INEQUALITY AND INCLUSIVE GROWTH: Policy Tools to Achieve Balanced Growth in G20 Economies

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BETTER POLICIES FOR BETTER LIVES

Rising income inequality in many G-20 economies is a major economic and social challenge. This note sets out a framework and policy advice to achieve more inclusive growth.

- While average living standards in much of the world have continued to rise, income inequality has been increasing in many advanced economies and remains very high in emerging economies.

- Income inequality affects well-being in all areas of life and future opportunities and there is increasing evidence that greater inequality hinders the overall rate of growth.

- Growth-enhancing reforms can both reduce inequality, for example by removing barriers to employment or formal jobs for the low-skilled, but also increase inequality, for example by encouraging technological change that increases the wages of higher-skilled workers relative to those with fewer skills and leading to job polarization.

- An OECD assessment of the G-20 Brisbane Growth Strategies suggests just under a quarter of measures would reduce inequality with a smaller number increasing wage and income inequality, and most measures having no clear effect.

- ***Given the scale of the inequality challenge, however, the policy response cannot rely on the side-effects of growth-enhancing reforms alone.*** To reduce inequality meaningfully, specific policies are needed to tackle the causes of inequality, particularly to provide the skills and support necessary to maintaining high employment and quality jobs.

- Redistribution can play an important part in reducing inequality, but tax and transfer policies should be designed in a growth-friendly way that minimises trade-offs between the objectives of strong and balanced growth.

- Across G-20 countries, reforms to the tax-transfer system, investment in skills and labour market policies and raising women's participation in economic life are the most commonly identified policy needs to reduce inequality. Expanding the social safety net is a widespread need in emerging economies.

The ***Annex*** summarises OECD country-specific policy advice to G-20 countries aimed at reducing inequality and achieving inclusive growth.

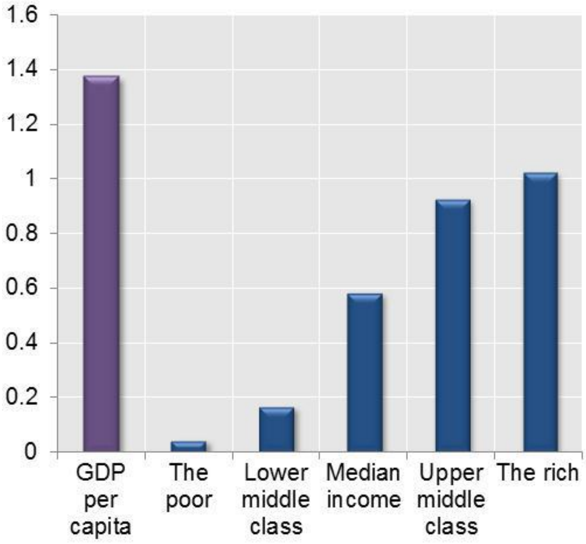
1. There has been a significant and widespread increase in income inequality

Over the past few decades, progress in average living standards has been accompanied by high levels of income inequality in emerging economies, despite a decline in some, and a significant increase in inequality in many advanced economies. It is clear that the dispersion of household income – as measured by the Gini coefficient –increased in most advanced G-20 economies between the mid-1990s and the late 2000s, notably the United States (Figure 1, Panel B). While there some issues of data comparability, income inequality is generally much higher in emerging G-20 economies. It. Inequality increased since the mid-1990s in China, Indonesia and South Africa but declined considerably in Brazil, Mexico and Turkey.

Figure 1. High and rising inequality

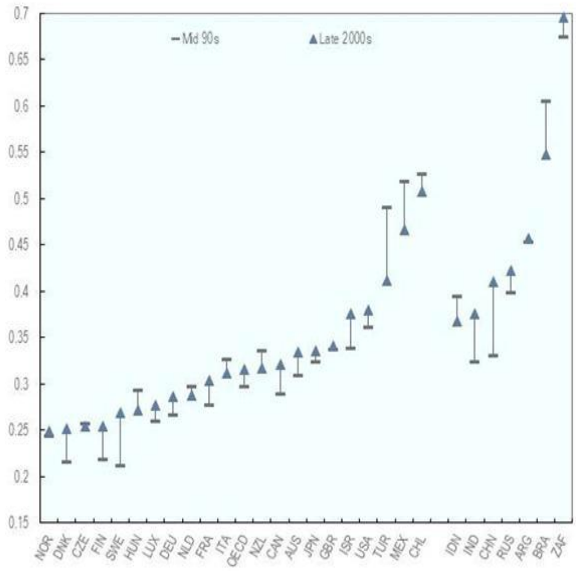
Panel A. Growth has been unequally share

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



Panel B. Rise in income inequality over the past two decades has been widespread

Gini coefficient of HH disposable income from mid-1990s to mid-2000s



Source: Going for Growth (2015) and OECD Income Distribution Database.

Within the OECD economies, gains in real disposable income from 1995 to 2011 have been stronger on average in the upper-half of the distribution (Figure 1, Panel A), in particular for the very top earners in many countries. Household incomes of the lower middle class and the poor have on average barely progressed. Inequality will continue to rise in many advanced countries – in the absence of policy changes - if skill-biased technical progress and innovation continue to be major drivers of growth (Braconier et al, 2014).

Across all income groups, household disposable income has grown slower than GDP per capita. Indeed, National Accounts data show that in most OECD countries real household income has grown much less than real GDP per capita over the last decades (see Atkinson, 2012; OECD, 2011a, Causa and Ruiz, 2015). The disconnect between real GDP and income accruing to households may reflect developments in income flows between the domestic and the external sector as well as in prices of consumption relative to output, in particular in the terms of trade. It may also reflect developments in income distribution between the household and non-household sectors of the domestic economy, mainly corporations and general government.

There are indications that trend towards greater income inequality is mirrored in rising concentration of wealth, which is less widely shared than income. The bottom 40% owns only 3% of total household wealth in the 18 OECD countries for which comparable data are available, whereas their share of total household income is 20%. The wealthiest tenth of households own half of all total household wealth, whereas the top 10% of income earners receive around a quarter of all cash income. Since the crisis, there are indications that wealth inequality has deepened: comparable data from five OECD countries[1] show that the wealth concentration at the top has increased in four since the crisis (OECD 2015a).

In advanced economies, a number of explanations have been put forward for the rising gap between the earnings of the highly skilled and those of the low-skilled (OECD 2011). First, skilled-biased technological progress and capital deepening also shifted production technologies in both industries and services in favour of skilled labour. Second, a rapid rise in the integration of trade and financial markets generated a relative shift in labour demand in favour of highly skilled workers. Second, these structural changes got underway in the early 1980s and accelerated from the mid-1990s. Other key factors may include changes in labour market institutions such as declining bargaining power of workers, changes towards less redistributive tax and transfer systems, and privatization of state-owned enterprises and changes in product markets. While there is a general consensus on the list of potential causal factors, different studies assign different relative weights to the various factors, although skills—biased technological change appears to be the leading factor.

In emerging economies, in addition to the global trends of technological change, globalization and structural labour market changes, high levels of inequality are also shaped by a large informal sector, widespread regional divides, gaps in access to and quality of education, and substantial barriers to employment and career progression for women. Access to financial markets and to social and physical infrastructure is often limited for poorer families. Economic growth accompanied by expanding social protection systems has enabled the emerging economies to achieve considerable progress in the fight against extreme poverty, but large differences remain across countries. Rapid growth by no means assures that growth is evenly shared. The tax system typically delivers only modest redistribution, reflecting such problems as tax evasion and administrative bottlenecks, which constrains also the expansion of social safety nets.

2. Achieving strong, balanced and inclusive growth

The G20 has committed to taking action to "support development and Inclusive Growth, and help to reduce inequality and poverty" in the context of achieving strong, sustainable and balanced growth, specifically lifting G20 GDP by 2% by 2018 (Brisbane Summit).[2,3]

Tackling inequality and poverty is a key requirement to increase well-being and reduce economic hardship for those at the lower end of the income distribution. Income inequality affects opportunities and outcomes in all areas of life. Poorer households have more restricted access to education and healthcare than the better off, and this in turn prevents them from fulfilling their potential. Children from poorer households are more likely not to complete compulsory education and less likely to pursue higher education. Lower education is in turn associated with shorter and less healthy lives.

[1] This includes three G-20 members: Australia, Canada, and the United States.

[2] Brisbane G-20 Leaders' Communiqué, November 2014.

[3] G20 Labour and Employment Ministers at their meeting in Ankara on 3-4 September declared that "Tackling inequalities is … important for achieving both stronger economic growth as well as our priority of creating better jobs and having more inclusive societies" and agree "to undertake a mix of policies appropriate to our national circumstances including improving wage-setting mechanisms, institutions for social dialogue, social protection systems, employment services and active labour market policies.

Evidence from OECD countries suggests a 30-year old person with tertiary education can expect to live, on average, 6 years longer than someone without upper secondary education.

There is also growing evidence that rising income inequality in itself is hampering growth (Cingano, 2014; Ostry et al, 2014). A key channel through which income inequality affects growth is by hampering equality of opportunity and curbing investments in education by the poor and lower middle classes. This effect is seen not only for the poorest 10% but for a much broader spectrum of lower middle class earners covering the bottom 40% of the income distribution (Cingano, 2014).

Income inequality is also associated with some aspects of weak labour market performance. Low labour force participation, unemployment, underemployment or low-quality jobs contribute to inequality. In emerging economies, those at the bottom of the income distribution are likely to be in the informal labour market with low qualifications, and will not find the opportunities to improve their skills and often face considerable difficulties in shifting to a formal job (OECD, 2015c).. Those in the informal sector and not covered by core labour laws and social insurance programmes for pensions, health and work injuries. They are hit harder in case of economic downturns and adverse personal events. As earnings potential becomes more dispersed, people from poorer families face weaker employment prospects, while there is little effect for better-off families.

While each country may have its own preferences between limiting income inequality and other objectives, it is generally accepted that - for any given rate of growth of average incomes - it is more sustainable and balanced if all incomes are rising than if a sizeable part of the population is experiencing stagnation or decline in its living standards. A more equal pattern of gains will tend to produce more well-being and sustain stronger growth.

Inequality also raises political challenges because it breeds social resentment and generates political instability. When large groups in the populations gain little from economic growth or only benefit from a small share, the social fabric frays and trust in institutions is weakened. Inequality can also fuel populist, protectionist, and anti-globalisation sentiments if many people they feel that they are losing out to a small group of winners.

3. How to tackle inequality to achieve more inclusive and balanced growth?

Policy makers have a range of instruments and tools to tackle rising inequalities, promote opportunities for all and foster inclusive growth. There is, however, no single best model or policy mix to adopt. Each country faces different challenges lying behind inequalities in opportunities and outcomes, and will have instruments available to address them. Countries also vary in their degree of aversion to inequality. Nevertheless, there are some policy responses that are relevant across groups of countries.

There are two ways that countries can achieve inclusive growth by striking a balance between the growth of average incomes and the distribution of income, taking into account the complementarities and trade-offs that exist between the objectives and the policies to achieve them:

- Pro-growth fiscal and structural policies designed in an equity-friendly way.
- Policies to narrow income inequality designed in a growth-friendly way.

Pro-growth equity-friendly policies

Pro-growth policies can both narrow and widen income inequalities. In some cases, policies may be "win-win" in the sense of making a substantial contribution to both higher growth and narrowing income inequality. Such policies include investment in skills and training, used to boost the earning potential of lower earners, and changes to the tax-benefit system that create strong incentives to work and boost incomes in low-income households.

By contrast, there is a clearer trade-off between GDP and income distribution with some other policies. This includes policies that work through channels that require high-skilled labour, such as innovation policy or removing barriers to trade in advanced economies. Reducing the level or duration of unemployment benefits, for example, increases incentives to work and reduces the number of unemployed people, but also lowers the welfare of those who remain out of work and potentially depresses wages at the bottom end of the income distribution. In cases where such trade-offs exist, supporting measures to offset or mitigate the impact on inequality may be helpful. In the longer term, these trade-offs may be less acute as the economy and the supply of skills adjusts to the new policy environment. Nevertheless, supporting measures may be very important during the transition.

The consequences of pro-growth labour reforms on inequality often depend on the relative size of their employment and wage effects (Table 1). The inequality-raising effect of higher wage dispersion may be offset by higher income for those securing employment, such that overall earnings inequality does not rise. The relative impact of pro-growth changes on wage dispersion and employment in various policy areas is discussed in more detail in the latest OECD *Going for Growth* report (OECD, 2015) and in OECD (2011).

The OECD's preliminary qualitative assessment of the inequality impact of the G-20 Brisbane Key Commitments structural reform measures shows that just under a quarter of measures would reduce inequality with a smaller number increasing wage and income inequality, but most measures have no unambiguous or clearly defined effect on inequality (Box A).

Table 1. Examples of Trade-Offs and Complementarities between Growth-Enhancing Policies and Inequality

A pro-growth change in:	Effect of change on:		
	Wage dispersion	**Employment**	**Overall earnings inequality**
Labour Market Policies			
Easing Employment Protection Legislation (EPL) (overall protection)	+	= / +	= / +
Easing EPL (reducing duality)	-	+	-
Lowering minimum wage	+	= / +	=
Lowering unemployment benefit replacement rate	+	+	=
Strengthening active labour market policies (ALMPs)	=	+	-
Lowering labour tax wedges	+	+	- / =
Removing barriers to female labour force participation	-	+	-
Innovation and Technology			
Technical progress (Higher MFP)	+	=	+
Higher R&D intensity	+	=	+
Globalisation			
Deeper trade integration	=	=	=
Higher FDI openness	=	=	=
Education / Human capital			
Higher share of skilled workers	-	+	-
Product market competition			
Lowering regulatory barriers to entry	+	+	=

Sources: Braconier and Ruiz-Valenzuela (2014); Koske et al. (2012); OECD (2011c).

Note : "+" represents increase in the variable whereas" –" represents decreases. "=" corresponds to the cases where the net impacts are unclear.

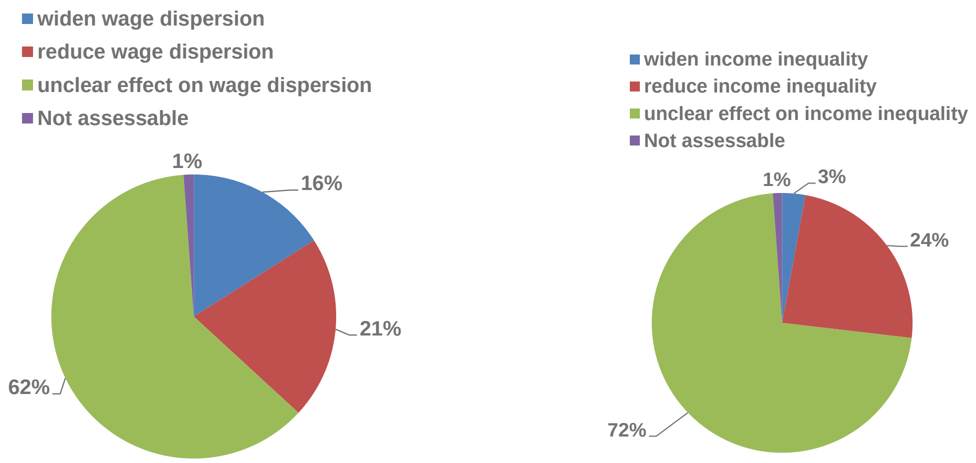
Box A. Preliminary Assessment of Impact G-20 Brisbane Key Commitments

An assessment by the OECD of the G-20 Brisbane Key Commitments structural reform measures shows that just under a quarter of measures would reduce inequality with a smaller number increasing wage and income inequality, and most measures having no unambiguous effect on inequality (see Figure).

This assessment is based on applying the OECD framework shown in Table 1 (OECD, 2015b) to the Key Commitments identified by OEC members. This broad-brush qualitative assessment is necessarily imprecise with a large number of measures considered to have an uncertain impact on inequality.

A number of commitments are assessed as tending to increase wage dispersion, but in most cases this is offset by the positive effects of rising employment. Key Commitments are more likely to have a clear downward effect on income inequality for advanced than emerging G-20 economies. This reflects differences in the composition of policy commitments. Spending on training (active labour market policies) and measures to raise female participation are the most common income inequality-reducing commitments of G-20 members.

Impact on wage dispersion *Impact on income inequality*



Source: OECD calculations.

Policies to tackle inequality in a growth-friendly way

Given the scale of the inequality challenge, the policy response cannot rely alone on the side-effects of growth-enhancing reforms. Specific policies are needed to achieve inclusive growth by tackling inequality and its causes in a growth-friendly way.

The most favourable approach is to tackle inequalities *ex ante* at their origins rather than *ex post* through taxes and transfers. This includes tackling impediments that lower income households face in acquiring skills and being supported by institutions necessary to maintaining high employment and quality jobs. Over time, investment in education and skills - including ensuring that those from lower income households have access on an equal footing - can help to address the root causes of inequality in lifetime incomes.

Nevertheless, social transfers and redistribution are often needed to reduce income inequality and also to support households facing difficult economic transitions. These should be designed in a growth-friendly way to minimise the trade-off with growth and to ensure that such support is sustainable. Redistribution strategies based on transfers and taxes alone may not necessarily be effective or financially sustainable. Tax and transfer policies should also avoid creating disincentives to formal employment.

4. What policy levers would help to tackle inequality of income and opportunity?

This section assesses in more detail the major elements of effective strategies to reduce income inequality, drawing on extensive OECD work on the drivers and causes of income inequality since *Growing Unequal* (OECD, 2008b), *Divided We Stand* (OECD, 2011) and *In It Together* (OECD, 2015).

These elements include:

- strengthening women's participation in economic life.
- promoting employment and good-quality jobs.
- improving skills and education.
- strengthening tax-and-transfer systems for efficient redistribution.

Tackling inequality inevitably goes beyond these policy areas, including though the spillovers from pro-growth policies (as discussed in the previous section). Especially in emerging G-20 economies, provision of infrastructure, health care and public administration reforms can play a role in reducing inequality. In all countries, it is important that access and provision of public services reaches those who need it most. Financial inclusion and education can also play a role in closing income gaps.

The OECD's *Inclusive Growth framework* provides an approach to assessing these issues (Box B).

Box B. The OECD's Inclusive Growth framework

The OECD's Inclusive Growth framework starts from the recognition that increase income prosperity does not necessarily lead to generalised gains in wellbeing and that economic growth is not sufficient for society's progress if not widely shared (OECD, 2014). It recognises that GDP growth itself may be undermined by rising inequality.

It is based on a 3-prong approach:

- ***Multi-dimensional - which growth?***
  The approach accounts for income and non-income related outcomes, specifically employment and health.

- ***Distributional - whose growth?***
  It considers groups of households like the middle class or the bottom 10, 20, 40 %

- ***Policy relevant - what drivers?***
  It establishes quantitative links between each outcome and key policy variables to allow policy makers identify synergies and trade-offs.

The framework is based on a solid understanding of the key drivers of the well-being and inequality outcomes, including explicit analysis of main policy trade-offs and synergies. This includes robust identification of empirical relationships between living standards and policies. It focusses on the amenability of multi-dimensional outcomes to policy instruments. This framework and its empirical underpinning continue to be developed.

Raising women's participation in economic life

Women often experience wage penalties and a poorer labour market situation. Policies to eliminate the unequal treatment of men and women in the labour market and to remove barriers to female employment and career progression would help to overcome this.

G-20 members have committed to reducing the gender gap in labour force participation by 25% by 2025 and endorsed a set of policy principles to achieve this, including:[4]

- Support lifelong access to education and training.
- Provide access to affordable and quality child care, paid parental leave, family-friendly work opportunities and conditions, and support for elderly care.
- Widen access to services for women (in the formal or informal economies), including tailored employment services, active labour market programmes and skills development opportunities
- Address legal, regulatory and behavioural barriers to employment for women.
- Promote non-discriminatory practices at the workplace, including on pay and career progression.

[4] See Annex D G-20 Labour and Employment Ministerial Declaration, Melbourne, 10-11 September 2014.

- Extend social protections, especially to those in poor households or those working in the informal economy, including in regard to work safety, health services and income security.
- Improve work incentives, income support, other transfer payments and related forms of social security.

Promoting employment and good-quality jobs

Labour income is the main determinant of income and a highly unequal distribution of labour income can reflect low participation in (formal) labour markets, unemployment or under-employment, as well as differences in wages. Job quality, those that offer career and investment possibilities with good working conditions, also varies across individuals. Policies can play an important role in improving both the quantity and quality of jobs.

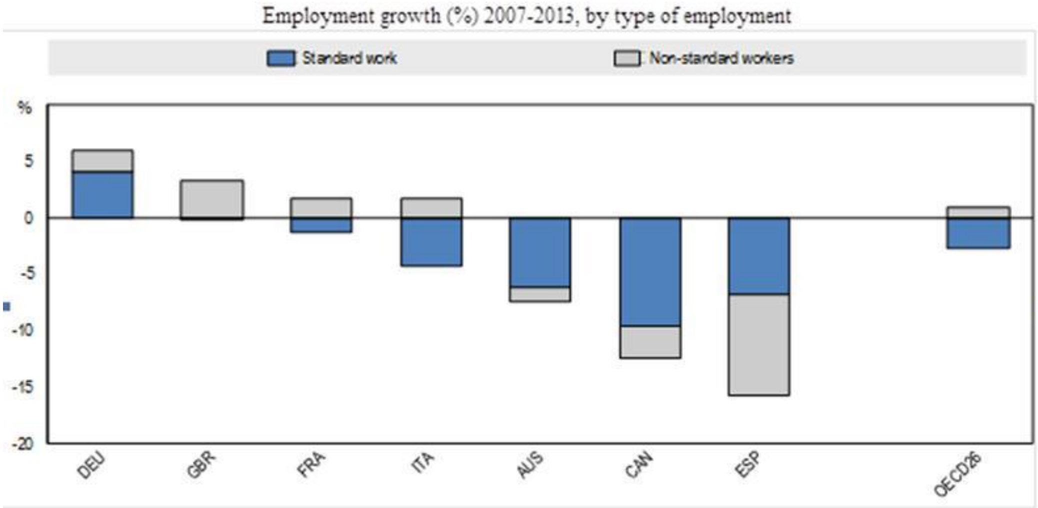
Access to employment for some disadvantaged groups, such as youths, older workers, women and migrants is relatively low in many economies. This reflects a combination of low skills, but also a range of other factors including regulatory barriers to entry and competition in sectors with large market potential, and the effects of tax-benefit systems. Activation policies, which effectively help and encourage the unemployed to find jobs, are particularly important.

However, the creation of new jobs, including for the lower-skilled workers, should reflect good quality employment. Job creation in advanced economies over past decades has relied heavily on lower quality "non-standard jobs" (Figure 2). The G20 Job Quality Framework outlines policies to boost job quality along three key dimensions: earnings quality; labour market security; and the quality of the work environment.

Rates of in-work poverty have also been rising in many countries. Labour market segmentation with "dual labour markets" between those with protected jobs with good conditions and those on less protected contracts are a major economic social issue in several advanced G-20 economies. In many advanced countries, there is an increasing divide in hours worked between higher- and lower-wage earners. Labour market regulations contribute to achieving higher quality jobs by supporting good employment conditions. However, they can reduce employment for specific groups by creating obstacles to employment (Bassanini and Duval, 2009). Achieving an appropriate balance between employment and social protection rules for permanent and temporary workers is needed to avoid labour market dualism. Labour regulations can also have a positive impact on employment of lower-skilled households through rules that support childcare and female participation.

Minimum wages can contribute to reducing wage inequality at the lower end of the income redistribution. However, excessively high minimum wages can also harm employment. Some advanced G-20 countries have scope to introduce or raise minimum wages. The interaction with other policies, including tax-transfer systems, needs to be carefully considered and the impact carefully assessed in setting its level. For instance, in some countries, increases in minimum wages are substantially clawed back through higher taxes and reductions in benefits. In-work benefits can serve to ensure a more effective reduction in in-work poverty while keeping the minimum wage at a modest level to avoid job losses.

Figure 2. Changes in non-standard jobs plays an important role in employment growth



Note: Working-age (15-64) workers, excluding employers as well as students working part-time. Non-standard workers include workers with a temporary contract, part-timers and own-account self-employed.

Source: European Union Labour Force Survey (EU-LFS), Labour Force Survey for Canada, Household, Income and Labour Dynamics in Australia (HILDA) for Australia.

Countries with large informal sectors, notably in emerging economies, should address this matter with urgency. Shifting the emphasis from protecting jobs to enhancing employability could lead to more hiring in the formal sector and to the creation of better quality jobs. Labour market policies should complement policy measures in other areas to expand the size of the formal sector, for example in the tax and competition areas. The costs of formalising jobs should also be reduced for both employers and workers in terms of administrative and tax burdens.

Skills and education

Skills and education are key to improving workers' productivity and wages and can help to raise the incomes of lower-skilled workers. Better job-related training and education for the low-skilled, including through on-the-job training and active labour market policies would help to boost future earnings. This requires measures to ensure that training performs better, as well as ensuring sufficient incentives for both workers and firms to invest more in on-the-job training (OECD, 2006). To compensate for mobility (staff turnover), corporate tax policies that encourage employers to make additional investments in the human capital of their employees are warranted (e.g. deduction of training expenses as business costs). These principles are reflected in the G20 Skills Strategy adopted by G20 countries as part of their commitment to support development and Inclusive Growth.

Greater participation in education for children from poorer households would help to improve social mobility in G-20 countries. Investment in early childcare education is one of the most effective means to ensure that children from a disadvantaged family background overcome their learning gaps relative to their more fortunate peers and that they do not drop out of school early. This should be accompanied by concerted efforts to ensure that people of all ages are able to develop and upgrade relevant skills. Improving the quality of education will also be important for some emerging economies.

Active labour market policies contribute to improving the skills of those out of work. This can be especially important in tackling low income in specific groups with low skills and weak employability. Youth unemployment is high in many countries, while in many others many young people are Neither in Employment, Education or Training (NEETs). This can have long-term consequences on life-time earnings if not addressed. Thus it will be important that action is taken to implement the objective set by the G20 Labour and Employment Ministers to reduce the share of young people most at risk of being left behind in the labour market by 15% by 2025.[5]

A focus on the early years, as well as on the needs of families with school children, would have a powerful effect on socio-economic differences in education outcomes. The emphasis should be put on quality education, besides ensuring universal access. More should be done to provide youth with the skills they need to get a good start in the labour market. With a rapidly evolving economy, further efforts, with the close involvement of business and unions, should be made in promoting a continuous up-grading of skills during the working life.[6]

Access to tertiary education is important for improving the prospects and living standards of lower-skilled people and giving individuals the opportunity to acquire the skills needed in the labour market. Educational or learning accounts can be a means to help achieve this objective (OECD, 2005), but tax incentives need to be designed in such a way that they do not disproportionally benefit higher-wage earners.

Tax-and-transfer policies

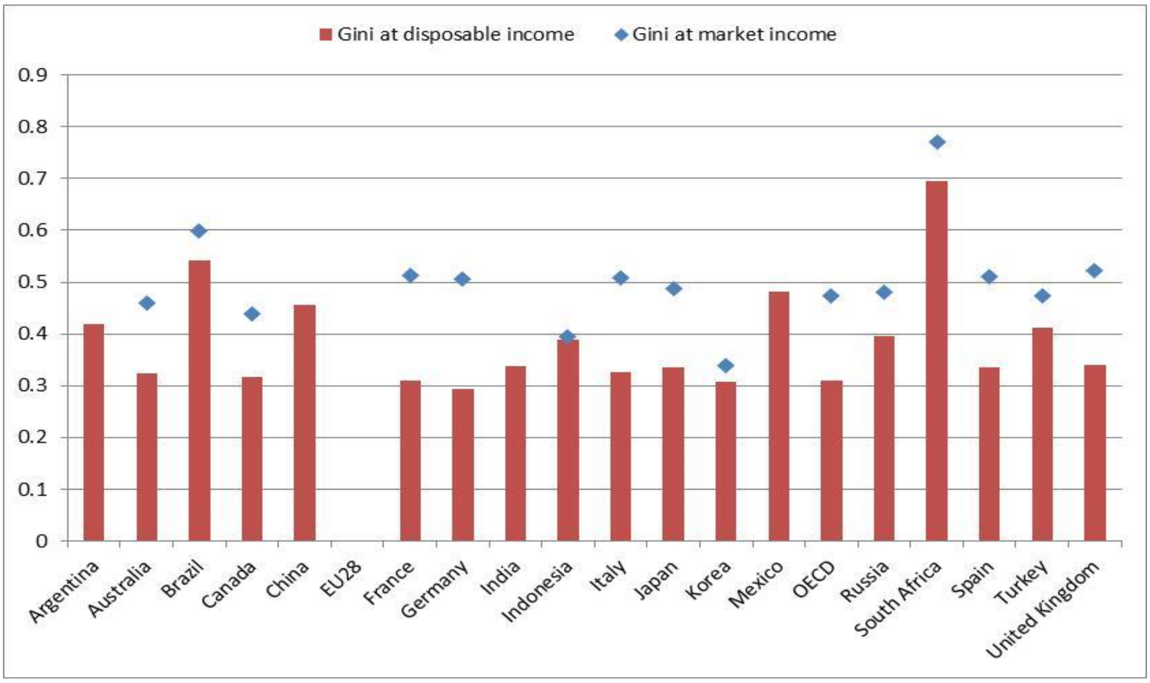
Tax and benefits policies can have important powerful and direct effects on growth and inequality. Taxes and transfers give governments the means to achieve redistribution of income to reduce inequality, as well as to incentives along the income distribution. Among advanced economies, there is typically a large difference between inequality in market incomes and disposable incomes, that is incomes after direct taxes and cash transfers (Figure 3). For emerging economies where data is available, redistribution typically has much less impact as the result of lower levels of social spending and taxation.

In addition, tax and benefit policies also have large effects on labour market outcomes via their impact on the incentives for individuals to participate in the labour market and for firms to hire, train and adjust the mix of capital and labour in the production process.

[5] G20 Labour and Employment Ministerial Declaration, Ankara, 3-4 September 2015.
[6] These are all elements of the G-20 Skills Strategy which has been proposed by the Turkish Presidency.

Figure 3. Market and disposable income Gini indices

2013 or latest year available



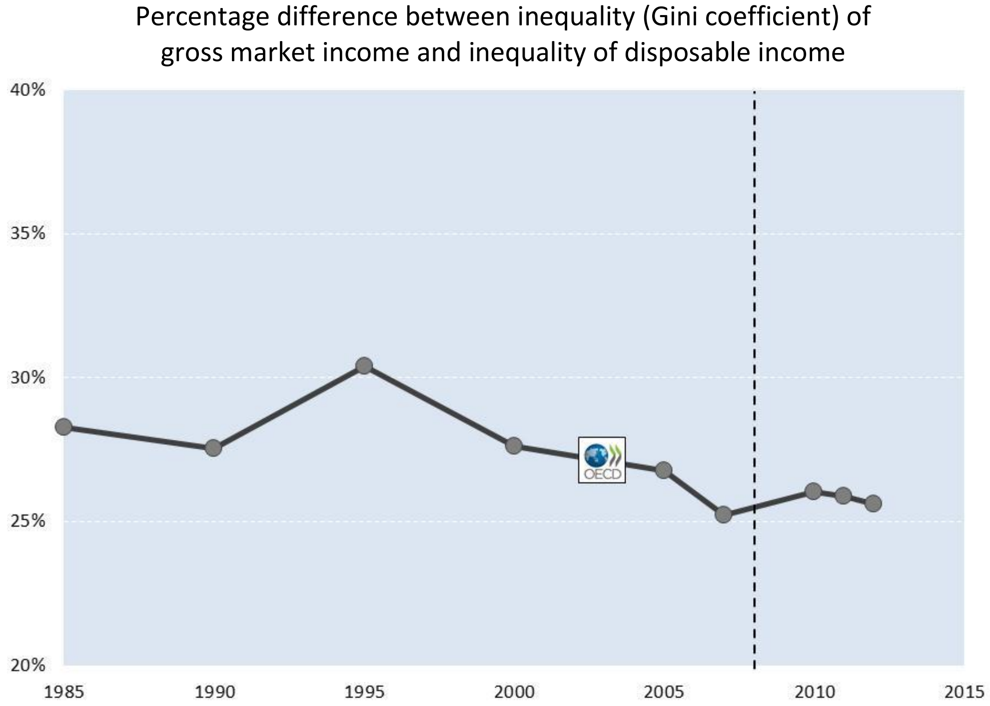
Note: Data are based on equivalised income from the OECD Income Distribution Database http://oe.cd/idd for all countries except for Argentina, Brazil, China (income based, in dark grey) and India and Indonesia (expenditure based, in light grey) for which inequality at market income is not available. Market income is disposable income before receiving social transfers and paying income taxes, except for Mexico and Turkey where it is before receiving social transfers but after paying taxes. No data for Saudi Arabia.

Source: OECD, 2015a. http://dx.doi.org/10.1787/888932535337

Taxes and social benefits have played an important role for inequality trends. Between the mid- to late 1990s and up to the global financial crisis, falling tax-benefit redistribution was one main factor driving the rise of inequality of disposable income (OECD, 2011). In the first years after the crisis, higher tax-benefit redistribution cushioned the steep rise in market income inequality (Figure 4). In later years, as entitlements to social benefits expired and most governments implemented fiscal consolidation programmes, income inequality increased once again (OECD, 2015a)

The weakening of redistribution in advanced economies can be explained by a number of factors. Overall, this appears to be largely driven by reductions in the real value of benefits, in part as working-age benefits did not keep pace with real wages. At the same time, changes in the numbers of unemployed and reforms to benefit eligibility criteria appear to have played a role, whereas benefit targeting seems to have played less of a role. Spending on out-of-work benefits shifted towards “inactive” benefits. This partly reflects some positive developments, such as reduced recourse to early retirement schemes. However, much of this increase in some countries was linked to a sharp increase in disability benefits without work requirements. While adequate social protection is important, poorly-designed disability benefits can exclude people from the economic and other benefits of integration into the workforce, often more-or-less permanently.

Figure 4. Aggregate redistribution in G-20 OECD economies



Source: *OECD Income Distribution Database*.

Taxation has not become more progressive as inequality of market incomes has increased. Trends to lower income tax rates offset efforts to make taxes more progressive. Social security contributions have done little to reduce inequality due to their relatively flat-rate structure. It may be necessary to review whether existing tax provisions are still optimal in light of equity considerations and current revenue requirements. This is especially the case where the share of overall tax burdens borne by high-income groups has declined in recent years (e.g. where tax schedules became flatter and/or where tax expenditures mainly benefitted high-income groups). The tendency for the position of low-income groups to stagnate or deteriorate underlines the need for well-designed income-support policies. Potential trade-offs in the design of tax instruments between economic efficiency and equity need to be carefully managed.

Public social spending is on average much lower in emerging economies. That said, redistribution policies have been strengthened in many of them, with several countries making their cash transfers more generous and others aiming at widening their coverage of unemployment benefits and health insurance, and expanding educational opportunities. At the same time, taxation is still relatively low in emerging economies. General consumption taxes (VAT and sales tax) account for the bulk of tax revenue, and their share is considerably larger than the OECD average. High levels of self-employment and sizeable informal sectors have up to now been limiting the capacity of the tax authorities to verify tax payers' declared income and there have been administrative bottlenecks in tax collection on personal income. The policy priorities to address this in many emerging G-20 economies include:

- Developing effective and efficient protection systems such as unemployment insurance, ensuring that programmes also encourage formal employment and tackle poverty.
- Conditional cash transfers that are particularly well-suited to reducing inequality and promoting social mobility as they combine income support with the requirement to maintain investments in human capital.

- Reducing reliance on product-based subsidies – such as oil, food and fertilisers in emerging economies, which tend to be more regressive than people-based cash transfers.
- Investment in human capital and child health.
- Enhancing the distributive capacity of the tax system may require an emphasis on improving revenue collection procedures and strengthening the extent to which taxpayers comply voluntarily with their obligations. A focus on the fight against corruption would also help improve tax collection.
- Strengthening social welfare programmes to better target individuals most in need, together with promoting mechanisms of in-work benefits.

Among advanced economies, there is scope to increase the redistributive impact of social and other government spending, in particular to help poorer families:

- Raise financial incentives and opportunities to work, especially for women and those with children.
- Implement more progressive personal income tax structures.
- Cut tax expenditures that disproportionately benefit higher-income individuals.
- Reduce the labour tax wedge on low-income households through in-work tax credits and other income-conditional tax allowances
- Improving the effectiveness of social spending, particularly for enabling access of lower-income groups to higher education and good quality health services.
- Raise the effective retirement age in line with increased life expectancy, including by raising pension ages, while ensuring adequate provisions for the poor whose life expectancy is on average shorter
- Limit regressive nature of indirect taxes by enlarging tax allowances and tax credits targeted at low-income households. Increase the share of taxes on property and energy, and increase the focus of taxation on inheritance.
- Increase investment in education and skills

Tax policies need to ensure that wealthier individuals but also multinational firms pay their share of the tax burden. To that end, implementation of AEOI and OECD-G-20-BEPS project is essential.

Priorities for G-20 countries

Annex 1 provides an **overview of OECD country-specific policy recommendations** that tackle inequality for G-20 countries from *Going for Growth* and key recommendations in *Economic Surveys*.[7] While this does not provide a comprehensive assessment of inequality challenges and policy gaps, it should nevertheless provide some guidance for G-20 Members.

The OECD's existing assessment of policy priorities to reduce inequality in G-20 countries shows that a wide-range of measures are relevant in different economies (Figure 5). The tax-transfer system, investment in skills and labour market policies are the most commonly identified policy needs. Expanding the social safety net is a widespread need in emerging economies.

[7] The analysis does not cover Argentina or Saudi Arabia.

Within tax-transfer systems, common policy priorities include reforming tax systems to reduce the tax burden on low earners and to increase incentives for female participation. It would be helpful to broaden tax bases to reduce inequality, including by eliminating regressive tax expenditures and increased taxes on property. In advanced economies, improving in-work benefits through better targeting and design would help to improve income distribution and employment of the low-skilled. In many emerging economies, removing disincentives to formal employment would improve jobs quality. This would support increasing the scope and generosity of the social safety net, including through cash transfers. In advanced economies, more affordable childcare is needed in many countries.

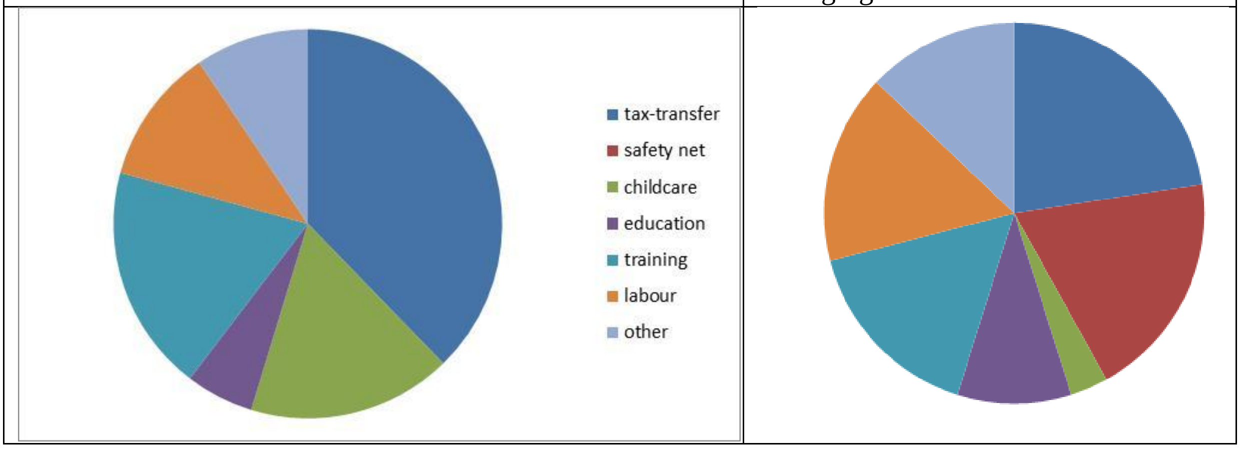
A common theme across many countries and policies is the need to target public support more on those with the greatest needs, including in terms of the social safety net, a progressive tax system and ensuring access to services such as health, education and training.

Investment in skills and education are common priorities. Training and active labour market programmes are needed especially in advanced economies to put those with lower skills in a stronger position in the labour market. In advanced schools, ensuring that young people leave with the skills necessary to find good jobs and avoiding poor education in disadvantage groups are high priorities. This includes ensuring that educational resources are targeted towards students from poorer backgrounds. In emerging economies, needs are more likely to focus on primary education, supporting high school completion and supporting wider access to higher education.

Policy recommendations on labour market policy largely focus on increasing labour market formality in emerging economies and reducing labour market dualism where it exists in advanced economies. A small number of countries should introduce or raise minimum wages.

Figure 5 Priority policy areas to reduce in equality in G-20 economies

Advanced G-20 economies	Emerging G-20 economies



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Annex 1. Selected OECD recommendations to G-20 members relating to inequality and inclusive growth

Recommendations from recent OECD *Economic Surveys* and *Going for Growth* (OECD, 2015b) with high relevance for reducing inequality and promoting inclusive growth. This provides an overview of recent OECD advice. This Annex is not a fully-updated in-depth assessment of the policy requirements to tackle inequality in each country. The number of recommendations captured in this Annex and their nature may vary partly depending on the focus on the *Surveys*, as well as the specific needs of countries.

Country	Recommendation
Australia	Monitor the proposed welfare reforms to ensure they raise work-force participation cost effectively without adverse social outcomes.
	Better target superannuation (pension) tax
	Press on with facilitating access to childcare that is both affordable and scheduled to allow combining work and family life.
	Simplify and rationalise the system of indigenous-community support; envisage a smaller menu of programmes that focus more tightly on improving health outcomes, educational achievement and labour-market participation.
	Monitor the proposed higher education reforms to ensure that choice and quality is enhanced and access is not compromised.
Brazil	Scale up early childhood education and early detection and tutoring classes to reduce drop–outs and grade repetition in secondary schools.
	Build more schools where needed to ensure full-day schooling nationwide.
	Reinforce the PRONATEC initiative with more resources to keep on expanding vocational training and apprenticeships.
	Give higher priority to increasing Bolsa Familia and other policies under the Brasil Sem Miseria programme rather than pension expenditure.
	Remove the automatic link between increases in the minimum pension and the minimum wage.
	Introduce a general minimum retirement age and strengthen the disincentives for early retirement.
	Increase the funding for public health services and create more training places for doctors and nurses.
	Increase the progressivity of direct taxes by reviewing the rate schedule, exemption thresholds and reconsidering the cap on social security contributions paid by employees.
Canada	At the municipal level, expand low-cost rental housing supply by adjusting zoning regulations to promote more multi-unit dwellings.
	Enhance opportunities for seasonal workers to retrain.
	Provide clear guidelines for resource companies on how to engage with affected Aboriginal groups so that projects bring long-term benefits to these communities.
	Continue to work with provinces and territories to harmonise training and certification requirements of all apprenticeship

	programmes across the country to increase completion rates and inter-provincial mobility for apprentices.
	Reduce regressive and distortive income-tax expenditures.
	Complement income-contingent loans with need-based grants to improve access for students from disadvantaged backgrounds
China	Enhance skill provision from early childhood through to adult learning.
	Extend public service provision and social security coverage to all migrant workers. Make social security benefits portable across the country.
	Grant farmers greater land-use rights, and make them more enforceable and easier to trade.
	Boost public spending on education, including by increasing teacher compensation to improve education quality. Ensure equal opportunities for disadvantaged children.
	Open up public schools to all children of internal migrants, or, where such schools are not available, provide vouchers to enable them to attend private schools.
	Establish a countrywide workplace training-based vocational education system; enhance career guidance and better disseminate information on jobs.
	Expand the coverage of rural social welfare payments.
France	Accelerate the elimination of economic rents and privileges to favour competition and equity.
	Cut taxes further on labour.
	In secondary vocational education provide highly qualified teachers and more individualised support for students lacking basic skills. Provide workplace trainers with pedagogical training.
	Lower social security contributions further by shifting the financing of benefits that accrue to society at large, such as those for families, to less distortive taxes (e.g. environmental, real property and inheritance taxes). Eliminate tax loopholes, such as preferential tax treatment of certain investment income, and broaden the base of personal, capital and corporate income taxation.
	Combat school failure at an early stage, limit grade repetition drastically, and develop individualised instruction. Improve teachers' training by focusing on knowledge transmission and creativity, and boost incentives to attract high-quality teachers in disadvantaged schools.
Germany	Make the tax system more supportive of inclusive growth. Broaden tax bases by updating property tax valuations and extending capital gains taxes on residential real estate, except for owner-occupied housing. Equalise the inheritance tax burden for different forms of wealth. Raise the tax rates applying to household capital income towards the marginal income tax rates applying to other household income
	Lower social security contributions, especially for low-pay workers.
	Focus additional pension entitlements on reducing future old age poverty risks.
	Continue to expand early childcare provision, notably for full-day

	care. Ensure equal access of the most vulnerable to affordable high-quality childcare independently of their place of residence and socio-economic background. Extend the supply of all-day schools.
	Improve the quality of early childhood education and care by raising the staff-to-children ratio in accredited facilities, by further raising professionals' qualifications and by better integrating education and care. Abolish the cash-for-care subsidy.
	Reform the system of joint taxation and give consideration to removing free health insurance for non-working spouses, while ensuring that low-income households are compensated.
	Provide more financial resources to schools with a comparatively high share of pupils with weak socio-economic backgrounds.
	Provide more support for disadvantaged youth to complete formal upper secondary education, in particular mainstream VET.
	Continue reducing early tracking in schools. Continue reducing the assignment of pupils to special needs schools and make sure assignment to such schools does not reflect the socio-economic background of pupils.
	Reduce the gap in employment protection between permanent and temporary workers for example by limiting the use of multiple successive fixed-term contracts with the same employee.
	Better target the preferential tax treatment of minijobs towards low-wage workers.
	Give consideration to raising the maximum amount of means-tested student support. Develop tuition fees in combination with student loans with income contingent repayments.
	Improve targeted active labour market policies, for instance by monitoring self-selection problems within target groups.
	Extend compulsory pensions to the self-employed.
India	Shift public spending away from energy subsidies towards investment in physical and social infrastructure.
	Reduce barriers to formal employment by introducing a simpler and more flexible labour law which does not discriminate by size of enterprise.
	Continue improving access to education, especially at the secondary level, and better focus on the quality of education at all levels. Provide better and earlier vocational training.
	Further modernise labour laws to ensure equal work opportunities for women. Enhance the implementation of gender-related laws.
	Expand secondary and higher education for women and skills training for female entrepreneurs.
	Gradually extend government sponsored health insurance to primary care, beginning with deprived communities, in particular in rural areas and urban slums.
	Improve the Income Tax Act by further broadening its base, including by abolishing the tax allowance for interest paid on housing and education loans.
	In promoting financial inclusion, rely further on mobile banking and branching through local businesses, allow micro-finance institutions to take deposits.

Indonesia	Increase, and further improve targeting of, spending on poverty alleviation and health measures.
	Direct more public resources to improving education access and outcomes, as per existing government targets.
	Increase financial inclusiveness by further developing branchless banking.
	Tackle labour market informality by reducing rigidities in the formal sector, and by enhancing the effectiveness of the tax-transfer system for poverty alleviation and channelling other social benefits.
	Continue to phase out fuel and electricity subsidies, which will allow a reprioritisation of government spending programmes. Compensate the poor through existing poverty reduction schemes, as necessary.
	Reinforce the direct link between domestic and world fuel prices. Continue to phase out electricity subsidies. These will allow a reprioritisation of government spending programmes. Compensate the poor through existing poverty reduction schemes, as necessary.
	Implement plans to lift government spending on infrastructure, particularly for projects that facilitate regional development.
Italy	Fully roll-out all implementing decrees of the Jobs Act.
	Change the composition of spending on active labour-market policy: limit training programmes to those who need them most, especially among youth; tailor assistance to job seekers according to their specific situation.
	Encourage female labour force participation with more flexible working-hours arrangements, and promote wider provision of good quality care for children and the elderly.
	Fully implement the unified unemployment benefit system. Require recipients to actively seek work, and to accept employment or training when offered.
	Further expand post-secondary vocational education. Increase university tuition fees and introduce a system of income-contingent-repayment student loans.
Japan	Increasing female employment by expanding childcare, reforming aspects of the tax and social security systems that reduce work incentives for second earners and breaking down labour market dualism to reduce gender inequality.
	Break down labour market dualism by increasing the coverage of social insurance and upgrading training programmes for non-regular workers, and reducing effective employment protection for regular workers, in particular by increasing transparency.
	Prevent discrimination against non-regular workers.
	Improve the targeting of public social spending and introduce an earned income tax credit for low-income workers.
	Reform social assistance by reducing benefits and enhancing work incentives while expanding its coverage.
	Provide training programmes for recipients of public assistance who are capable of working.
	Ensure access to high-quality early childhood education and care for children from low-income families.

	Reduce reliance on private, after-school lessons, particularly in *juku,* and increase the accessibility of students from low-income families to after-school lessons.
	Expand public loans for tertiary education to encourage students from low-income households to invest in higher education.
Korea	Break down labour market dualism by reducing employment protection for regular workers and by increasing social insurance coverage and training for non-regular workers.
	Raise the employment rate, particularly for women, by creating high-quality part-time jobs and improving the quality of childcare.
	Target the Basic Old-Age Pension benefit on the lowest-income elderly to ensure that they escape absolute poverty. Increase the coverage of the National Pension Scheme and maintain the replacement rate at around 50%. Expand company pensions and strengthen personal pension plans.
	Encourage greater use of flexible employment and wage systems to promote the continuous employment of older workers, while expanding and upgrading lifelong learning and training opportunities to improve their job prospects
	Set a minimum mandatory retirement age and gradually increase it with an aim of eventually abolishing mandatory retirement.
	Address the household delinquent debt problem while limiting moral hazard and containing the growth of household debt.
	Improve vocational education and training to meet the needs of SMEs and facilitate the use of the Internet to enhance their growth.
	Ensure better access to employment support programmes to encourage youth to work.
	Encourage the use of parental leave and flexible working arrangements, including more part-time jobs. Expand the supply of affordable, high-quality childcare.
	Relax the eligibility conditions for the Basic Livelihood Security Programme and ensure adequate funding, while improving the work incentives of recipients.
	Expand the earned income tax credit (EITC) by relaxing the eligibility conditions and aiming, in the long run, to include the self-employed.
	Ensure that the National Health Insurance meets its goal of universal coverage and further lower co-payments ceilings to provide adequate care to low-income households and persons with chronic health problems.
	Reduce dependence on private tutoring, including *hagwons.* Improve access to after-school tutoring by further expanding Internet and broadcast teaching systems and expanding the after-school programmes in schools.
	Expand student loans through the new programme that makes repayment contingent on income after graduation.
Mexico	Improve the equity and efficiency of education spending by refocusing such spending on pre-primary, primary and secondary education.
	Encourage more women to join the formal labour force by improving access to quality child-care for children under three years

	of age and extending active labour market policies.
	Approve draft legislation for unemployment insurance and universal pensions to protect job seekers and elderly people against the risk of income losses, and reduce inequality.
	Fully roll-out the new Prospera cash transfer programme to help beneficiaries expand their capabilities, complete their education, join the formal sector and obtain well-paid jobs.
Russia	Increase spending on active labour market programmes and temporary income support to unemployed.
	Increase overall education funding, in particular in poor regions, while continuing to restructure education institutions. Reconsider school fees for optional courses in primary and secondary education to reduce access inequalities.
	Raise temporary income support to unemployed to allow them to devote more resources to job search.
Spain	Shift the balance from labour to indirect taxes by cutting employer social security contributions for low-skilled workers, increasing environmental and real estate taxes, and narrowing exemptions to value-added tax, corporation and income taxes
	Strengthen active labour market policies by improving vocational training, strengthening the capacities and efficiency of the public employment services, and enhancing coordination between the different levels of administration.
	Boost resources and efficiency of public employment services. Strengthen activation and extend training measures for the unemployed.
South Africa	Improve employment opportunities by expanding affordable public transport, including integrating minibuses into the public transport system, and building new, denser settlements closer to economic centres.
	Establish a public employment service as a one-stop shop for job seekers to lower the cost of job search and hiring costs for employers, which would improve the matching of workers to jobs.
	Broaden personal and corporate income tax bases by reducing deductions, credits and allowances. Increase tax rates on higher incomes.
	Expand placement assistance for young job-seekers and support for young entrepreneurs focused on management training.
	Gradually phase out school fees in the public school system. Teach English as a second language earlier, while maintaining mother-tongue instruction for longer. Expand vocational education and training. Improve teacher training, enhance accountability and monitoring of school leadership.
	Reduce implicit and explicit subsidies for energy and coal consumption, and use other instruments, such as cash transfers or supply vouchers, for protecting the poor.
Turkey	Eliminate restrictions on the full range of modern employment forms in the formal sector (including temporary work, employment through work agencies, home-based work and remote work).
	Strengthen the social safety net and the up-skilling avenues for the

	unemployed, expanding the most successful schemes.
	Reduce labour tax wedges for low-skilled workers across the country and expand earned income tax credit type support.
	Continue to strengthen incentives for female labour force participation through reforms facilitating the hiring of women in the formal sector.
	Reduce the persisting large quality gaps among both schools and universities. Develop pre-school education. Strengthen vocational education and life-long training in co-operation with the business sector.
	Make permanent the cuts granted during the crisis and further reduce social security contributions for low-skilled workers throughout the country, financing this by a widening of the tax base.
	Make continuing work in the formal sector after official retirement age more attractive and actuarially neutral.
United Kingdom	Broaden the tax base, such as equalising income taxes and social security contributions between the self-employed and employees.
	Monitor the impact of previous reforms such as the Education Act 2011 on the average quality of education outcomes and equity across social groups. Encourage the expansion of high quality postsecondary vocational programmes
	Implement the Universal Credit and monitor its effectiveness in moving people towards employment. Increase spending on active labour market policies and improve their efficiency by fostering competition among contracted providers, better profiling customers and developing a performance measurement system. Further reduce the cost of childcare to increase work incentives for parents.
	Review the effects of schooling reforms on equity, fair access and user choice for disadvantaged students. Encourage the highest quality teachers to move to the most disadvantaged schools
United States	Make the personal tax system more redistributive by restricting regressive income tax expenditures, such as mortgage interest deductions for owner-occupied housing.
	Raise labour earnings at the low end by expanding the EITC, which would be more effective if supported by a higher minimum wage.
	Strengthen the portability and recognition of training by involving employers in programme design.
	Provide comprehensive work support to get disability recipients back to work.
	Provide support to parents with young children by expanding access to paid family leave nationally.
	Help states develop right-to-ask policies to support flexible working arrangements.
	Increase access of low and moderate-income families to quality preschool and childcare.
	Work with employers in preventing the negative effects of job strain on mental health, prolonged sick leaves, job loss and disability-benefit claims.
	Expand effective targeted pre-school initiatives such as Head Start, Early Head Start and evidence-based home visiting programmes.

	Support the adoption and introduction of common core standards in primary and secondary education.