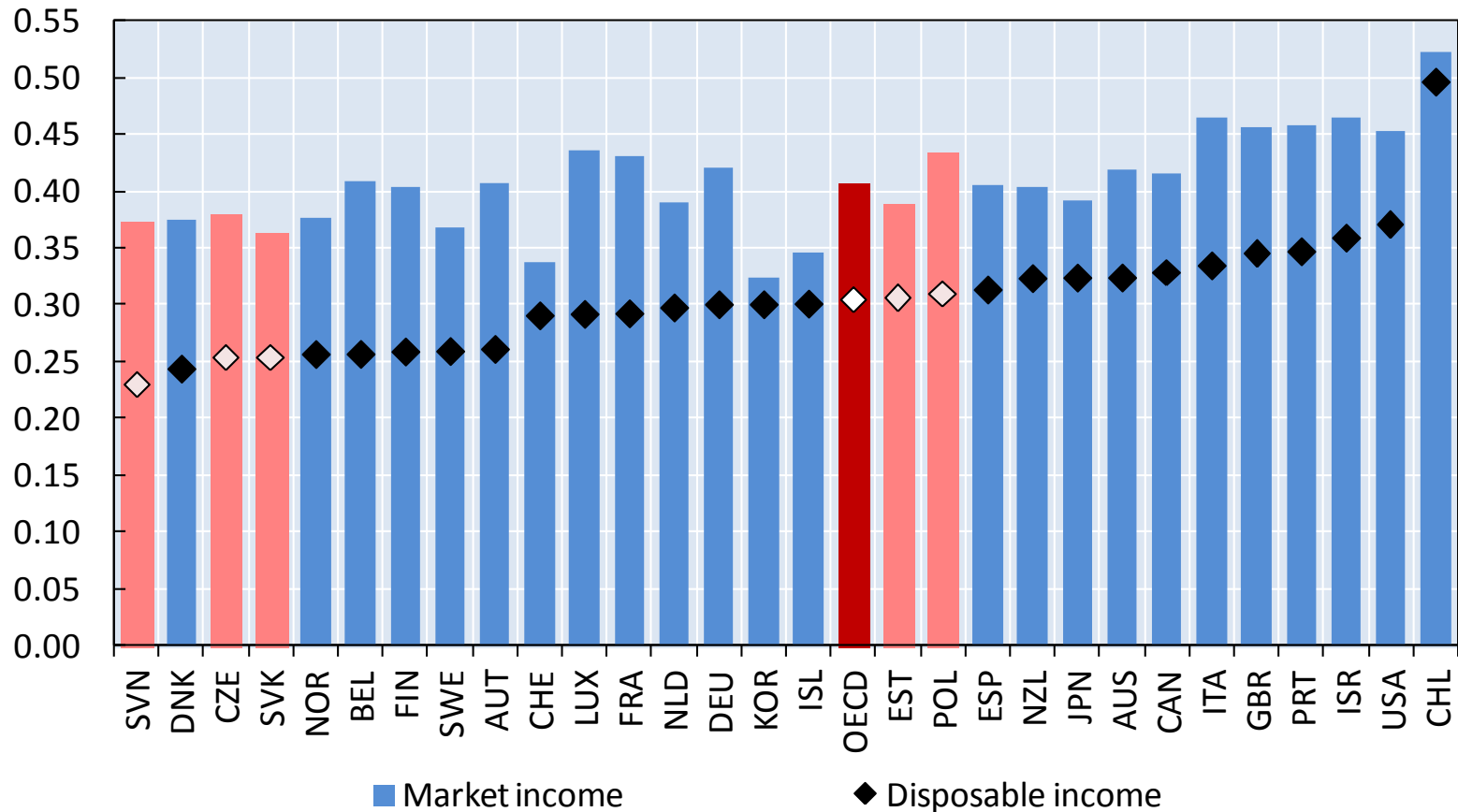


Composition effects: Education Sector Hours worked Occupation Age  
 Sum of all rate of return effects plus the contribution of the constant  
 Total earnings gap between men and women

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

## Gini coefficient of market income and disposable income

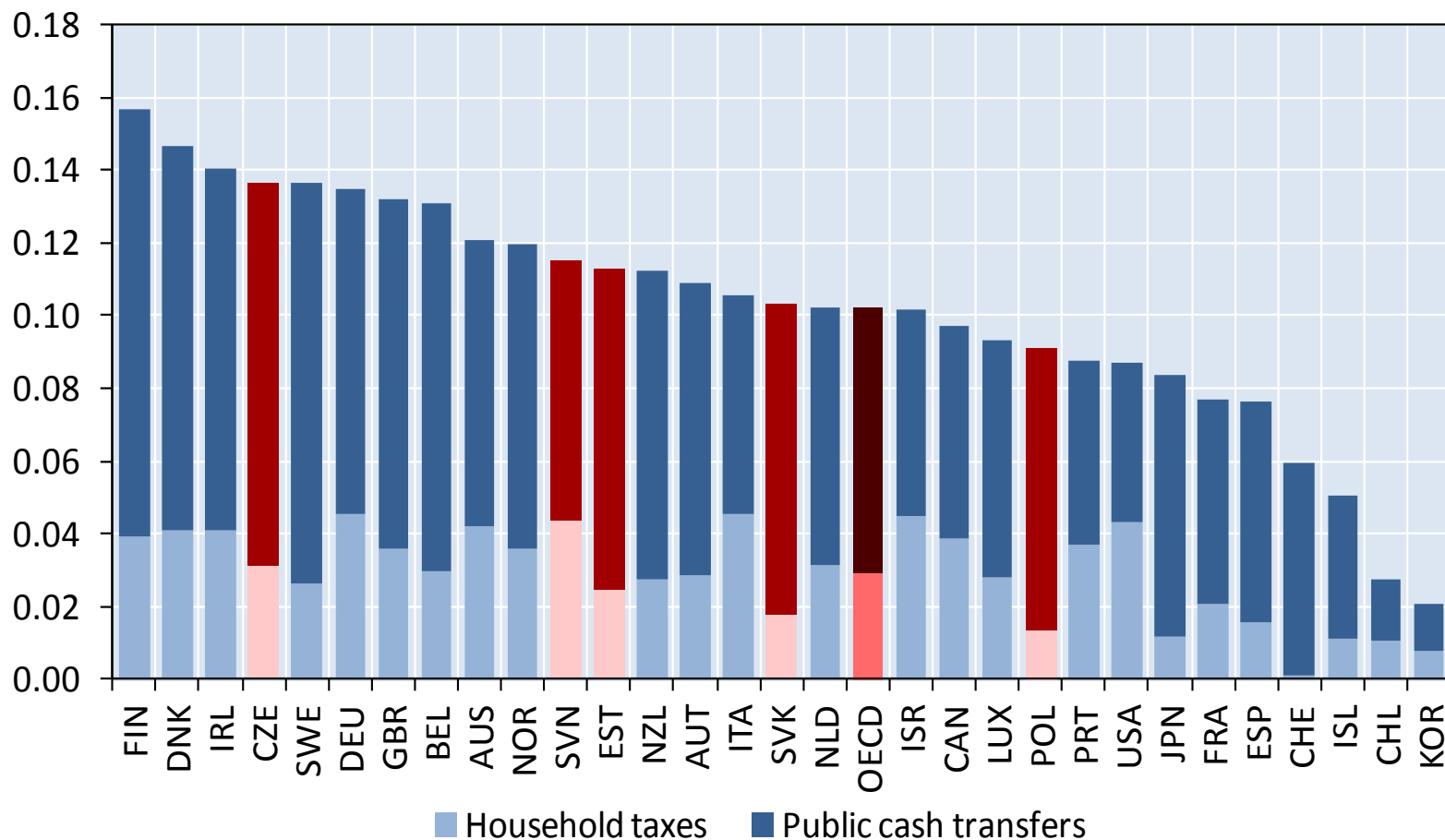
Late 2000s



# In most, but not all countries the redistributive impact of transfers is higher than that of taxes

## The redistributive impact of taxes and transfers

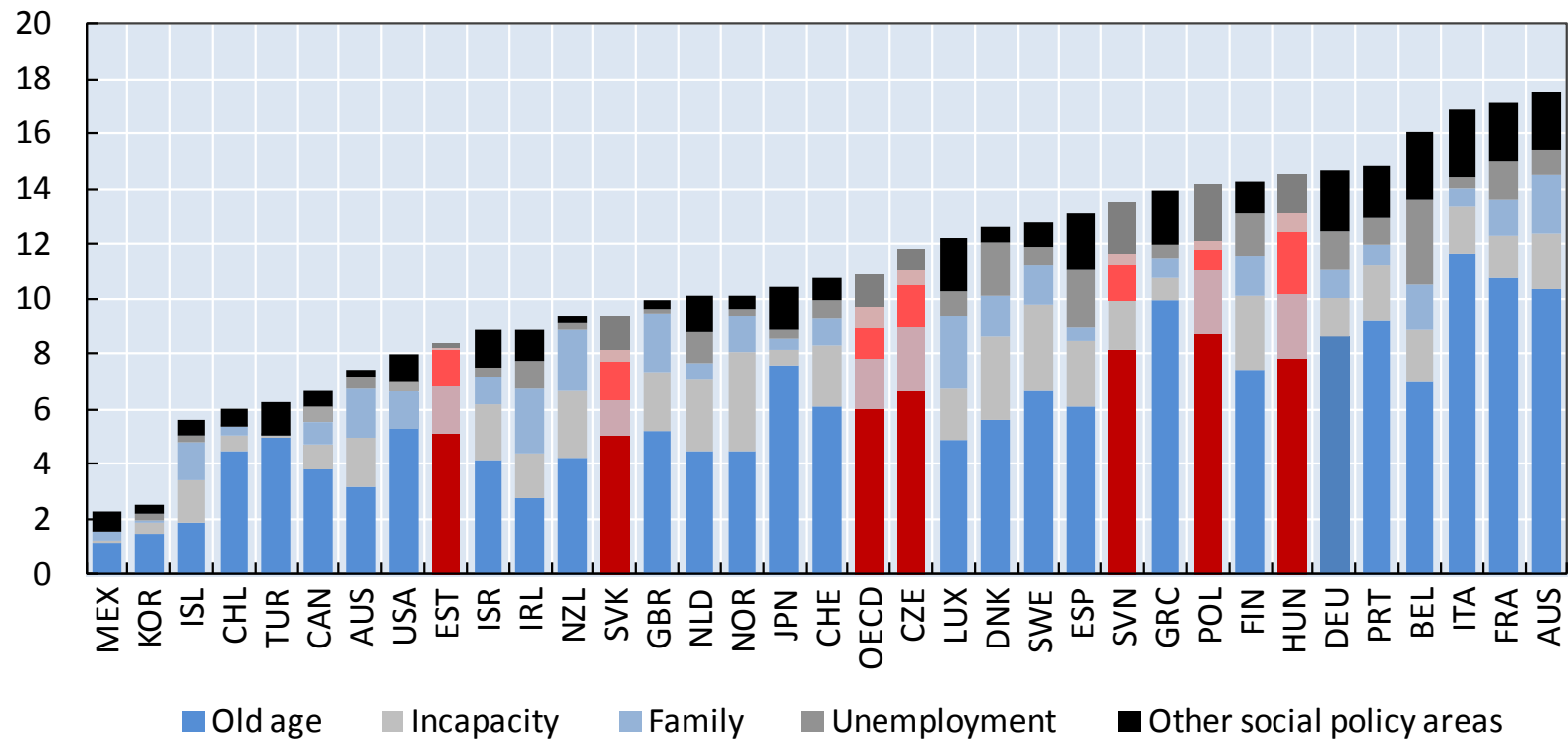
Point reduction in concentration coefficients, late 2000s



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

## Public cash transfers to households

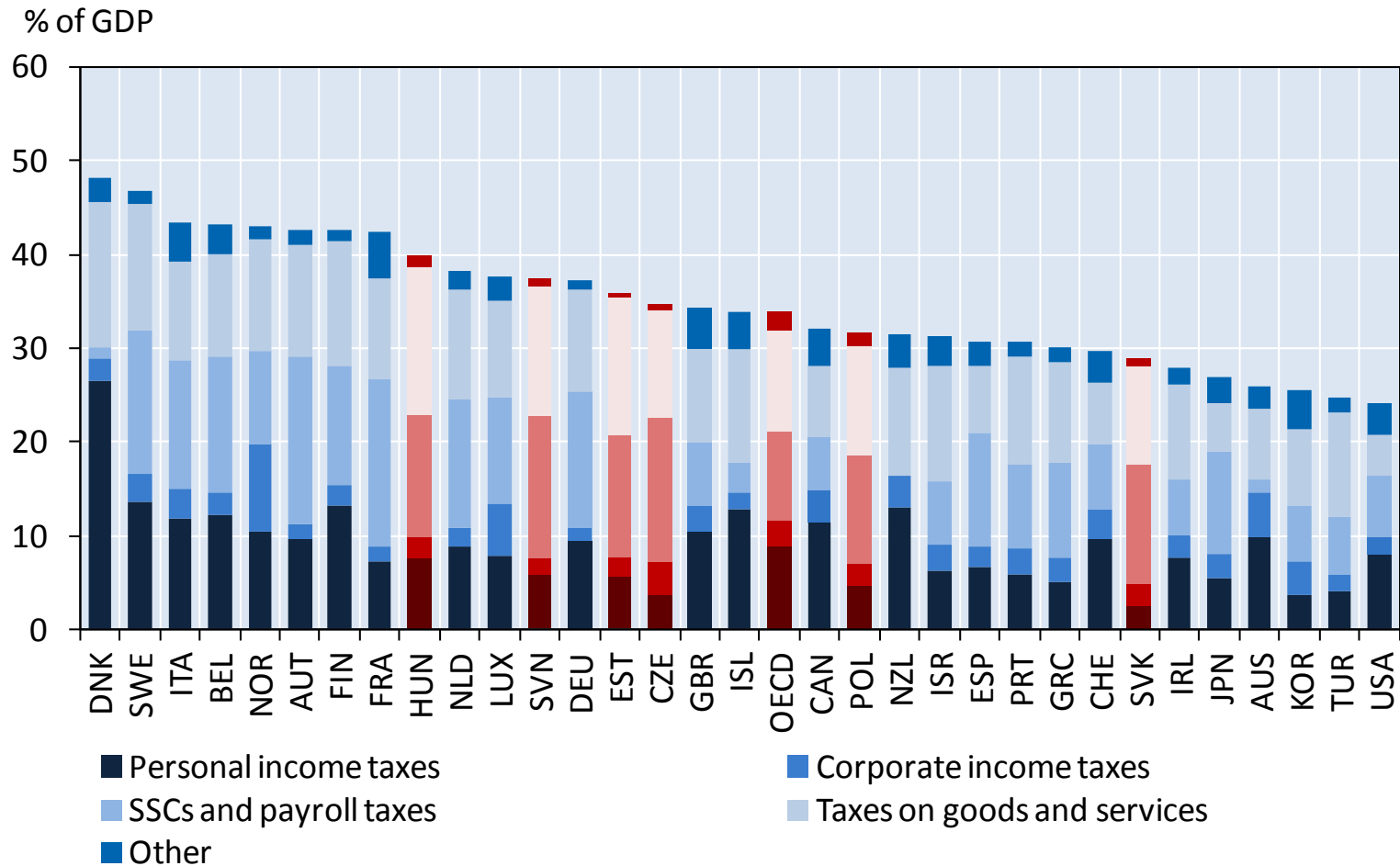
% of GDP, 2007



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

## Size and composition of total tax revenues

2009



The tax and transfer system

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

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.

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.

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 person

- 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