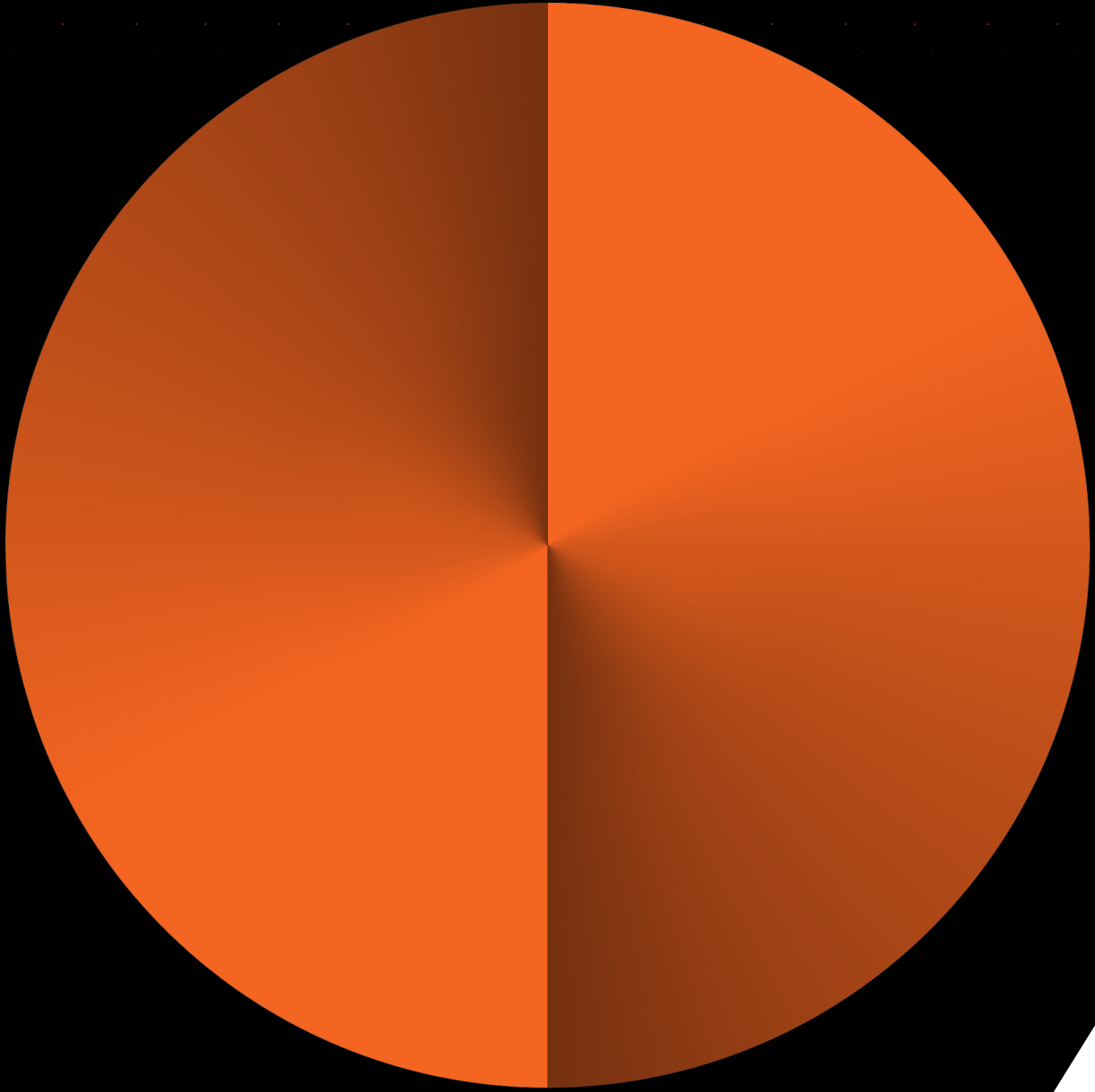


# Meeting of the OECD Council at Ministerial Level

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## UPDATE REPORT 2017 - INCLUSIVE GROWTH

# **Update Report 2017 - Inclusive Growth**

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## EXECUTIVE SUMMARY<sup>1</sup>

1. **Global economic integration has been a source of prosperity for many years, but is coming under growing political pressure partly due to uneven sharing of the benefits of growth. It is perceived as one of the causes of increased inequalities and a source of disempowerment for individuals and communities.** The OECD has long highlighted the necessity of rethinking the traditional model of economic growth to put people's well-being centre-stage and has launched the *Inclusive Growth* Initiative in 2012 to develop a strategic policy agenda for feeding this new vision of growth. The OECD efforts on the Inclusive Growth agenda have culminated in the 2016 Ministerial Council Meeting Declaration on Enhancing Productivity for Inclusive Growth. The Declaration highlighted that an effective response to address the twin challenge of fostering productivity growth and reducing inequalities requires leveraging on technological advances and innovation to boost economies and ensure that higher productivity growth translates into broadly shared gains in well-being. This report provides an update of the OECD activities undertaken in response to the Declaration, building on major OECD flagships such as Going for Growth 2017, Tax and Inclusive Growth, updates of the Divided We Stand analysis and various other OECD pieces.

2. **Over the last couple of decades, inequalities of income have risen or remained stubbornly high in various OECD countries as did wealth and well-being inequalities, although these general trends mask great disparities across countries and regions.** Over the past two decades, income inequality has widened or plateaued at a high level in several OECD countries, often with large regional discrepancies, as richer households have pulled away from their middle and lower income peers. The trend is more mixed for emerging economies, though the absolute levels of inequality remain much higher than in OECD countries. Wealth is significantly more unequally distributed than income in countries where comparable information is available. In addition, since the crisis, multidimensional living standards of the poorest households have trailed behind, with those in the middle faring a little better, whilst those at the top have seen substantial improvements.

3. **To improve the opportunities of the next generation we must address the unequal outcomes of current generations.** Child development is key for sustaining well-being at every stage of life. Yet, for the most disadvantaged children, multidimensional inequalities start accumulating early and achievement gaps widen throughout schooling, making it harder for them to climb the socio-economic ladder. While parental educational background has a particularly strong influence on children's opportunities to pursue quality education in many OECD countries, poor children manage to overcome family background barriers and obtain high educational outcomes in some countries.

4. **Addressing the spatial dimension of inequalities between urban and rural areas would have a great impact on reducing overall inequalities.** There are large income differences between urban and

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1. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

rural areas in both OECD countries and emerging economies. Income inequality is also higher in cities than in other locations and tends to be even higher in the largest cities, as they attract highly skilled workers and the most productive firms. Regional disparities concern many well-being dimensions, not only income. Such disparities tend to be larger when broader living standards measures are considered.

5. **Research shows that some drivers of prosperity may have differentiated impacts on inclusiveness outcomes but governments can work to settle in a virtuous circle where growth translates into higher well-being for all and inclusiveness underpins stronger growth in a sustainable manner.** Fiscal redistribution through taxes and transfers plays a crucial role in containing the impact of market income inequality on disposable income, but fiscal policy has become less redistributive over time. In some countries, distributional objectives were not explicitly embedded in mainstream economic policies, but were seen only as part of the social agenda, and looked at “ex-post” issues. More broadly, a number of longstanding structural transformations to the way OECD economies function, combined with policy settings, have likely fuelled inequalities. These include: technological change and digitalisation in connection with economic globalisation, several aspects of financial deepening and functioning of financial markets and job polarisation.

6. **Digitalisation and globalisation have had many profoundly positive impacts, but policies could and should do better to help those directly affected by the associated changes, thereby mitigating the widening of socio-economic gaps in countries where inequality is very large.** Digitalisation and globalisation connect people, enterprises, cities, countries and continents in ways that vastly increase individual and collective potential. They provide entirely new ways for people to connect, socialise, collaborate and participate in societies; they enable the production of more and better products and services at cheaper prices, thus increasing consumers’ welfare; they foster the diffusion of knowledge and technology; they spur innovation, productivity and growth and have allowed millions of people in developing and emerging economies to escape poverty and improve their living standards. Yet, capital flows and global economic integration have also increased the difficulty for governments in taxing mobile capital income, with possible detrimental effects on inclusiveness. Digitalisation might also have impacted wage inequality and productivity growth, by exacerbating the divide between highly and low skilled workers. Globalisation and digitalisation impacts are among the factors responsible for a growing disconnect between productivity growth of firms standing at the frontier and that of laggards. While some of these mechanisms have been documented by recent OECD work, more research is needed to further corroborate these findings.

7. **More work should be undertaken to assess all the consequences of inequalities, including for long-term growth, as they may be large.** Inequalities lower investment in human capital among the bottom 40%, jeopardising productivity growth. Rising inequalities also put further pressure on public social budgets, as often going hand in hand with larger transfers and smaller revenues. Finally, high inequalities may also be hindering trust in public institutions, constraining governments’ capacity to act and weakening structural reform implementation efforts. While some of these mechanisms have been thoroughly documented by OECD work, there remain areas where further efforts are required to fully appreciate the consequences of inequalities.

8. **The cross-cutting challenge presented by the persistence of multidimensional inequalities and stagnating productivity underlines the need for a profound reappraisal of the growth narrative that was focused on maximizing material well-being, on average growth rates, and on efficiency of markets.** This reappraisal ought to entail a renewed look at the rules which govern our economies and the role of national governments in designing and enforcing those same rules, but focusing on people, and outcomes that matter to people. Such an exercise should span across an array of domains essential for promoting growth and helping all individuals and firms to fulfil their potential: from making financial markets work better as channels of capital to productive activities, to looking again at the role of public

policies for enabling and promoting innovation, and to reinvigorating market competition to unleash business dynamism and level out the playing field for all firms. It requires considering the distributional impacts of economic policies, and prioritising policies that will benefit the bottom 40%.

9. **A central pillar of this new policy setting concerns the role that national governments should play to enable individuals to flourish throughout their lives.** If the government is to rise to the challenge of addressing unequal outcomes and to prevent disadvantage cascading down generations, whilst acting as a catalyst for stronger productivity growth, it needs to be reconfigured to serve its citizens as a launching pad. In practical terms, this will call for a re-orientation away from a risk-only approach to welfare provision, towards a lifelong enabling platform that furnishes individuals with capacity enhancing assets in the form of human and social capital, good health and active support in labour markets and builds strong foundations for learning and adaptation for life and through life.

10. **Efforts to ensure that all individuals have the opportunity to lead meaningful and productive lives are reliant on a thriving business sector.** Businesses are uniquely placed to provide employment opportunities, foster individual well-being at the work place, contribute to the development of skills, and promote the creation and dissemination of knowledge and technology. Yet, to fulfil this role, businesses need an environment that ensures a level and competitive playing field, enables them to access the skills they need and finance at fair cost, whilst providing regulatory clarity and consistency. Firms are also facing important inequality trends, as frontier firms can attract the best talent, and have access to finance, technology and quality infrastructures. At the bottom, laggard firms and SME's may face structural conditions that are less conducive to growth and development. Government policy also has a part to play in setting up the framework conditions to promote innovation, supporting responsible business conduct, engendering respect for labour rights and the environment, and ensuring that companies pay their taxes.

11. **At the same time, implementation challenges will mean that the policy-making process also needs to be rethought, necessitating the adoption of a more systemic approach.** Adopting such an approach will better enable policy makers to deploy coherent policy sets covering a range of areas: from life-course focused education and skills policies, to product and financial market regulation and fiscal structure. This will require institutional reforms that will help policy makers to reach beyond silos and better equip them to deal with cross-cutting challenges that impact several traditionally distinct policy domains. Institutional redesign is equally crucial to ensuring that policy makers at distinct levels in the hierarchy of governance (the local, national and global levels) have a capacity to act that is properly matched with the scale of the challenges they face. Policies aimed at promoting growth should consider how growth will have an impact on many other outcomes, and how to ensure that those policies avoid the “grow first, distribute later” assumption that has characterised the economic paradigm until recently. It is now clear that growth strategies need to consider from the outset the way in which its benefits will be distributed to different income groups.

12. **Policy makers have a range of instruments and tools at hand to tackle rising inequalities, promote opportunities, and foster inclusive growth.** While each country's challenges are unique, there are some common building blocks behind successful inclusive growth strategies, which could be reflected in the form of broad packages of policies aimed at either exploiting *synergies* by boosting growth and inclusiveness, or mitigating *trade-offs* while jointly addressing slow productivity growth and increased inequalities.

13. **All in all, inclusive growth strategies need to be country-led and context sensitive.** OECD countries face diverse challenges on growth and inclusiveness, with inequality in outcomes and/or opportunities being very large in some jurisdictions but relatively contained in others; by the same token, productivity growth is unfolding at a pace that is often uneven across countries. This implies that priorities



on inclusive growth should be context sensitive and must take into account national circumstances, including social preferences on redistribution but also a country-specific understanding of drivers of inclusive growth.

## INTRODUCTION

14. **Across the OECD, globalisation is coming under growing political pressure.** Globalisation is perceived as being at the root of some of the biggest policy challenges that governments currently face. None more so than the rise in inequalities, experienced in many advanced economies over the last thirty years. The rise in inequalities has contributed to feed a growing disconnect between citizens and public institutions, and a feeling amongst many individuals that they have been disempowered. The subsequent political fallout highlights the dangers in trying to consider our economies as somehow separate from their social context. Our complex socio-economic systems find themselves stuck with fundamental asymmetries between the global nature of economic activity, business and finance and the resolutely national foundations of governance and polity.

15. **The rise in inequalities in OECD countries cannot be attributed solely to globalisation.** Instead, it is more likely down to the combined range of factors including globalisation, but also spanning technological change, financialisation, competition failures, an increased use of aggressive tax planning and tax avoidance practices and a decline in the redistributive power of the state. The current macroeconomic environment of slow growth, poses further challenges to achieving inclusive growth especially in the current economic outlook characterised by a growing disconnect between economic fundamentals and productive investments (such as infrastructure and capital spending) and market evaluations. Overall, however, despite the fact that the OECD has intensively researched the causes of rising inequality, many questions remain, particularly on the interplay between these various forces and policies.

16. **Regardless of their origins, the profound social and economic consequences of the rise in inequalities in the OECD need to be addressed.** Inequalities tear at the fabric of our societies. Inequality of incomes translates seamlessly into inequality of opportunities for children, including education, health and jobs, and lower future prospects to flourish individually and collectively. The OECD Inclusive Growth (IG) Initiative came to existence in response to the realisation that inequalities are reaching a tipping point and the ultimate objective of economic growth should be improving people's well-being (**Box 1**). Rethinking economic growth in such a way that all socio-economic groups can contribute to it and derive fair benefits from their participation means making educational systems, labour markets and institutions more inclusive and more fair, messages that the IG Initiative highlighted through its first flagship project *All on Board*. More recently, the focus shifted to the consideration of the factors that are driving inequalities at the heart of economic functioning, in particular through productivity growth dynamics. Through its work on the *Productivity-Inclusiveness Nexus*, the OECD has highlighted the "breakdown of the diffusion machine", namely the failure to translate rapid technological change into shared productivity growth across all firms and economic sectors. Repairing the diffusion machine requires policies aimed at creating a level playing field for all firms, including supporting innovation and experimentation, providing access to finance and boosting competition, but also to reduce the costs of exit when firms cannot compete and perform. The seeds of this work culminated in the 2016 MCM Declaration on Productivity for Inclusive Growth (**Box 2**).

### Box 1. The OECD Inclusive Growth Initiative

The OECD's *Inclusive Growth* Initiative was set up in 2012 in response to the Ministerial mandate for a New Approaches to Economic Challenges (NAEC) initiative to "develop a strategic policy agenda for Inclusive Growth". Based on extensive OECD work done to document the increased inequalities of income and outcomes ("*Growing Unequal*" and "*Divided we stand*"), the initiative developed a multidimensional approach to assess, promote and monitor inclusive growth, which delivered the OECD Framework for Inclusive Growth, *All on Board: Making Inclusive Growth Happen*.

Over 2015-16, the Initiative pursued work along four main pillars: measurement, sectoral, national and regional. In this context, the Inclusive Growth datasets and measurement tools were refined and extended to provide broader geographical coverage; sectoral analysis was carried out in several areas, including in the social area (gender, youth), intergenerational mobility, innovation, education, finance, governance, regional development, and a regional consultation was conducted in Southeast Asia; the [Centre for Opportunities and Equality](#) was launched. A report on *The Productivity-Inclusiveness Nexus* was produced for the MCM 2016; the Group of Ambassadors "Friends of Inclusive Growth" was established; and the Inclusive Growth in Cities Campaign was launched, bringing a coalition of 50 mayors engaged to foster inclusive growth.

The Inclusive Growth initiative leverages work done in different parts of the house related to inequalities and opportunities, as well as on productivity dynamics and digitalization. The main OECD directorates that have contributed to the 2015-16 activities of the Inclusive Growth initiative are ELS, ECO, EDU, STI, GOV and STD, though in the new biennium the Inclusive Growth agenda is being mainstreamed across the whole house (see Annex 1). The initiative has been led by the Office of the Secretary General, with the Chief of Staff and Sherpa overseeing the work.

The initial stages of the Inclusive Growth initiatives have been funded by a grant from the Ford Foundation.

### Box 2. The 2016 MCM Declaration on Enhancing Productivity for Inclusive Growth

Ministers at the 2016 Ministerial Council Meeting adopted a **Declaration on Enhancing Productivity for Inclusive Growth**. The Declaration highlighted that an effective response to address the twin challenge of fostering productivity growth and reducing inequalities requires leveraging on technological advances and innovation to boost economies and ensure that higher productivity growth translates into broadly shared gains in well-being. The MCM Declaration called the OECD to identify synergistic policies for addressing the [Nexus](#) between Productivity and Equality; strengthening our understanding of the Nexus; exploring policies that could reap the benefits of digitalisation; promoting measures ensuring a level-playing field for business, including by assessing the factors affecting business dynamism and efficiency; further exploring how the public sector is contributing to productivity growth; and refining productivity measurement.

17. **This update report takes stock of the ongoing implementation of the OECD mandate in this area, providing an update of the various OECD work streams that respond to this mandate.** In particular, the OECD follow-up to the MCM declaration and the work on the Nexus has been organised under two sets of activities: first, deepening our understanding of the interplay of factors underpinning the joint evolution of inequalities and productivity; second, identifying new transversal policy solutions that can reduce inequalities by increasing productivity diffusion and gains across firms; and that can sustain long-term investment in growth and productivity by lowering inequalities of opportunities at the level of individuals, firms and regions.

18. **This report presents the main results of these activities, framing them in the context of the 2017 MCM theme “Make Globalisation Work: Better Lives for All”.** While the link between globalisation and inclusive growth is complex and more in-depth work is needed, this report shows that many of the recent trends in inequalities and productivity can be better understood considering the technology-fueled and increasingly globalised nature of our economies and, more importantly, that policies fostering inclusive growth need to be designed and implemented by strongly taking into account the interconnectedness of our marketplaces, institutions and societies.

19. **Fostering inclusive growth requires a wide range of actions at different scales.** National and subnational policies must address and bridge the growing economic and social divides of our economies, redesigning fair and effective rules for individuals and firms to be able to flourish. Countries should also engage with global policies on inclusive growth, that ensure international coordination and cooperation on issues such as tax competition, labour and social protection and investment in productive expenditures such as health and education.

20. The report first presents the latest evidence on inequalities, social mobility and equality of opportunities, while also providing some evidence on regional disparities (Chapter One). It then provides insights on selected drivers of inequalities, mainly in relation to globalisation and digital transformation of economies, before highlighting some of the costs and consequences of growing inequalities, as observed in the majority of OECD countries over the last two decades (Chapter Two). The final part of the report (Chapter Three) discusses a number of pro-IG growth solutions that address different elements of inclusiveness and productivity diffusion, but that would generally benefit from a coordinated implementation across the government and among its different levels. The report also stresses the importance of countries’ collective policy action on some of these fronts.

## CHAPTER ONE

### THE ISSUE: THE RISE OF INEQUALITIES

**Over the last couple of decades, inequalities of income have risen or remained stubbornly high in various OECD countries as did wealth and well-being inequalities, although these trends mask great disparities across countries and regions.** Over the past two decades, income inequality has widened or plateaued at a high level in a majority of OECD countries, often with large regional discrepancies, as richer households have pulled away from their middle and lower income peers. The trend is more mixed for emerging economies, though the absolute levels of inequality remain much higher than in OECD countries. Wealth is significantly more unequally distributed than income, serving to cement the unequal outcomes of one generation to weigh down on the opportunities of the next. In addition, multidimensional living standards of the poorest households have trailed behind, with those in the middle faring little better, whilst those at the top have seen substantial improvements.

**The unequal outcomes of one generation tend to frame the opportunities of the next.** Child development is key for sustaining well-being at every stage of life. Yet, for the most disadvantaged children, multidimensional inequalities start accumulating early, achievement gaps widens throughout schooling, making it harder for them to climb the socio-economic ladder. While parental educational background has a particularly strong influence on children's opportunities to pursue quality education in many OECD countries, poor children manage to overcome family background barriers and obtain high educational outcomes in some countries.

**Inequalities in OECD countries and emerging economies have a profoundly spatial dimension, with big differences within countries between urban and rural areas.** Income inequality is higher in cities than in other locations and tends to be even higher in the largest cities, as they attract the highly skilled workers and the most productive firms. Regional disparities concern many well-being dimensions, not only income. Such disparities tend to be larger when broader living standards measures are considered.

**The following chapter explores the evolution of these trends, starting from the consideration of income and wealth inequalities, as well as the evolution of broader living standards for different income groups of the population.** The chapter then presents evidence on equality of educational opportunities and social mobility, and concludes with an analysis of regional disparities.

21. **Over the last couple of decades, inequalities of income have risen or remained stubbornly high in various OECD countries, although these trends mask great disparities across countries and regions.** Inequalities have grown in many OECD countries and go beyond income, spanning across multiple life domains. In addition, the unequal outcomes of one generation tend to frame the opportunities of the next. For the most disadvantaged children, multidimensional inequalities start accumulating early, and achievement gaps widen throughout schooling, making it harder for them to climb the socio-economic ladder. Inequalities in OECD countries and emerging economies have a profoundly spatial dimension, with big differences within countries between urban and rural areas.

*1.1 Income inequality has risen or remained persistently high in most OECD countries, whilst falling in several emerging economies, though from significantly greater heights*

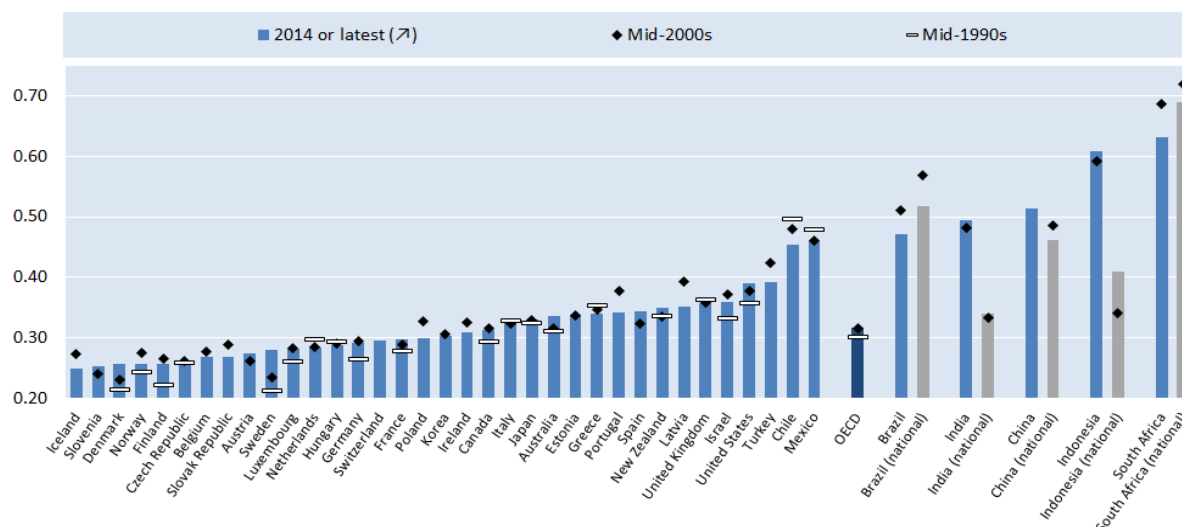
22. **Over the past two decades, income inequality has generally widened in the OECD and remains high by recent historical standards in several countries, though inequality did not evolve uniformly across countries and over time.** In 2014, average disposable income inequality in the OECD area, as measured by the Gini coefficient, had reached 0.316 up from 0.301 in the mid-1990s (**Figure 1**). Nationally, disposable income inequality stood at a higher level than it had in the mid-1990s in 13 of the 21 OECD countries where long term trends are available. Growth in income inequality has not changed uniformly over time, tending to occur in sporadic spurts, at different times across different countries since the mid-1990s. Inequality trends have been uneven across countries, suggesting that, broadly speaking, countries with rather extensive redistribution systems such as Sweden and Denmark have not been spared by the rise of inequality, but also that income inequality does not pose similar challenges to OECD countries. In addition, similar changes in income inequality, as measured by the Gini coefficient<sup>2</sup>, may mask different trends in relative progress of different income classes (**Figure 2**).

23. **In emerging economies, though poverty has fallen in many cases, income inequality remains significantly higher than among the most unequal OECD countries.** In contrast to the OECD area, some emerging economies have experienced a decrease in income inequality over the past decade (**Figure 1**), with countries like Brazil and South Africa seeing a reduction from the mid-2000s, though from very high levels. Indonesia, on the other hand, has become more unequal over time. In almost all cases, income inequality in emerging economies is still some way higher than in the most unequal OECD countries. In addition, regional disparities are growing within emerging countries (OECD, 2017).

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2 The Gini coefficient is a standard measure of income dispersion. While Gini coefficients have some limitations, notably in capturing inequality changes that control for compositional changes in the demographic structure of the population, alternative measures of inequalities point to similar findings on inequality trends.

Figure 1. Income inequality has widened in several OECD countries over the last two decades



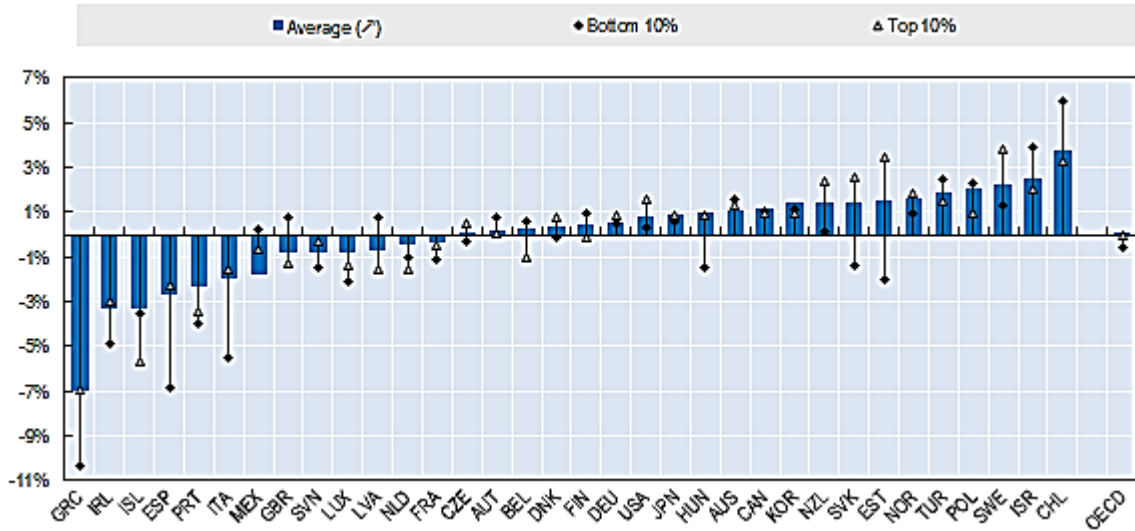
- Light grey bars refer to national estimates in emerging economies. They can differ from OECD estimates (blue bars) which use a methodology that satisfies minimal comparability requirements (both across emerging countries and with respect to OECD countries). Gini coefficients using OECD methodology (blue bars) are based on equivalised incomes. They are based on per-capita incomes in Brazil, China and South Africa, and on per-capita consumption in India and Indonesia.

Source: OECD Income Distribution Database (IDD), [www.oecd.org/social/income-distribution-database.htm](http://www.oecd.org/social/income-distribution-database.htm), as at 17-January 2017. Secretariat calculations.

24. **Rising inequality in OECD countries has, in large part, been down to richer households pulling away from their middle and lower income peers especially in countries severely hit by the financial crisis.** Over the past two decades, disposable incomes at the top have risen faster than those of the bottom 10% and even the bottom 40%. Though in the immediate aftermath of the crisis inequality initially declined in some countries, as automatic fiscal stabilisers kicked-in and top incomes took a hit, the subsequent faster growth of top incomes and weaker improvements at the bottom, partly due to the removal of anti-crisis fiscal measures and fiscal retrenchment (see also Chapter Two), have meant that income inequality has not receded in the majority of countries in the last decade (**Figure 2**). Also, market income inequality has augmented at the onset of the crisis (**Figure 3**), with the poorest households suffering from a 15% reduction of their labour income. Unemployment and underemployment patterns explain a large chunk of income losses (OECD Employment Outlook 2013).

**Figure 2. Average household disposable incomes are still below pre-crisis levels in a third of OECD countries**

Trends in real household disposable income, average annual change between 2007 and 2014 (or closest year) by income group, total population, in percentages



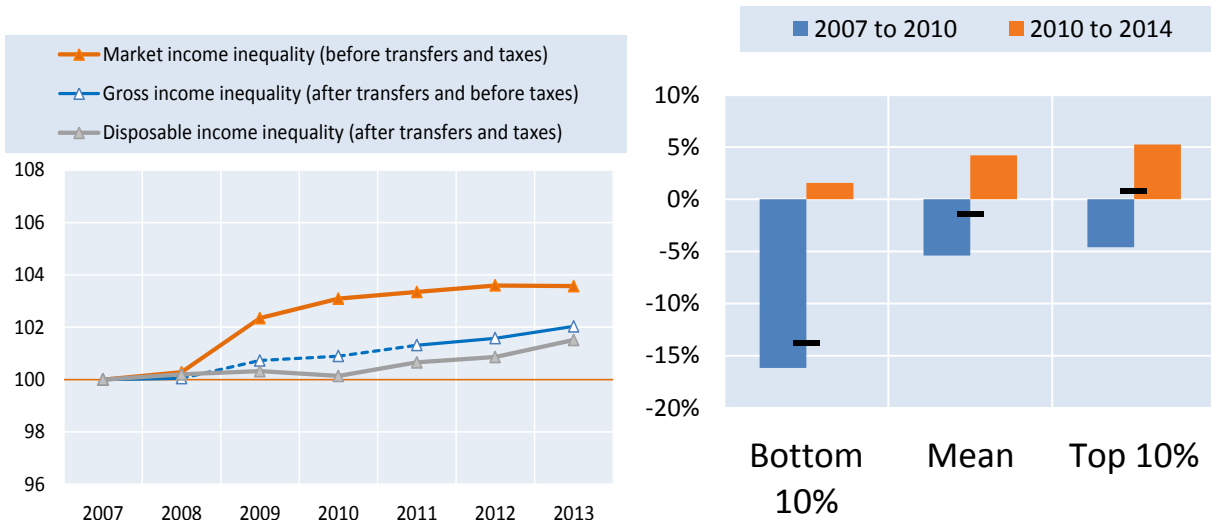
2. Data for the United States refer to 2008-2015; Data for France refer to 2008-2014; 2006-2012 for Japan; and to 2007-2013 for the other countries. Data for USA (2015) and France (2014) are provisional.

Source: Provisional data from OECD Income Distribution Database (IDD), [www.oecd.org/social/income-distribution-database.htm](http://www.oecd.org/social/income-distribution-database.htm), as at 17/01/17

**Figure 3. Poor households were strongly hit by the crisis**

Panel A Inequality before and after redistribution through transfers and taxes, respectively, 2007=100, working-age population, OECD average

Panel B Real labour income growth 2007-2014, by income group, OECD average



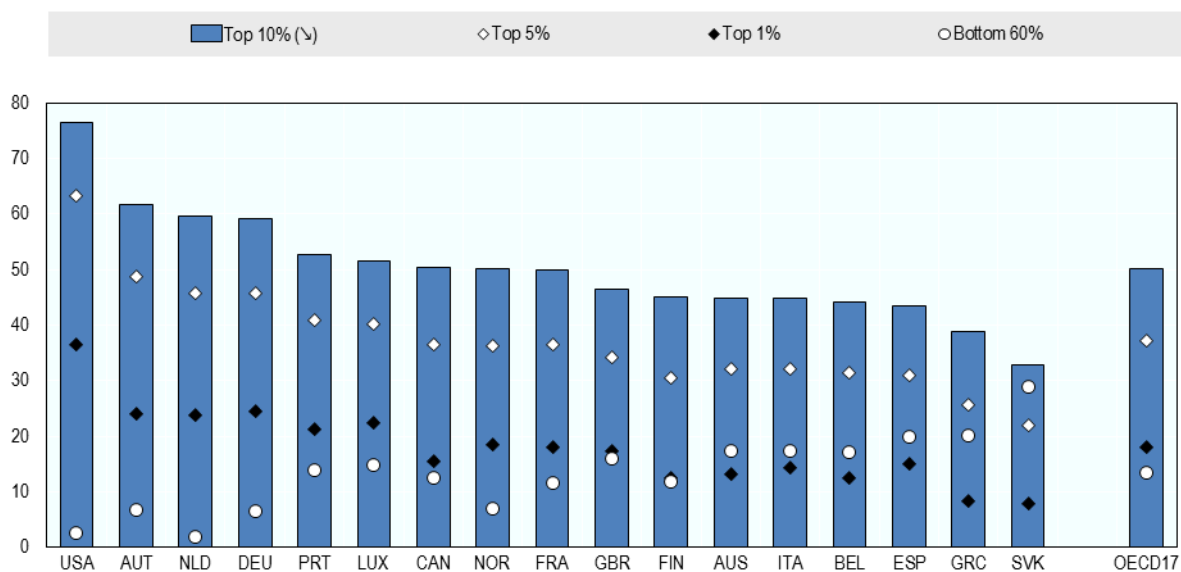
Source: OECD Income Distribution Dataset - <http://www.oecd.org/social/OECD2016-Income-Inequality-Update.pdf>

## 1.2 Wealth in the OECD is much more unequally distributed than income

25. **Across OECD countries, wealth is much more highly concentrated than income.** Wealth is most concentrated in the United States, Austria, the Netherlands and Germany. On average across the OECD countries, the 10% of wealthiest households possess half of total wealth, with the next 50% holding almost the other half, and the bottom 40% owning little over 3% (Figure 4).<sup>3</sup> In the last thirty years, tax data indicate that, in selected countries where comparable data exist, wealth inequality has grown, often linked to increases in stock and housing prices relative to wages (OECD, 2015).

**Figure 4. Wealth is highly concentrated in the hands of the top 10%**

Wealth shares of top, middle and bottom of the net wealth distribution, 2010 or latest year



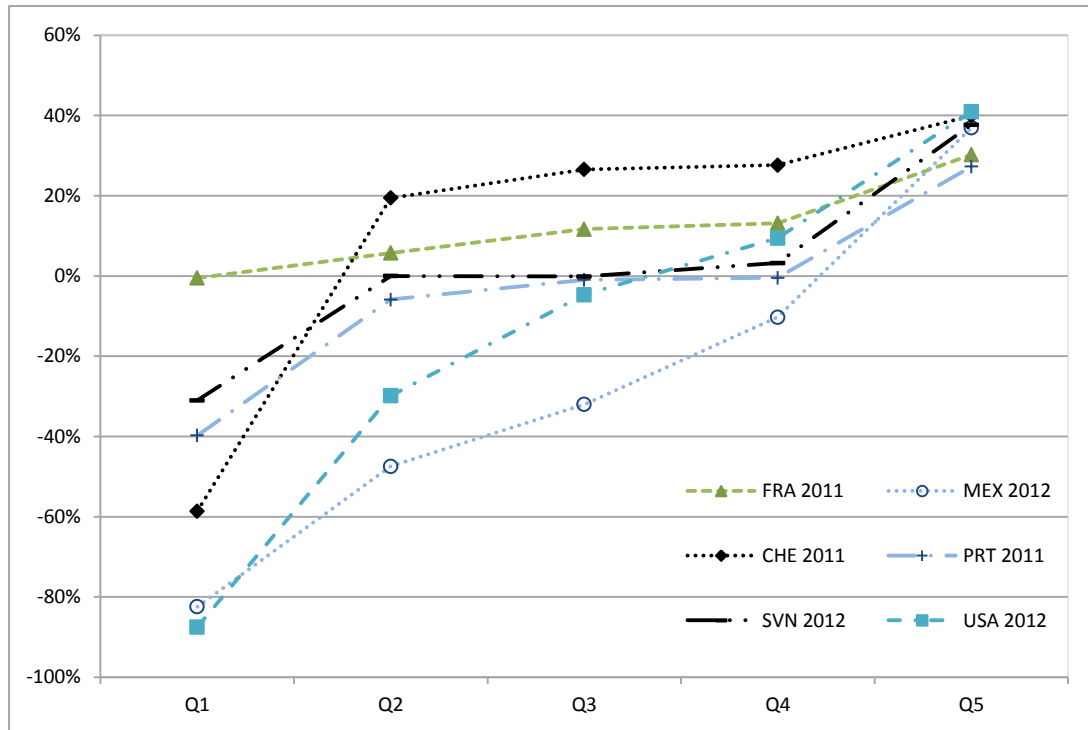
Source: OECD (2015, In It Together), Secretariat calculations from OECD Wealth Distribution Database

26. **The combination of inequality in disposable income and in savings accounts suggests that inequalities in income and savings tend to reinforce each other.** Income and wealth are correlated as higher wealth holdings, especially financial assets, generate higher capital income and, conversely, higher income results in higher wealth as saving increases with income. Recent evidence shows indeed that households from the top quintile of the disposable income distribution save three times more than the average, while households from the bottom quintile generally undergo (largely) negative savings rates (Figure 5). Large differences can be observed across countries, however. While part of wealth disparities may be due to life-cycle effects and real compositional effects of the age structure of the population, there is evidence that the correlation of wealth and income inequality has been exacerbated by characteristics of financial markets and institutions and the so called financialisation, as people with higher incomes have benefitted more than their poorer peers from credit-financed investment opportunities (Denk and Cazeneuve-Lacrouz, 2015) whilst lower-income groups have had fewer opportunities to invest in housing, education and other assets. In addition, higher-income groups are also likely to earn higher return on capital invested given their ability to bear more risk (Picketty, 2016).

3 Part of the wealth inequalities differences across countries might be related to a different population structure.



Figure 5. Rich households in savings



Note: Saving as a percentage of disposable income by equivalized disposable income quintile

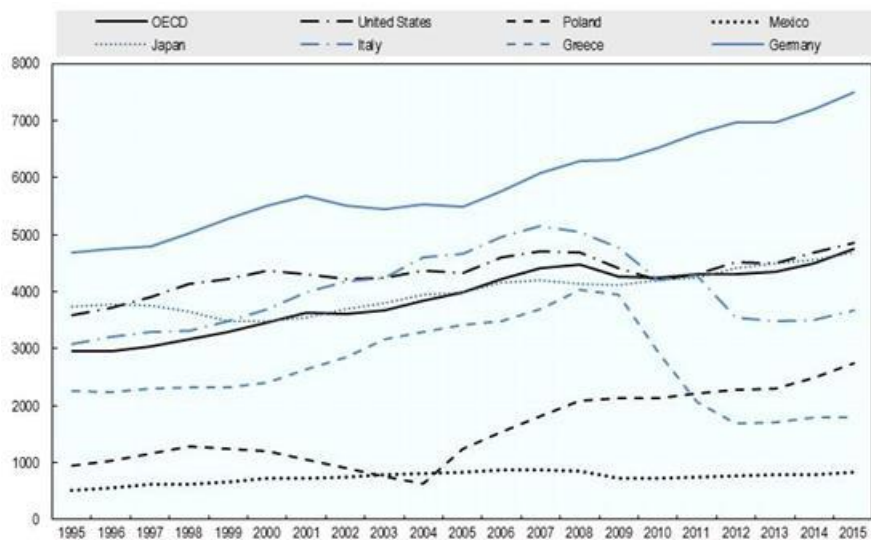
Source: Zwijnenburg, J., S. Bournot and F. Giovannelli (2017)

### 1.3 Living standards of the poor are trailing behind

27. **Taking a broader view of welfare outcomes highlights how the quality of life of the poorest households has stagnated in several OECD countries since the crisis.** The OECD has developed a broader measure of multidimensional living standards that considers job and health outcomes together with income inequality (see **Box 3**). This more comprehensive measure of economic welfare shows that, since 2008, the living standards of the poorest have stagnated in Mexico, Japan and the United States, strongly declined in Italy and Greece, whilst soaring in Germany (**Figure 6**). In all but one OECD economies, the main detractor to growth in living standards has been higher income inequality.

**Figure 6. The quality of life of the poorest households has stagnated in several OECD countries since the crisis**

Multi-dimensional living standards, 10% poorest households, selected countries 1995-2015, 1995-2015, values in constant 2010 USD



*Source:* OECD calculations based on OECD Annual National Accounts, OECD Income Distribution Database

*Note:* Multi-dimensional living standards are expressed in US dollars at 2011 PPP and calculated as a function of household average disposable income, unemployment rate, life expectancy and income inequality. The chart shows levels of living standards See Box 1 for more information on the methodology.

#### 1.4 Inequalities in the OECD countries extend far beyond income to touch many vital areas of life

28. **The gains to health in OECD countries over the last century have been remarkable, but not equally shared.** Life expectancy has risen steadily over time across the OECD, increasing on average by three months each year since 1970 as a result of improvements in education and living conditions over recent decades, a reduction in some important risk factors to health (notably tobacco smoking) and healthcare systems that are predominantly universal and that have steadily improved the quality of the care they provide. However, these health gains have not been equally shared. In particular, the poor and less educated are more likely to be in worse health and die prematurely than those in better socioeconomic circumstances. For example, a twenty five-year old man with the lowest level of education can expect to live at least four years less than a man with tertiary education across all but one of the OECD countries with comparable data (**Figure 7**). Differences are particularly large in Central and Eastern European countries.

#### Box 3. The OECD Measure of Multidimensional Living Standards

The OECD has built a measurement framework for defining the concept of Inclusive Growth. This framework has three key features: multi-dimensionality, focus on distributions and policy linkages. Based on this framework, a new measure of multidimensional living standards (MDLS) has been developed with the purpose of understanding whether aggregate income growth was moving hand in hand with well-being of individuals, as captured by MDLS.

More specifically MDLS reflect outcomes in income and non-income components of well-being and their distribution across households. MDLS at aggregate level are computed in three steps: first, one needs to measure *income-based* living standards at the individual level. Second, it is necessary to bring one or several *non-income* dimensions into the analysis and measure these dimensions at the level of individuals or groups of individuals in order to combine them with money income. Lastly, the broader living standard measure is aggregated across individuals.

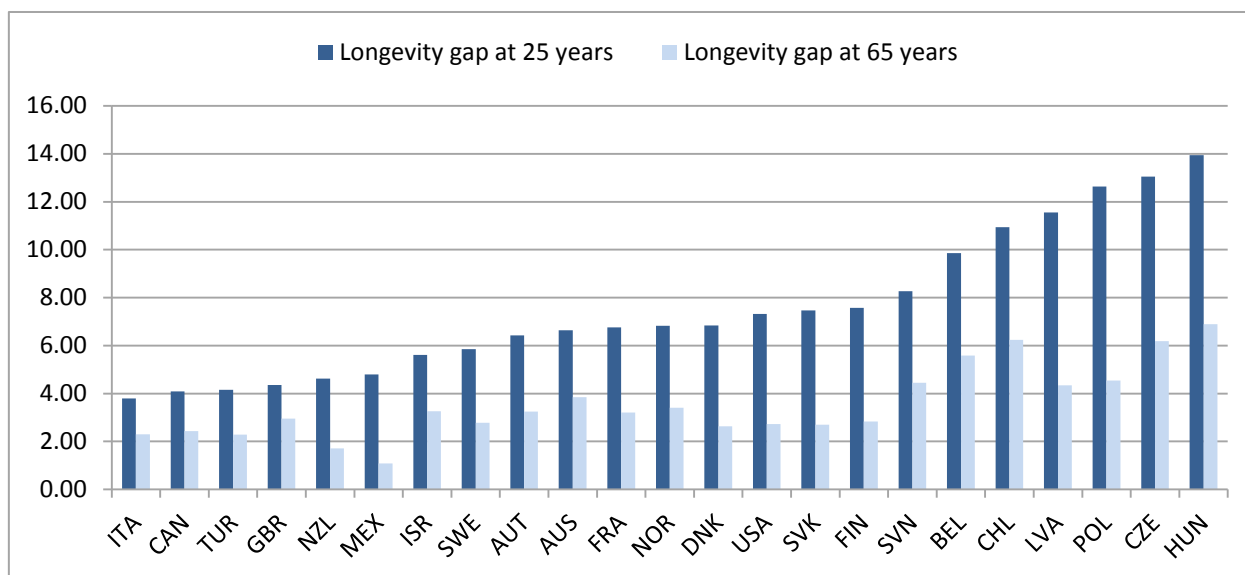
For measuring the **income dimension** of MDLS, gross household real disposable income has been chosen as the relevant indicator. Then, for **non-income dimensions**, *jobs and of health* were retained, and measured respectively by unemployment rate and life expectancy. Although these do not cover all well-being dimensions, they are highly significant determinants of people's life assessment. The second step entails the valuation of non-income factors using the method of "equivalent income" (Fleurbaey and Blanchet, 2013), which is defined as the *hypothetical income that would make an individual indifferent between her/his current situation in terms of non income aspects of life and a benchmark situation*.

The monetisation of the benefits from non-income components requires the computation of 'shadow prices'. These shadow prices can be based on several methods (see Boarini et al., 2015, for a review and Murin et al., 2015, for in-depth analysis), but it is possible to reconcile results from various methods and obtain robust estimates that fall in a relatively narrow range. Based on these estimates, a reduction of the unemployment rate by one point is deemed to be equivalent to a gain in household income of 2%, and the increase in longevity by one year to an income gain by 5%.

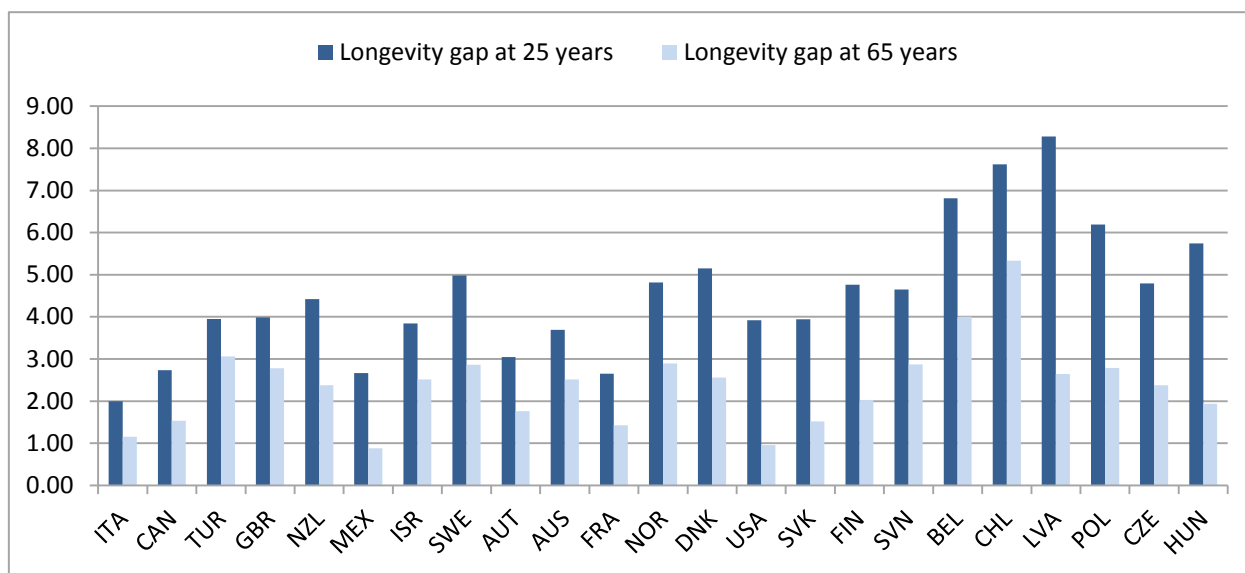
On a third step, MDLS measures are aggregated across individuals through the use of a generalised mean, which is equal to average living standards minus a penalty reflecting the inequality in living standards across individuals. Standard calibration is used to adjust the inequality penalty to the gap between average and median living standards, so that the resulting index of MDLS reflects the situation of the median household. A significant amount of empirical research has already been conducted in the area (including in testing proxies other than longevity to capture health) and continues to ascertain the robustness of results and the expansion of the measure to other dimensions of well-being and their distribution (Boarini et al., 2016).

**Figure 7. The gains to increase longevity have not been shared equally**

Figure 8. Panel a: Gap in life expectancy among men at ages 25 and 65 by educational level, 2011 (or latest year)



Panel b: Gap in life expectancy among women at ages 25 and 65 by educational level, 2011 (or latest year)



*1.5 Inequalities tend to cumulate throughout an individual's life and to tend to frame the opportunities of the next*

29. **Multidimensional inequalities often tend to accumulate throughout an individual's life, making it harder for those who start from a disadvantaged position to climb the socio-economic**

**ladder.** Inequalities of education, health, employment and earnings, wealth, and well-being compound over the life course (OECD Preventing Ageing Unequally Action Plan) and stand in a symbiotic relationship with inequalities of social capital, such as cultural exposure and access to parental networks (OECD, 2016). Together, they influence multiple well-being outcomes in childhood and later in life (Becker and Tomes, 1979; Corak, M., 2013; OECD 2015). In turn, these unequal learning and labour market outcomes contribute to growing income and wealth inequalities in adulthood, perpetuating a vicious cycle. **Table 1.1** underscores how few OECD countries demonstrate outstanding equity performance over the individual life course (cells highlighted in red signal below-OECD average performance in equity). Estonia, Japan, Korea and the Netherlands have a level of equity performance above OECD average in eleven out of twelve indicators, while most other countries have ample room for improvement to ensure a good level of learning outcomes for individuals from disadvantaged backgrounds (OECD, 2017). Chile, the Slovak Republic and the United States, in particular show below-OECD average performance on the large majority of indicators. Israel, Italy, Poland, Turkey and United Kingdom also fall behind in many indicators. In these countries, the gaps between the socio-economically advantaged and disadvantaged in access to early childhood education, learning outcomes of students and young adults, and labour market outcomes of adults are exceptionally large.

**Table 1. Unequal Outcomes tend to accumulate across the life course**

	OECD average	Australia	Austria	Belgium	Canada	Chile	Czech Republic	Denmark	Estonia	Finland	France	Germany	Greece	Ireland	Israel	Italy	Japan	Korea	Netherlands	New Zealand	Norway	Poland	Slovak Republic	Slovenia	Spain	Sweden	Turkey	United Kingdom	United States
<b>Economic indicator</b>																													
Gini coefficient (1)	0.32	0.34	0.28	0.27	0.32	0.47	0.26	0.25	0.36	0.26	0.29	0.29	0.34	0.31	0.36	0.33	0.33	0.30	0.28	0.33	0.25	0.30	0.27	0.26	0.35	0.28	0.39	0.36	0.39
<b>Early childhood</b>																													
Early childhood education experience among disadvantaged students (%) (2)	66	43	81	89	43	28	84	73	77	51	87	79	60	34	73	84	96	80	93	60	78	28	64	61	80	62	2	61	61
Net childcare costs for low income families (3)	14	14	6	7	46	m	27	0	12	13	4	4	5	41	17	m	23	0	10	23	12	11	27	10	15	4	m	8	52
<b>Student learning outcomes</b>																													
Score-point difference in science associated with one-unit increase in the index of ESCS (4)	40	43	46	48	33	38	51	39	31	31	54	46	37	39	43	31	39	32	44	52	36	39	45	46	31	38	31	48	49
Difference in science performance between students whose parents are highly and poorly educated (5)	79	62	108	98	71	93	c	86	c	39	84	94	80	66	81	49	c	55	70	82	c	121	152	111	56	59	74	87	97
Students performing below Level 2 in science (%) (6)	20	13	16	17	10	40	16	18	8	4	21	15	24	16	36	25	12	11	13	14	21	17	20	14	20	16	47	17	24
Resilient students (%) (7)	28	33	28	26	38	15	29	20	46	53	24	25	20	29	13	24	41	44	32	35	17	31	20	30	28	24	23	30	19
<b>Adults skills and labour market outcomes</b>																													
Score-point difference between 20-29 year-old adults with highly and poorly educated parents (8)	46	38	58	56	36	53	56	48	37	50	50	47	36	36	61	36	27	23	36	44	48	55	80	45	32	39	42	65	57
20-29 year-olds with poorly educated parents performing below Level 2 in numeracy (%) (9)	35	29	28	28	34	71	35	27	25	22	28	34	38	31	52	34	16	12	17	30	43	35	53	31	30	19	45	52	51
16-29 year-olds who are NEETs with poorly educated parents (%) (10)	19	18	13	9	17	16	23	11	18	8	21	13	36	21	26	25	17	17	6	13	8	26	58	18	17	13	34	29	13
Difference in employment rate between 30-65 year-olds with highly and poorly educated parents (11)	16	10	14	22	14	8	18	18	18	14	17	15	15	17	20	22	4	-1	11	3	12	30	31	28	17	12	21	15	17
Difference in earnings between 30-65 year-olds with highly and poorly educated parents (12)	5	5	5	4	4	6	5	3	4	3	5	6	2	6	3	8	4	6	4	4	4	5	5	4	5	2	6	8	12

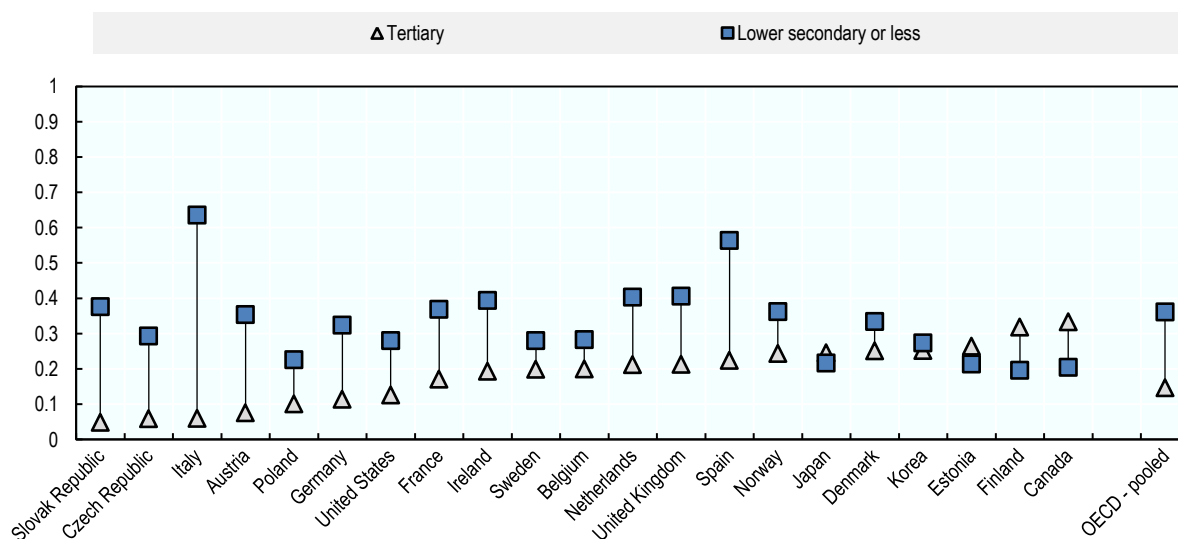
**Notes on indicators by its number:** OECD countries that participated in 2012 and 2015 Survey of Adult Skills are included in this table. (2) Percentage of students from the bottom quarter of the socio-economic profile reporting more than a year of pre-primary education. (3) Net childcare costs for a sole-parent family with two children (aged 2 and 3) and full-time earnings at 50% of the average wage. (4) ESCS refers to the PISA index of economic, social and cultural status. (5) Children whose parents are highly educated are children who have one or two parents with tertiary education (ISCED level 5 and Children with low-educated parents are children who have one or two parents who have attained secondary education (ISCED level 2) as their highest level of education. (7) A student is classified as resilient if he or she is in the bottom quarter of the PISA index of economic, social and cultural status (ESCS) in the country or economy of assessment, and performs in the top quarter of students among all countries and economies, after accounting for socio-economic status. (8, 9, 10, 11, 12) Highly educated parents are defined as at least one parent obtained tertiary education and poorly educated parents are defined as neither parents obtained upper secondary education. (12) Hourly earnings include bonuses for wage and salary earners, PPP-corrected USD.

**Sources:** (1) OECD Income Distribution Database; (2) PISA 2012 Database; OECD (2013), **PISA 2012 Results: What Makes Schools Successful (Volume IV): Resources, Policies and Practices**, <http://dx.doi.org/10.1787/9789264201156-en>, Table IV.3.34V; (3) OECD Family Database, 2012. (4) OECD PISA 2006 Database; OECD (2007), **PISA 2006: Science Competencies for Tomorrow's World: Volume 1: Analysis**, <http://dx.doi.org/10.1787/9789264040014-en>, Table 4.4c; (5) OECD PISA 2006 Database; *PISA 2006 Vol. I*, Table 4.7a; (6) OECD, PISA 2006 Database; OECD (2016g), **PISA 2015 Results (Volume I): Excellence and Equity in Education**, <http://dx.doi.org/10.1787/9789264266490-en>, Table I.2.2a; (7) OECD, PISA 2006 Database; *PISA 2015 Vol. 1*, Table I.6.17. (8, 9, 10, 11, 12) Survey of Adult Skills (PIAAC) (2012,2015) databases.

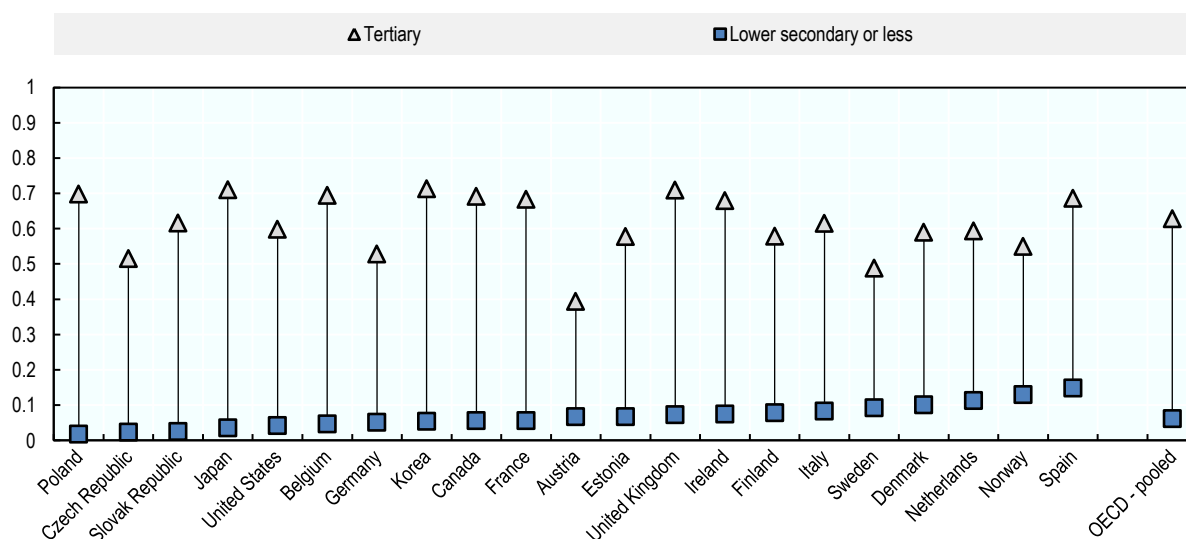
30. **Of all the factors outlined above, parental educational background plays a particularly important role in influencing children’s opportunities to pursue an education across the OECD.** On average, in the OECD, children with lower-educated parents have just a 15% chance of attaining tertiary education. Whereas, they would have been four times more likely (63%) to finish university if at least one of their parents had attained tertiary education (**Figure 8**). At the same time, children with better-educated parents are six times less likely to drop out at lower secondary level or before, compared to students whose parents have a lower educational background. There are, however, stark differences across countries. In Italy, a person whose parents did not attain upper secondary education is ten times more likely to not attain upper secondary level herself than to reach tertiary education. In Canada, Estonia, Finland and Japan the same individual will actually be *more* likely to attain tertiary education than stay at the same level as their parents. In general in emerging economies, individuals’ attainment levels are informed to an even greater extent by parental educational background, particularly for those whose parents have attained very high or very low levels of education. This is particularly salient for the children of lower educated parents in Indonesia and South Africa (OECD 2017, forthcoming). Additionally, besides cognitive skills being unequally distributed, socially disadvantaged children have also lower chances to develop strong socio-emotional skills (self-confidence and team work, among others), and access to networks that more affluent children have.

**Figure 8. Parents' education has a strong influence on child educational outcomes**

Panel a: Likelihood of educational attainment if neither parent has attained upper secondary education



Panel b: Likelihood of educational attainment if at least one parent has attained tertiary education



Source: OECD (2017, forthcoming). Secretariat calculations using OECD PIAAC.

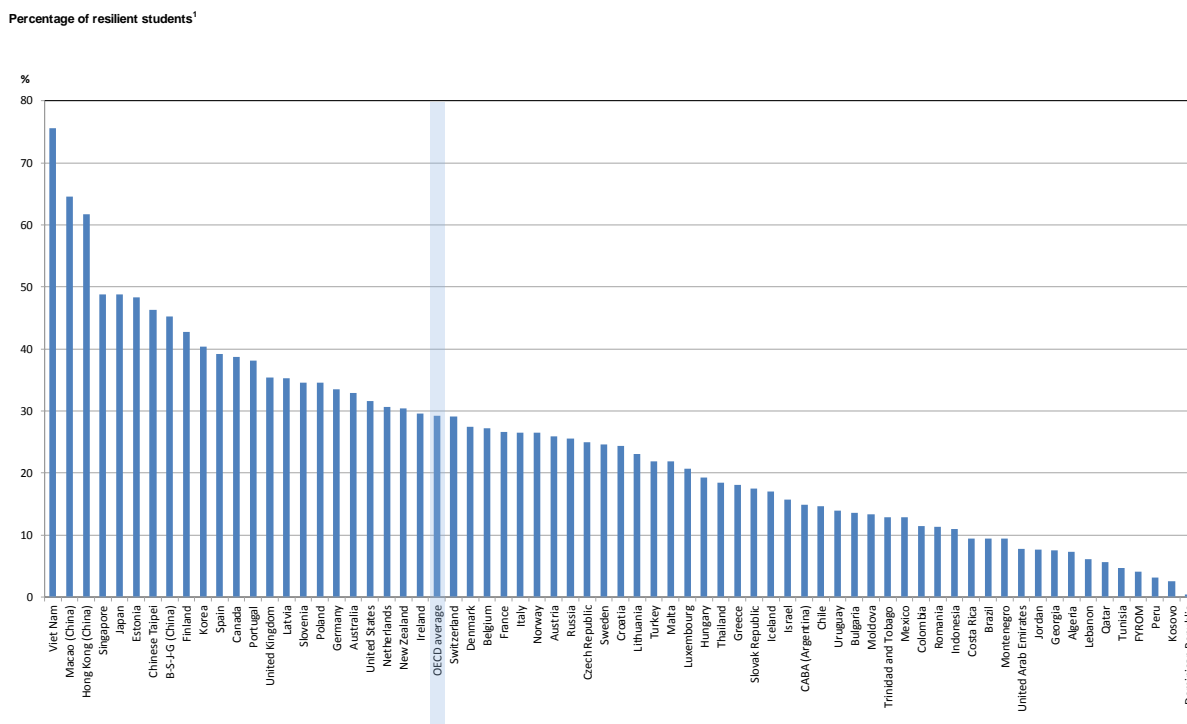
31. **In some countries, however, children with low socio-economic backgrounds do obtain high educational outcomes.** The latest OECD PISA results show that on average across OECD countries, 29.2% of disadvantaged students beat the socio-economic odds against them and score among the top quarter of students in all participating countries, after accounting for socio-economic status. These students make up over 40% of disadvantaged students in Estonia, Finland, Japan and Korea<sup>4</sup> On the other end of the scale, less than one in five disadvantaged students in Mexico, Chile, Israel, Iceland, the Slovak Republic, Greece and Hungary (**Figure 9**) can be placed in that category.

4. In PISA, a student is classified as resilient if he or she is in the bottom quarter of the PISA index of economic, social and cultural status in the country/economy of assessment and yet performs in the top quarter of students among all countries, after taking their socio-economic status into account.



**Figure 9. Some countries have higher proportion of students who were able to overcome their disadvantages**

Percentage of top-performing students with a low socio-economic background

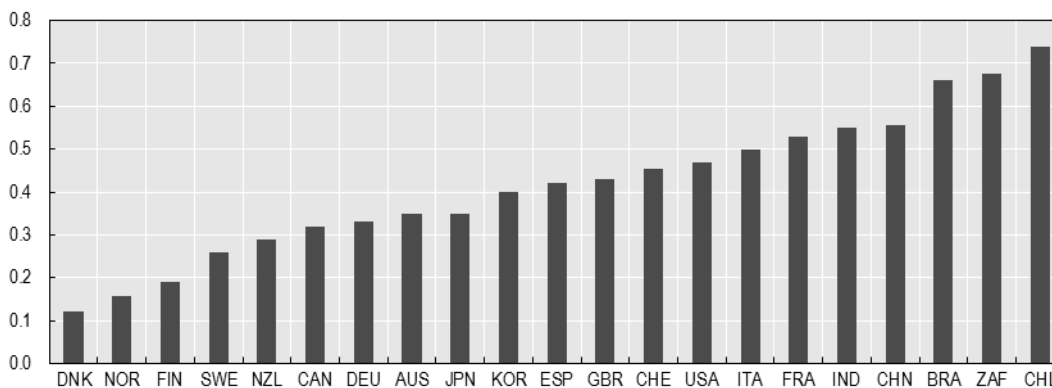


1. A student is classified as resilient if he or she is in the bottom quarter of the PISA index of economic, social and cultural status (ESCS) in the country/economy of assessment and performs in the top quarter of students among all countries/economies, after accounting for socio-economic status. Countries and economies are ranked in descending order of the percentage of resilient students. Source: OECD, PISA 2015 Database, Table I.6.7.

32. **Yet, on the whole, social mobility is low in many OECD countries.** The chances that sons earn a wage that is not correlated to what their fathers were earning, are very low in a number of OECD countries, including France and Italy, but considerably higher in the Nordic countries, New Zealand and Canada (**Figure 10**). However there is an imperfect correlation between inequality and social immobility. Although the level of income inequality in Canada and Japan is similar to, or higher than, in France and Italy intergenerational transmission is not as marked, underlining that factors other than parents' socio-economic status can influence children's labour market outcomes.

**Figure 10. Outcomes for one generation frame the potential of the next**

Persistence of earnings from fathers to sons



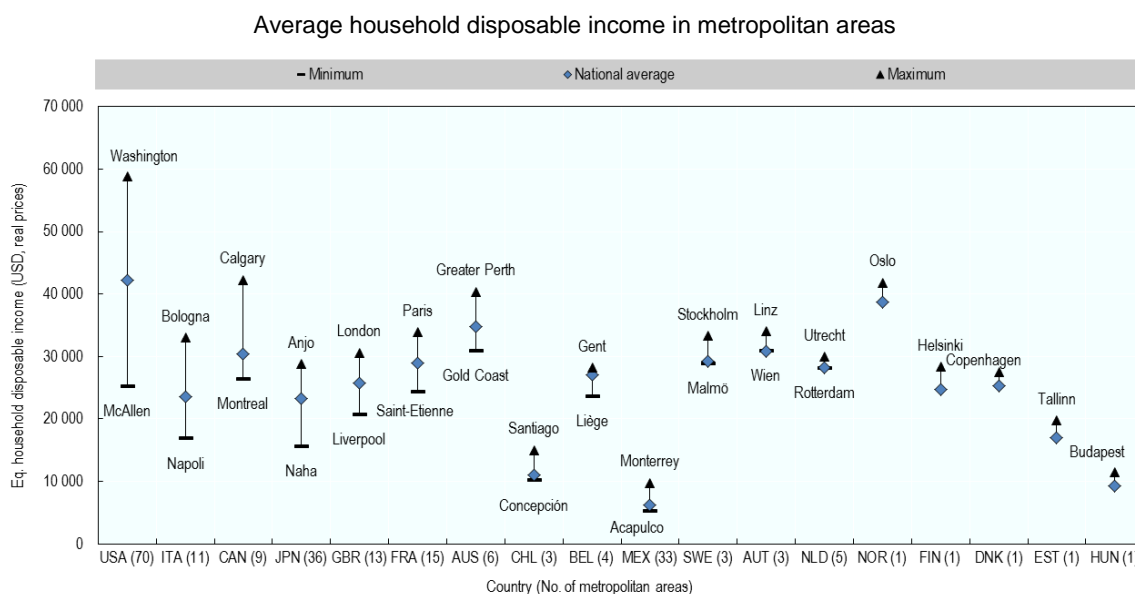
- The height of each bar represents the best point estimate of the inter-generational earnings elasticity. The higher the parameter, the higher is the persistence of earnings across generations, and thus the lower is inter-generational mobility. Estimates refer to sons and fathers of prime-age.

Source: OECD (2017, forthcoming). Estimates from Mendolia & Siminski (2015) for Australia, Chen et al. (2016) for Canada, Bratberg et al. (2007) for Denmark and Finland, Lefranc (2011) for France, Kim (2013) for Korea, Lefranc et al. (2012) for Japan, Jantti et al. (2006) for Norway and Sweden, Cervini-Plà (2015) for Spain, Gibbons (2010) for New Zealand, Bauer (2006) for Switzerland, Mocetti (2007) for Italy, Gregg et al. (2014) for the UK, Pfeiffer et al. (2014) for Germany, Piraino (2014) for South Africa, Guimaraes Ferreira and Veloso (2006) for Brazil, Chyi et al. (2014) for China, Hnatovska et al. (2014) for India and Nunez and Miranda (2010) for Chile. Comparability issues are discussed in depth in the paper.

### 1.6 Inequalities in OECD countries have a profoundly spatial dimension

33. **Many OECD countries see large regional income divides, with big differences within countries between urban and rural areas.** People living in cities earn on average 18% more than those living elsewhere, though these differences do not account for discrepancies in living costs that might significantly alter the picture.<sup>5</sup> In addition, there are large differences among cities in the same country (Figure 11). Large differences are observed in the United States, Italy, and Japan, where the average income in the most affluent metropolitan areas is almost twice as high as that in the metropolitan areas with the lowest income.

**Figure 11. Many OECD countries see large divides between cities and regions**



- The figure plots metropolitan areas, defined by the OECD as agglomerations with at least 500,000 inhabitants. For more information on the definition of metropolitan areas, see OECD (2012), *Redefining "Urban": A New Way to Measure Metropolitan Areas*, OECD Publishing, Paris. DOI: <http://dx.doi.org/10.1787/9789264174108-en>

Source: Adapted from OECD (2016), *Making Cities Work for All. Data and Actions for Inclusive Growth*. OECD Publishing, Paris.

34. **Income inequality is also higher in cities than in other locations and tends to be higher in the largest cities.** The concentration of highly skilled workers and the most productive firms in large cities as well as the existence of agglomeration economies contribute to explain these inequalities. When inequality is high in a city it might translate into people living in clearly separated neighbourhoods, a phenomenon which is known as spatial segregation. People living in disadvantaged areas often can only

<sup>5</sup> The lack of availability of comparable data on living costs at city level makes impossible to assess the extent to which differences in living costs may offset earning differences.

access lower quality public services, which might undermine their opportunities in a wide range of well-being dimensions (health, life-long learning and education, social connections, etc). In Denmark and the Netherlands, for example, spatial segregation in cities is relatively low compared with other countries, though the poorest tend to be more affected than in other countries such as Canada, France and the United States, where the levels of segregation are the highest (OECD, 2016a).

35. **Moreover, such spatial disparities tend to be larger when broader economic welfare is considered.** Regional disparities are higher in almost all OECD countries when considering multidimensional economic welfare. When looking at regions and considering together income, income inequality, jobs (unemployment rate) and health (years of life expectancy) – through the overall measure of living standards – regional disparities are higher than those in disposable income only for most OECD countries. This suggests that well-being outcomes tend to amplify the differences observed in terms of household income levels, i.e. people living in regions with high levels of income are also likely to have better jobs and health outcomes, on average. Disparities exist not only in the levels of economic welfare, but also in the different drivers of welfare over time. For instance, in Canada and France, the welfare of the top performing regions mainly increased through household income growth since 2003. However, in the case of Italy and the United Kingdom the largest contributor to welfare growth was an improvement in health outcomes. Differences in sub-national investment choices play a critical role in the spatial disparities of well-being outcomes.

## CHAPTER TWO

### UNDERSTANDING THE RISE IN INEQUALITIES: DRIVERS AND CONSEQUENCES

**A wide range of factors seem to have contributed to the rising and persistently high inequalities.** Fiscal redistribution through taxes and transfers plays a crucial role in containing the impact of market income inequality on disposable income, but fiscal policy has become less redistributive over time. More broadly, a number of longstanding structural transformations to the way OECD economies function have likely fuelled market inequalities, these include: technological change and digitalisation in connection with economic globalisation, the structure and functioning of financial markets, and changing demands for work hours and skills yielding non-standard work and job polarisation.

**Digitalisation and globalisation have had many profoundly positive impacts, but they may also have resulted in increased inequality in OECD countries.** Digitalisation and globalisation connect people, enterprises, cities, countries and continents in ways that vastly increase individual and collective potential. They provide entirely new ways for people to connect, socialise, collaborate and participate in societies; they enable the production of more and better products and services at cheaper prices, thus increasing consumers' welfare; they foster the diffusion of knowledge and technology; they spur innovation, productivity and growth and have allowed millions of people in developing and emerging economies to escape poverty and improve their living standards. Yet globalisation may also increase the difficulty for governments in taxing mobile capital income, with possible detrimental effects on inclusiveness. Digitalisation might also have impacted wage inequality and productivity growth, by exacerbating the divide between highly and low skilled workers that were not equally able to make the most of digital economy opportunities. Technological change and exposure to trade are also affecting middle workers categories in routine-task intensive occupations. Globalisation and digitalization, working in the context of fundamental policy settings are among the factors driving the disconnect between productivity growth of firms standing at the frontier and that of laggards.

**While considerable progress has been made in understanding the roots and the consequences of increased income inequality, additional efforts are needed in particular to assess the role of policies in shaping the joint evolution of inequalities and productivity.**

**The consequences of inequalities are many.** First, inequalities lower investment in human capital among the bottom 40%, jeopardising productivity growth. Second, rising inequalities put further pressure on public social budgets, as often going hand in hand with larger transfers and smaller revenues. Third, high inequalities may also be hindering trust in public institutions, constraining governments' capacity to act and weakening structural reform implementation efforts.

**The following chapter examines some of the most important drivers of rising inequalities, with a focus on understanding how these drivers are changing in a global and digital world.** Then the chapter discusses selected consequences of inequalities, including for productivity dynamics, public finance and governments' capacity to act.

## 2.1 Understanding the drivers of increased inequalities

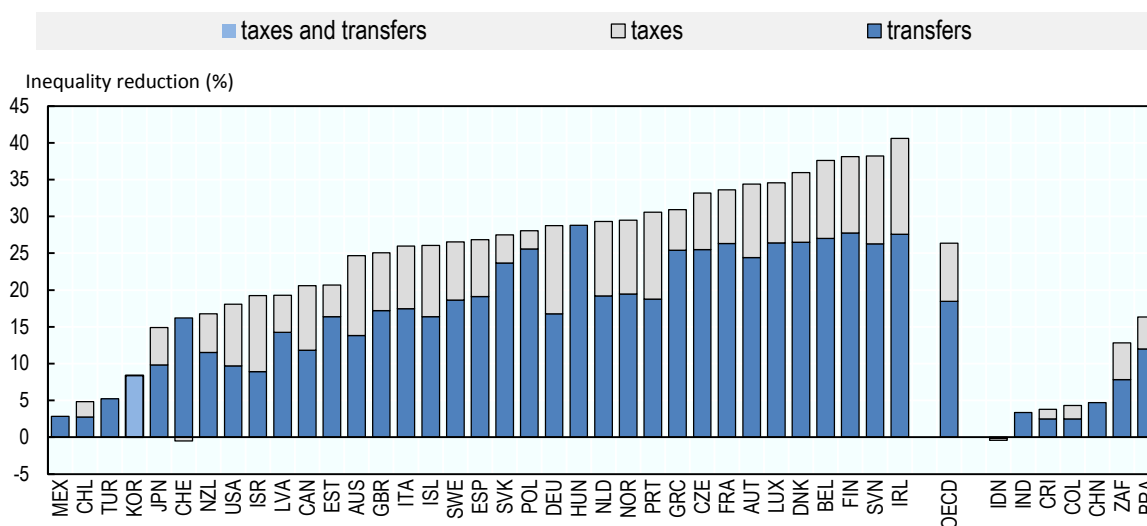
36. **A wide range of factors seem to have contributed to rising and persistently high inequalities.** Part of the increase observed in inequalities can be explained by the fact that tax and benefits systems became less redistributive over time, mainly because of the decline in the number of people entitled to transfers. Globalisation has also increased the difficulty for governments in taxing mobile capital income, and through tax planning and practices of some firms. All this may have impacted wage inequality and productivity growth. Finally, globalisation and digitalisation, working in the context of fundamental policy settings, are among the factors driving the disconnect between productivity growth of firms standing at the frontier and that of laggards.

### 2.1.1 The role of fiscal redistribution is vital for reducing market income inequality

37. **The welfare state plays an important role in redistributing market incomes<sup>6</sup> and reducing the gap between richer and poorer households in the OECD.** Such redistribution<sup>7</sup> is sizeable and, as measured by the percentage reduction in Gini coefficient, amounts to one fourth (25%) among the working-age population, on average across OECD countries (**Figure 12**).<sup>8</sup> The extent of redistribution varies highly across countries, ranging from less than 10% in Korea, Turkey, Chile and Mexico (3%) to close to 40% in Ireland, Slovenia or Finland. Redistribution is much lower in emerging economies, reducing inequality by more than 10% in Brazil (16%) and South Africa (13%) and by between 3% and 5% in China, Colombia, Costa Rica and India.

**Figure 12. The welfare state plays a crucial role in redistributing market incomes in OECD countries, but is less prominent in emerging economies**

Redistributive effect of taxes and transfer, 2013/14 (or latest year available) Relative reduction in market income inequality (Gini coefficient) due to taxes and transfers (working-age population)



Note: Data refer to 2015 for the Chile, Costa Rica, Israel and United States, 2013 for Belgium, Brazil, Colombia, Czech Republic, Estonia, Germany, Ireland, Italy, Luxembourg, Poland, Portugal, Slovak Republic, Sweden, Switzerland, Turkey and United Kingdom,

6. Gross labour and capital incomes.

7. Here defined as cash transfers and personal income tax and social security contributions.

8. For the United States, the tax/benefit system becomes more redistributive when accounting for in-kind health insurance benefits (such as Medicare/Medicaid). See, for example, table 3: of Burkhauser, Larrimore, and Simon, National Tax Journal, March 2012.

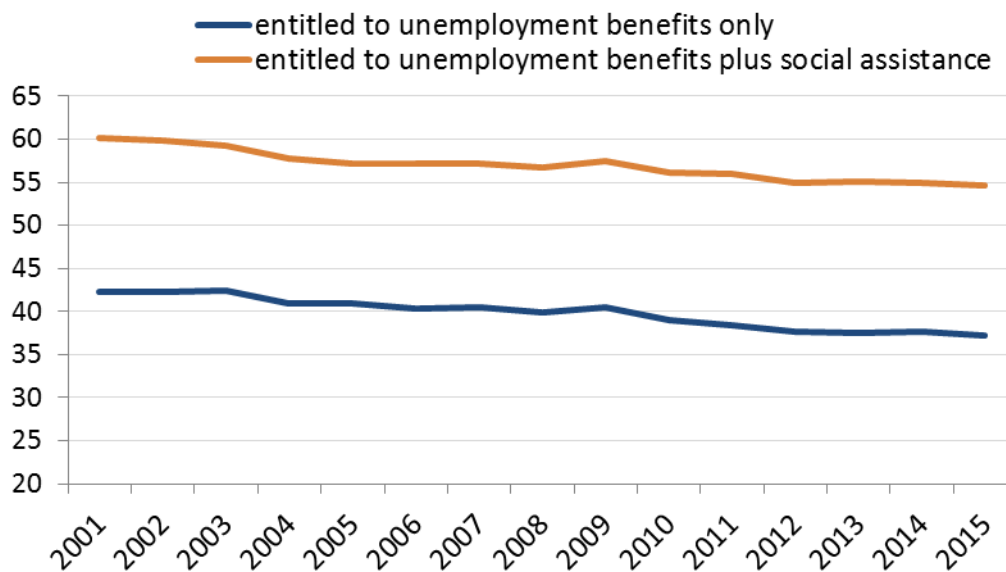
2012 for Japan and South Africa, 2011 for China and India and 2014 for the remaining countries. Data for Austria, Brazil, Canada, China, Colombia, Costa Rica, Denmark, Finland, France, Greece, India, Indonesia, Iceland, Israel, Latvia, New Zealand, Norway, Slovenia, South Africa, Spain, and the United States are preliminary. For Korea, no distinction between taxes and transfers can be made. No data on taxes available for China, Hungary, India, Mexico, and Turkey.

Source: OECD (2016), OECD Income Distribution Database (IDD), [www.oecd.org/social/income-distribution-database.htm](http://www.oecd.org/social/income-distribution-database.htm) and OECD (2017a forthcoming)

38. **Many tax and benefit systems became less redistributive between the mid-1990s and mid-2000s** (OECD 2015, OECD 2017 and Causa and Hermansen, 2017 forthcoming). During this period falls in redistribution were particularly strong in Finland, Israel, Sweden, the Netherlands and Denmark.<sup>9</sup> The main reasons for this decline are found on the benefit side: cuts to benefit levels (**Figure 13**), tightening of eligibility rules to contain expenditures for social protection and the failure of transfers to the lowest income groups to keep pace with earnings growth. The most important benefit-related determining factor in overall redistribution, however, has been the decline in the number of people entitled to transfers, as a result of tighter unemployment benefit eligibility rules and broader changes to the labour market including the rising share of non-standard labour contracts. Only in Israel and the United Kingdom income taxes had instead a stronger impact on the trend of declining redistribution than benefits. In Germany and Norway redistribution increased between the mid-1990s and mid-2000s, largely as a response to a considerable increase in market income inequality (OECD 2011).

**Figure 13. Unemployment benefits have become less generous in the OECD**

Average net replacement rate over a long period of unemployment, for four family types and two earnings levels, in %



Notes: Net replacement rates are calculated as after-tax income of benefit entitlements when unemployed divided by after-tax income when in work. Average for 28 countries, accounting for benefit receipt during each month of a "long" (60-month) unemployment spell, four family types (singles and married couples with and without children), and two earnings levels (full-time work at 67% and 100% of the average wage, AW). For married couples the percentage of AW relates to the previous earnings of the "unemployed" spouse only; the second spouse is assumed to be "inactive" with no earnings and no recent employment history. Where receipt of social assistance or other minimum-income benefits is subject to activity tests (such as active job-search or being "available" for work), these requirements are assumed to be met. Children are aged four and six and neither childcare benefits nor childcare costs are considered.

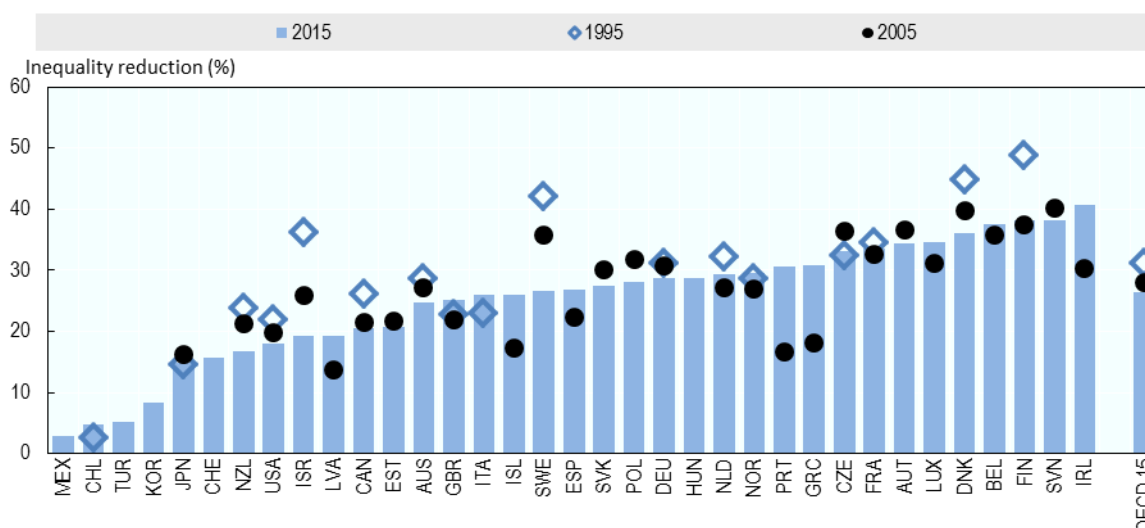
Source: OECD Tax-benefit models ([www.oecd.org/els/soc/benefits-and-wages.htm](http://www.oecd.org/els/soc/benefits-and-wages.htm)).

<sup>9</sup> It should be noted that, when the transfer system is very generous, as in Sweden and Norway, reducing transfer schemes may also strengthen the incentives to participate in the labour market, resulting in higher employment and income and ultimately in reduced labour market inequality.

39. During the early phases of the global financial crisis, redistribution helped cushion increases in market income inequality, but its role has since tended to fall in a majority of OECD countries in the most recent years (Figure 14). In Europe, this has been largely due to the softening of automatic stabilisers as the economy has recovered. In other countries, it reflects the phasing out of fiscal stimulus, as in the United States, where the extension of unemployment benefit duration carried out in 2008-09 was rolled back in 2011. In the European case, weaker redistribution has also resulted from fiscal consolidation measures pursued in response to rising fiscal deficits (OECD, 2016p) and in quest of financial and macroeconomic stability. On average across OECD countries, redistribution is currently 2 percentage points lower than in 2005. Redistribution fell particularly in Sweden, Israel and New Zealand, while it increased in countries hit harder by the crisis such as Portugal, Greece, Ireland and Iceland.

**Figure 14. The impact of redistributive policies on cushioning market income inequality diminished over time**

Trends in redistribution, 1995-2014/15 (or latest year available); Percentage reduction in market income inequality (Gini coefficient) due to taxes and transfers across OECD countries (working-age population)



Note: See previous chart for more information on year availability.

Source: OECD Income Distribution Database (IDD), [www.oecd.org/social/income-distribution-database.htm](http://www.oecd.org/social/income-distribution-database.htm)

### 2.1.2 Globalisation has increased the difficulty for governments in taxing mobile capital income

40. Increased levels of capital mobility have led to certain reductions in statutory income tax rates and in some cases to a greater reliance on less mobile tax bases, which has reduced the progressivity of tax systems and contributed to increased inequalities. The mobility of capital has led to increased tax competition and a trend towards lower statutory corporate income tax rates, as countries seek to attract investment. There is also some evidence that jurisdictions are not only engaged in tax competition with respect to the corporate income tax system, but also with respect to the personal income tax system, creating tax incentives to attract the tax residency of high-net-worth individuals for tax purposes, with a view to taxing their personal income at low rates (Kleven, Landais, Saez, & Schultz, 2013; Kleven, Landais, & Saez, 2013). In addition, tax reforms that do not equalise rates across entities create strong incentives to avoid taxes by re-categorising income (for example, earning income by selling one's labor through an S-corp rather than through individual income). These phenomena also drive down top tax rates and have meant that governments have increasingly sought to use taxes on less mobile bases to finance their expenditure. The distributional effects of these reductions in statutory tax rates, especially the reduction in top personal income tax rates, has been a contributing factor to the rise in inequalities. In addition, many high income individuals have used tax havens as a means to shelter income and assets offshore. While in recent years the work of the Global Forum on Transparency and the Exchange of

Information for Tax Purposes and the OECD's ongoing work on the exchange of information have been having a real impact, with estimates of the size of offshore assets ranging from USD 6.1 to 7.6 trillion (Pellegrini et al., 2016; Zucman, 2014), the use of tax havens over recent decades may have reduced the overall progressivity of the tax system and contributed to an increase in inequalities.

### ***2.1.3 Globalisation and digitalisation might have impacted wage inequality and productivity growth***

41. **Globalisation and digitalisation shape economies and societies and their effects reach well beyond the economic sphere.** Globalisation and digitalisation coin the daily life of everyone, making news from around the world available instantly, connecting people between countries through social media, increasing personal mobility, increasing our consumption possibilities and making basic knowledge available to everybody thanks to internet access. These represent large benefits for our societies.

42. **At the same time globalisation and digitalisation are at the core of policy and academic discussions regarding the rise in inequalities because of their impact on work, societal organisation and economic growth.** The effects of globalisation and digitalisation on income inequality have been hotly debated, in part because they are both outcomes of fundamental policy settings that are heterogeneous across countries. Evidence indicates that globalisation may have helped to reduce cross-country income inequality, as millions of people were lifted out of poverty and into an emerging middle class in developing countries (Milanovic, B. 2016). The evidence for intra-country inequality is mixed (Bourguignon, 2016, OECD, 2011), but it is plausible that globalisation and digitalisation may have contributed to widening the income distribution in OECD countries (OECD 2011), an issue which will be explored in greater detail in what follows. Looking ahead, digitalisation and (to a lesser extent) globalisation could have a profound impact on inequalities moving forwards (see **Box 4**, which provides an illustrative example on data).

#### **Box 4. The Data Economy: opportunities and risks from an Inclusive Growth perspective**

With the advent of the digital revolution, so called 'big data' and data collection processes have taken on increased significance in economic activity. Consequently, the issues surrounding data - how it is collected, who owns it and how it is used - are becoming ever more important to policy makers. However, comprehensive understanding of data and its extraction, applications and wider implications remain limited.

Broadly speaking, data has no intrinsic value. Rather, its value is dependent on complementary factors related to the capacity to extract information and apply it analytically for commercial gain. It is also inherently non-rivalrous, meaning that it can be used repeatedly and displays increasing returns, though it is excludable in the sense that it is possible to withhold access to non-paying consumers.

Data analytics have the potential to offer large benefits to societies and economies, leading to more effective decision making through the exploitation of an ability to conduct low cost and rapid experiments and the use of autonomous machines and systems able to learn from previous situations. This could lead to accelerated decision-making process, higher productivity and in some cases may even eliminate the need for human intervention.

Yet some of the fundamental properties of data, and how it is collected and used, raise important questions for policy makers. If left unchecked, data driven innovation may undermine the social fabric on which democratic market societies are based. This results from the fact that the growing information asymmetry embodied in the rise of 'big data' has tended to lead to shifts in power that show no signs of abating. In particular, there have been power shifts away: from individuals to organisations (consumers to businesses, citizens to governments); from traditional businesses to data-driven businesses, inducing the risk of market concentration and dominance; from governments to data-driven businesses, which can gain much more knowledge about citizens (and politicians) than governments can; and from lagging economies to data-driven economies. If unaddressed, this could exacerbate existing inequalities and lead to a new digital data divide.

The increased prominence of data also raises concerns for privacy. Comprehensive data collection can lead to the loss of privacy, with advances in data analytics making it possible to infer sensitive information, including from apparently non-personal data (e.g. meta-data). The misuse of such insights can affect core social values and principles, such as individual autonomy, equality and free speech. Discrimination enabled by data analytics, for example, may result in greater efficiencies, but also limit an individual's ability to escape the impact of pre-existing



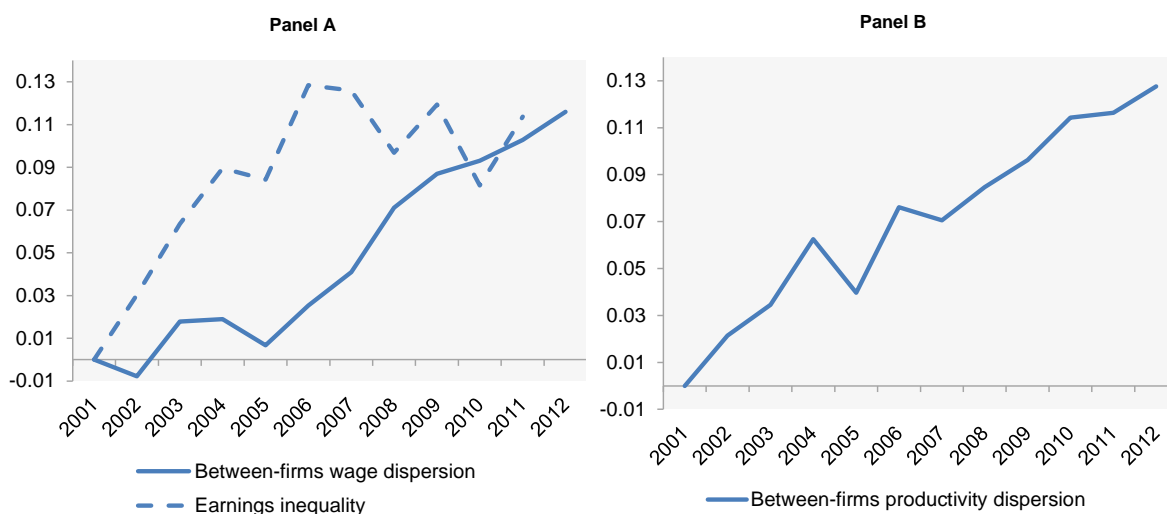
socio-economic factors. Meanwhile the applicability of core principles on which privacy protection relies (e.g. the definition of personal data and the role of consent) is being challenged.

Source : OECD 2015, Data Driven Innovation

43. As economies have become more globalised and technological change has become more pervasive, a steady increase in earnings inequality has been observed in many OECD economies. This spurt in earnings inequality (the solid line in **Figure 15**, panel A) has been driven by an increased pay differentials across firms, as shown in Figure 15 (dotted line, panel A) and by an increasing productivity dispersion across firms (**Figure 15**, panel B). These twin trends have been documented for several OECD and non-OECD economies (Germany, Italy, the United Kingdom and the United States, Denmark, Portugal, Sweden and Brazil) and seem to have their common root in globalisation and information and communications technology (ICT) diffusion (Berlingieri, Blanchenay and Criscuolo, 2017)<sup>10</sup>. At the same time, it is interesting to observe that the flattening in the measure of earnings inequality since the crisis has not been accompanied by a similar fall in between-firm wage dispersion, indicating that a diverse set of forces are at work.

**Figure 15. The great divergence in wage and productivity**

Wage and productivity dispersion over time within sectors and countries.



Note: The figure in panel A [B] plots the estimated year dummies of a regression of log-wage [productivity] dispersion (90<sup>th</sup> and 10<sup>th</sup> percentiles ratio) within country-sector pairs, using data from the following countries: AUS, AUT, BEL, CHL, DNK, FIN, FRA, HUN, ITA, JPN, NLD, NOR, NZL, SWE. The line referring to overall inequality plots the year fixed effects of a similar regression using the dispersion in earnings from the OECD Earnings Distribution database within each country. The data on overall inequality are only available at the country level and for a more limited set of countries: FIN, FRA, HUN, JPN, NOR, NZL for the whole period; AUS, ITA, SWE from 2002; and NLD between 2002 and 2010. Source: Berlingieri, Blanchenay and Criscuolo, 2017.

44. The OECD’s work on the *Productivity-Inclusiveness Nexus* has outlined a number of potential common drivers for the dispersion in both productivity and wages and some of these drivers are fundamentally linked to globalisation. For instance skill-biased technological change,

10 For Germany see Baumgarten, (2013); Card, Heining, et al. (2013); Goldschmidt and Schmieder, 2015. For Italy Card, Devicienti, et al., 2014, the UK Faggio et al., (2010) and the US Dunne et al., 2004; Barth et al., 2014; Song et al., 2015), and non-G7 countries, such as Denmark (Bagger et al., 2013), Portugal (Card, Cardoso, and Kline, 2016), Sweden (e.g. Hakanson et al., 2015) and Brazil (Helpman et al., forthcoming)

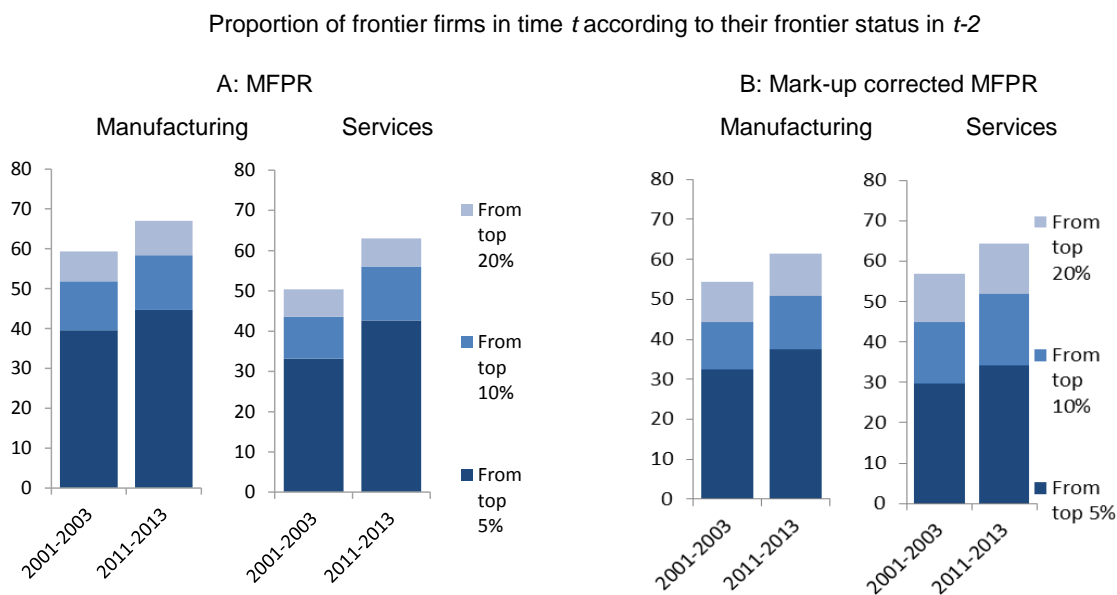
through the rise of ICT, increases the productivity and the demand of high-skilled workers and jobs with non-routine tasks, thus raising their relative wages vis-à-vis low-skilled workers and for jobs with routine tasks (Card and Di Nardo, 2002; Autor and Acemoglu, 2011). Similarly the increase in import penetration and offshoring has put workers in direct competition with low-skilled low-paid workers in developing countries (e.g. China starting in the late 1990s), bringing down their wages and increasing wage inequality (Autor, Dorn, Hanson, 2013). More recent OECD work (Berlingieri, Blanchenay and Criscuolo, 2017) finds that globalisation and digitalisation are not only associated with an increase in between-firm wage inequality, but also strengthen the link between wages and productivity dispersion.<sup>11</sup> To the extent that a generalised increase in the dispersion of productivity - which has characterised many economies in recent decades (see **Figure 15**, panel B) and is correlated with wage dispersion - can be expected to continue, globalisation and digitalisation will likely result in even stronger increases in wage inequality unless specific policies are put in place to counter these negative effects.

45. **Work on the *Productivity-Inclusiveness Nexus* has also suggested that globalisation and technological change may have helped enable frontier firms to achieve superior productivity performance (Figure 15).** Frontier firms are typically larger, more profitable, have better access to financial leverage, are more likely to apply for patents than other firms and are often better-placed to rapidly diffuse and replicate cutting-edge ideas, technologies and business models. They commonly operate across different countries (typically as part of an MNE group), interconnected with suppliers and customers from different countries and are thus well-placed to take advantage of the gains from trade in global value chains (GVCs) and greater international tax competition. This gives them a competitive advantage over their lagging counterparts, who have fallen behind, to enhance productivity and pay consistently higher wages to their staff. In sectors with high concentrations of Knowledge Based Capital (KBC) and strong uptake in Information Communication Technologies (ICTs), characterised by network externalities (a type of natural monopoly), frontier firms may even be benefitting from strong concentration of market powers through the accrual of rents (**Figure 16**) with competition policy lagging behind these developments. Lagging firms, which are often smaller, less globally engaged, and pay lower wages, are held back by a variety of barriers in their internal capabilities, such as limited skills and innovation absorption capacities, and in the external business environment. This also includes fundamental policies ranging from constrained housing markets to lack of managerial knowhow to regulated services, as well as poorly functioning financial markets that can both constrain access to finance to well-performing firms and may constrain exit through evergreening of loans to poorly performing firms.

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11 The work has been carried out in the context of a wider OECD-STI project called MultiProd, aimed at studying productivity patterns across countries using a distributed micro-data approach. For more information see: <https://www.oecd.org/sti/ind/multiprod.htm>

**Figure 16. Entry into the global frontier has become more entrenched amongst top quintile firms**



Notes: The figure shows the proportion of firms classified as global frontier firms at time  $t$  – i.e. in the top 5% of the industry MFPR or mark-up corrected MFPR distribution – according to their status two years earlier ( $t-2$ ). Estimates are averaged over each three year time period. For example, Panel A shows that on average over the period 2011-2013 in services, 43% of frontier firms (i.e. top 5%) were present in the frontier grouping two years earlier, while amongst the firms that entered the frontier grouping, 13% had MFPR levels in the top 5-10% (top 10%) and 7% had MFP levels in the top 10-20% (top 20%). Source: Andrews, Criscuolo and Gal (2016); see details therein.

46. **Country specific policy features also play a role in shaping the evolution of wage and productivity dispersions, the link between them, and how this role may be affected by these global trends.** Berlingieri, Blanchenay and Criscuolo (2017) focus on the role of pay setting institutions and labour market features, e.g. i) minimum wages (both in terms of hourly real minimum wage and the minimum relative to average wages of full-time workers); ii) employment protection legislation (strictness of employment protection for both individual and collective dismissals); iii) trade union density and; iv) coordination in wage setting.<sup>12</sup> The results of this analysis suggest that all of these policies have the intended consequence of reducing wage dispersion and hence overall inequality. At the same time, they significantly affect the link between wage and productivity dispersion. For instance, more centralized bargaining, and to a lesser extent higher employment protection legislation, are associated with a weaker link between productivity and wage dispersion; while this is not the case for changes in union density, whose effect is not significant. Tighter employment protection legislation and more centralised bargaining can therefore help limit wage dispersion, but at the same time weaken the link between wages and productivity. Additional work on the role of bargaining and wage setting systems is under way at the OECD in the context of the reassessment of the OECD Job Strategy; this work will be embedded in future

12 A significant amount of evidence has been gathered on the role of policy and institutions for explaining the observed increase in wage dispersion, in particular the decline in real minimum wage (DiNardo et al., 1996) and for the UK and the US in unionisation (e.g. Card, Lemieux, et al., 2004, and for an overview Machin, 2016). For continental European economies the focus has been on the centralization level of bargaining, given that, even in countries with low union densities, bargaining agreements are generality extended to non-unionised workers (see Card and Rica, 2006, Dell’Aringa and Pagani, 2007, and more recently Dahl et al., 2013). Recent studies based on longitudinal matched employer-employee data (e.g. Dahl et al., 2013, using Danish data), suggest that decentralization of wage bargaining is associated with higher wage dispersion. They also find evidence that under firm level bargaining wages are more likely to reflect individual productivity, thus their result might also suggest a stronger alignment between firm-level wages and productivity distributions.

stages of the OECD Inclusive Growth initiative to further clarify the impacts of bargaining on productivity and wage dispersion dynamics.

47. **Part of the analysis behind the Nexus remains exploratory and needs to be corroborated by additional research.** Understanding the Productivity-Inclusiveness Nexus is an unfinished job. There are countries for instance where the dispersion of productivity across firms is still poorly understood. For instance, evidence based on French data suggests that productivity gains at the frontier have been less persistent than in the past, suggesting that the breakdown of the diffusion machine may not be a long-term phenomenon. In Switzerland, productivity growth remains low even through inequality did not rise. In those countries where productivity dynamics have been stagnating despite unchanged and even relatively low levels of inequality, different drivers of productivity should be tackled and the type of policy solutions may obviously be different.

48. **Additional explanations of the Nexus should be further explored, including the one relying on the “Fissured workplace”.** There is still an intensive debate on what may determine the joint evolution of increased market inequalities and productivity dispersion among firms. Another explanation suggests that the declining labour share observed in many advanced and emerging economies can be accounted for by the increased tendency of multinationals to outsource many activities implying that workers are employed below the level where the value is captured (Weil 2014; ILO Global Wage Report, 2017).

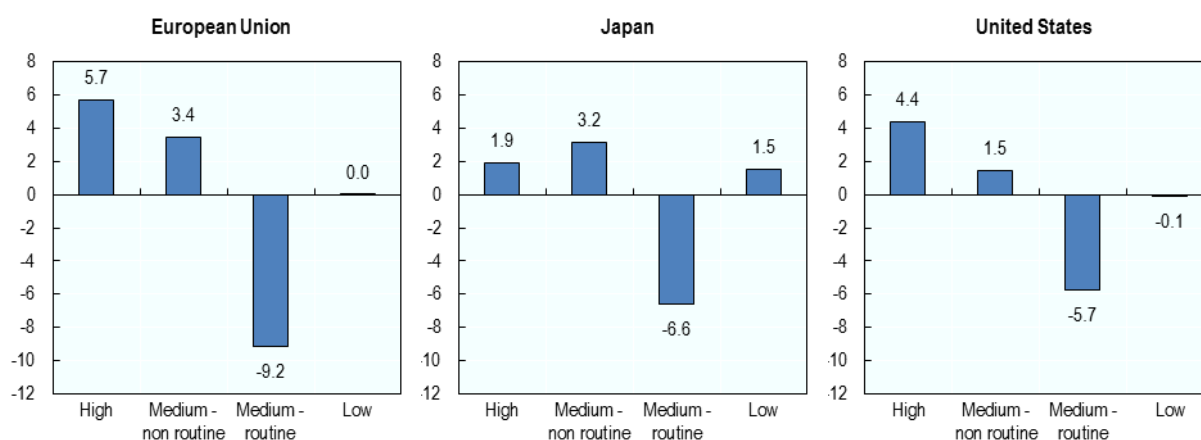
49. **Indeed the structural shift towards more temporary, part-time work and self-employment has likely also contributed to market income inequality growth, but additional OECD work should be conducted to further ascertain this question.** Both temporary and part-time jobs have increased in a majority of the EU countries. The increases in temporary employment during the pre-crisis period were particularly large in Poland, Portugal and Spain, with growth at over 10%. Similarly, there was rapid growth in part-time work during the 1980s and early 1990s and the average incidence of part-time employment rose during the crisis, increasing from 15.4% in 2007 to 16.8% in 2015 across the OECD. In addition, digitisation and automation have led to significant changes in occupational structures and, in particular, a decline in the demand for workers with mid-level skills.<sup>13</sup> Many but not all OECD countries have seen ‘job polarisation’ with the hollowing out of the middle of the distribution by skill level, as a growing share of the workforce is working either in high-skill non-routine, such as those involving interpersonal skills or creativity, or in low-skill non-routine, low-paid jobs, such as food services and security (**Figure 17**). In theory, however, an increase of temporary employment could be associated with a reduction or an increase of income inequality. On one hand, part-time work and self-employment may supplement one's existing part-time or full-time income, thereby potentially reducing the wage gap. For example, Krueger and Hall's 2016 study found that 61 percent of Uber drivers had a part-time or full-time job in addition to driving Uber. Part-time work may also supplement income for workers while they are searching for new work. On the other hand, part-time work resulting from an inability to find a full-time job may contribute to income inequality growth. Further work should be done by the OECD to assess the net impact of these two possibly counteracting forces.

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13 For example Autor et al., 2015 find that exposure to both technology and trade negatively impact the middle category of routine-task intensive occupations. The study also finds that the exposure to trade has also negative employment effects throughout the distribution, unlike the exposure to technology.

**Figure 17. Labour markets have polarised across occupations**

Percentage point changes in employment shares by occupation, 2002-2015



Source: OECD (2016) Secretariat estimates based on EU-LFS, Japanese Labour Force Survey, BLS Current Population Survey

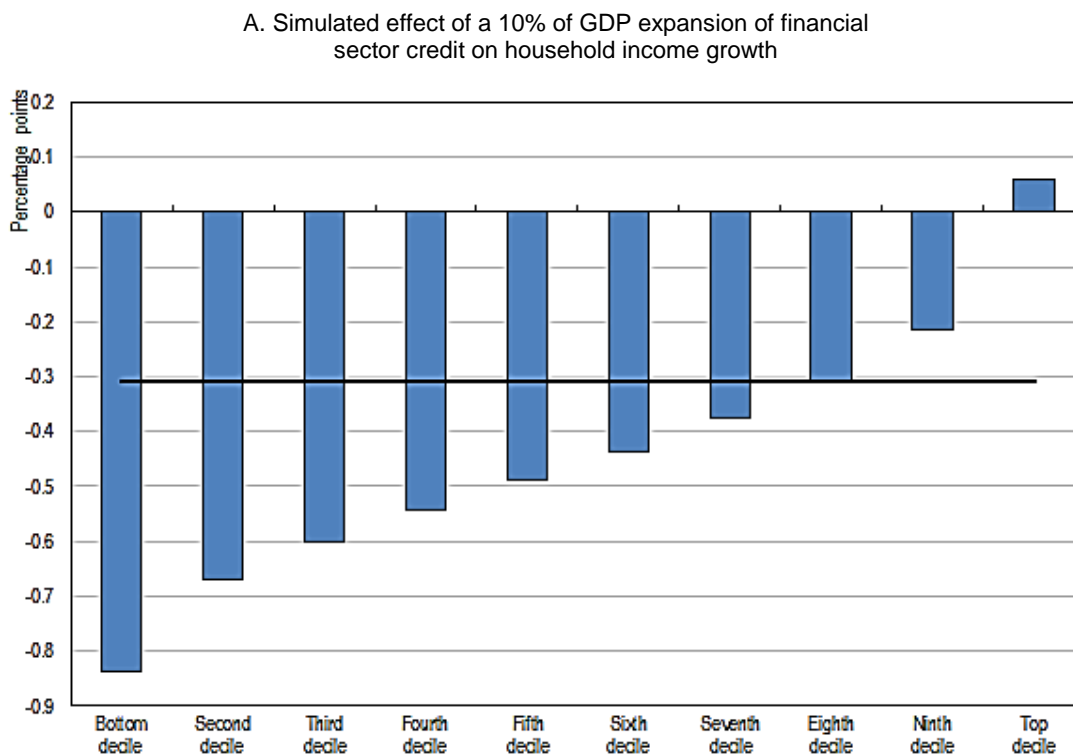
#### **2.1.4 Financialisation has had several important impacts on market income inequality**

50. **Finance is a critical ingredient of stronger growth but negative effects can kick in at the margin when some kinds of finance dominates.** There are many mechanisms through which stronger financial development can drive up economic growth. These include allocating capital to more productive uses, monitoring investments more professionally, facilitating international trade, smoothing demands from individuals and firms, strengthening the transmission of monetary policy and generating large productivity gains within the financial sector that spills over to productivity gains in other sectors (Cournède et al., 2015). However there is also evidence that credit-intermediated finance can slow growth and therefore the net overall effect is bound to an empirical question. In addition, the relationship between growth and finance varies significantly with the level of economic development, research suggesting that more finance is linked to higher growth at low levels of financial development, but that the link gradually becomes weaker as finance expands and turns negative when intermediated credit rises above 90% of GDP (see Cournède et al., 2015 for a review of these findings). These recent findings are in line with the theoretical insight that external finance is essential for economic development but that negative effects can kick in at the margin when the financial sector becomes too large.

51. **Financialisation might have exacerbated income inequality in OECD countries, though more research is needed to corroborate these findings.** Over the past fifty years, credit from banks and other intermediaries to households and businesses has grown three times as fast as economic activity. Empirical evidence suggests that more finance, in the form of more bank credit or larger stock markets, has been correlated by higher income inequality across OECD economies as availability of credit (to support additional financial investments) is positively correlated with income and wealth (**Box 5**) (Denk and Cournède, 2015). Further expansion in bank credit—particularly credit to finance real estates -- from the levels observed in OECD countries is associated with slower household income growth on average because of busts in housing markets. The negative effects are particularly acute at the bottom of the distribution where real estate busts have greatest costs to the wealth portfolio. Simulations suggest that the top 10% benefits (**Figure 18**). Stock market expansion is linked with stronger household income growth, but the benefits are concentrated at the top (because the distribution of equity wealth is at the top), whilst the very bottom of the income distribution is simulated to lose out. These effects, which have been identified on average across OECD countries, might not apply at lower levels of development (Cournède et al., 2015),

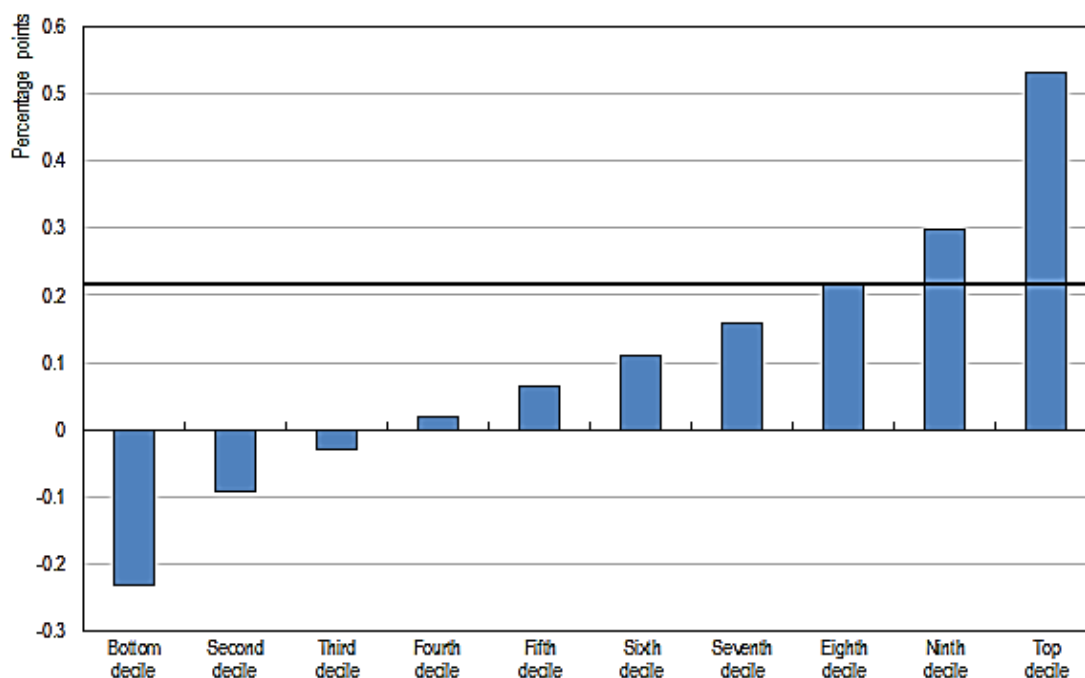
however they do control for possible reverse causality issues.<sup>14</sup> More generally, as growth in financial intermediation also increases the efficiency of resource allocation, and consumption, it would be important to conduct additional studies that look at the trade-offs between equity and efficiency involved by financial deepening.

**Figure 18. The benefits of credit and stock market expansion is simulated to accrue predominantly to high-income households**



14 The estimated finance-inequality link has made the object of a thorough robustness and causality-check exercise. First, those links are established after taking into account a wide range of factors driving income inequality (including unemployment, education and trade-openness). The study also controls for time-invariant differences across countries (e.g. legal systems or other institutional features), for country-specific time trends or year fixed effects or both. These checks highlight that the identified links reflect a relationship beyond the mere observation that finance and income inequality both followed upward trends over the past forty years. In addition, these results show that the estimated negative effect is not simply capturing the earnings dispersion generated by technological change. The results are also robust to exclusion of banking crises and to the consideration of other factors (such as the share of capital versus labour income).

B. Simulated effect of a 10% of GDP expansion of stock market capitalisation on household income growth



Note: Household income growth is household disposable income growth per capita. Stock market capitalisation is the value of all shares listed in a stock market. The horizontal line indicates the change in household income growth for the economy as a whole.

Source: Denk and Cournède (2016), "Finance and Income Inequality in OECD Countries," OECD Economics Department Working Papers, No. 1224, OECD Publishing, Paris. <http://oe.cd/finance>

**Box 5. Income, wealth, and financial inequalities**

OECD work highlights three key mechanisms (while not excluding other ones) behind this link:

- **Financial sector workers are very concentrated at the top of the income distribution.** In Europe, financial sector employees make up only 4% of the workforce but 20% of the top 1% earners. In Luxembourg and the United Kingdom, more than 30% of employees in the top 1% work for financial firms. This is justified as long as very high productivity underpins their earnings. However, detailed econometric investigations find that financial firms pay wages well above what employees with similar profiles earn in other sectors. The premium is especially large for top earners. The premium is positive associated with policies that support financial firms in distress (e.g. too big to fail).
- **High earners can and do borrow more.** The distribution of credit is twice as unequal as income in euro area countries (where internationally comparable data are available). More than 45% of total household credit goes to the top 20% of the income distribution in Austria, Finland, France, Germany and Italy.
- **Much of the benefits of stock market expansion goes to affluent households.** Stock holdings are disproportionately concentrated in the hands of high-income people. In the euro area, stock market wealth is four times more unequally distributed than household income. As a consequence, larger stock markets, which generate more dividends and capital gains, widen the income distribution.

Source: Denk and Cazeneuve-Lacrouz, 2015

52. **To the extent it fuelled investment opportunities for high-skilled individuals, private credit might have contributed to the increase in income inequality.** Estimates suggest the strong expansion of private credit over 1990-2010 might have contributed to a sizeable share of the widening of household disposable income inequality observed during the period (in the OECD countries for which the data are available). What is more, many large banks tend to benefit from an implicit government guarantee which lets them assume more risk, extend more credit and pay higher salaries to their top executives, exacerbating the problems of financial growth and inequality as outlined (Denk et al., 2015). This resulted in a socialisation of negative risk realisation (“Too big to fail”) and in a capture of positive risk realisation by bank top executives.

## 2.2 Inequalities have multiple consequences

53. **Assessing the impact of inequalities is crucial in order to take action to combat them.** OECD work has documented that the impacts of inequalities span across many areas. First, inequalities lower investment in human capital among the bottom 40%, jeopardising productivity growth. Second, rising inequalities put further pressure on public social budgets, as often going hand in hand with larger transfers and smaller revenues. Third, high inequalities may also be hindering trust in public institutions, constraining governments’ capacity to act and weakening structural reform implementation efforts.

### 2.2.1 Income inequality may impact productivity and economic growth

54. **Widespread increases in income inequality are a source of concern not only for their effect on social cohesion, but also for their potential impact on economic performance.** Economic theory predicts both positive and negative impacts from inequality on aggregate economic growth and the question of which effect dominates is bound to an empirical question. Recent work drawing from the experience of OECD countries over the three decades to 2010 shows that policies that yield higher income inequality may also result in lower economic growth (OECD, 2015), a joint outcome that is unsatisfactory. The negative relationship between inequality and growth would be associated with the income gaps between lower income households and the rest of the population. This includes the lowest earners – the bottom 10% less affluent households – as well as low earners – the bottom 40%. While this work needs to be interpreted with caution as it is relying on a limited number of observations, there is additional research documenting a growth dividend of inequality (Robles and Grigoli, 2017). This study however shows that the relationship is not monotonic and that at lower levels income inequality (for instance in selected Nordic countries) the relationship between inequality and growth is positive.

55. **Inequality constrains the ability of low-income groups to contribute to economic growth, hindering their accumulation of human capital.** Though further empirical work is required to establish and exactly quantify the causal relationship between inequality and growth, recent OECD work (OECD, 2015) estimates that rising inequality between 1985 and 2005 might have contributed to knocking more than 4 percentage points off growth between 1990-2010 in half of the OECD countries with available data. A main mechanism at play for this effect is under-investment in human capital, with families in low-income groups being unable to keep their children in education for as long as is optimal, or to afford high-quality education with detrimental effects on future earnings and difficulties in borrowing to invest in new opportunities (OECD, 2015). As a result, economic growth was slower than it could have otherwise been and has disproportionately benefited the better-off.

56. **Beyond human capital accumulation, failure to effectively put skills to use has contributed to slow productivity growth and enhanced inequalities.** Countries that make better use of their workforce’s skills tend to exhibit lower wage inequality and higher productivity growth. As a result, skills mismatch in OECD countries represents a drag on productivity as well as potentially a factor contributing to wage inequality. Simulated gains to moving all countries to the highest level of skill matching observed in the OECD would result in considerable gains in aggregate productivity, for example, a 3% gain in the United States and a 10% gain in Italy (McGowan and Andrews, 2015).

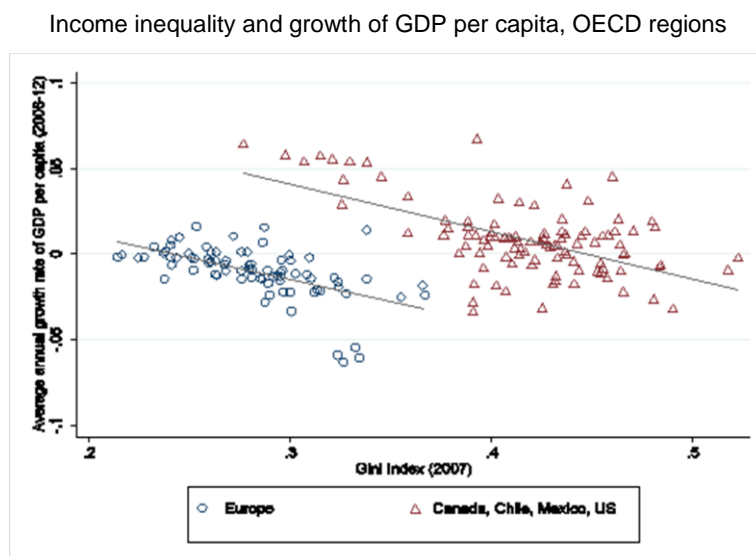


57. **Multidimensional inequalities also impact productivity and growth, with the effect of health inequalities being particularly damaging.** Across the European Union, 78% of people in the highest income quintile report being in good health, compared with only 61% for people in the lowest income quintile. There are also large disparities by socioeconomic status for diseases and risk factors that are major causes of disability and lower quality of life. In particular, people with the lowest level of education are more than twice as likely to report having chronic obstructive pulmonary disease (COPD) and diabetes as are those with the highest level of education. The economic impact of such health inequalities is significant. People in ill-health are more likely to be unemployed, are less productive when they do work and earn less.

### 2.2.2 More unequal regions grow less

58. **On average, more unequal regions have experienced slower growth rates of GDP per capita, though further work to refine and corroborate these findings.** The growth-inequality nexus has a geographical dimension, depending on whether we look at global, national, or regional levels. Recent OECD evidence provides initial evidence on the association between regional inequality and regional economic growth (Figure 19) (Royuela et al., 2014). Based on a sample of 15 countries over the period 2002-12, there is a relatively small negative correlation between income inequality within a region and the region's growth. The correlation is found to be stronger after 2008, suggesting that more equal regions also showed stronger resilience against the economic crisis. The negative inequality-growth relationship is also found to be sensitive to the size of cities. Less inequality is associated with higher growth especially in large cities, where inequality is already higher than the average.

Figure 19. On average, more unequal regions have experienced slower growth rates of GDP per capita



Source: Adapted from Royuela, V., Veneri, P., Ramos, R. (2014), "Income Inequality, Urban Size and Economic Growth in OECD Regions", OECD Regional Development Working Papers, Vol. 2014/10, OECD Publishing, Paris, <http://dx.doi.org/10.1787/5jxrcmg88l8r-en>

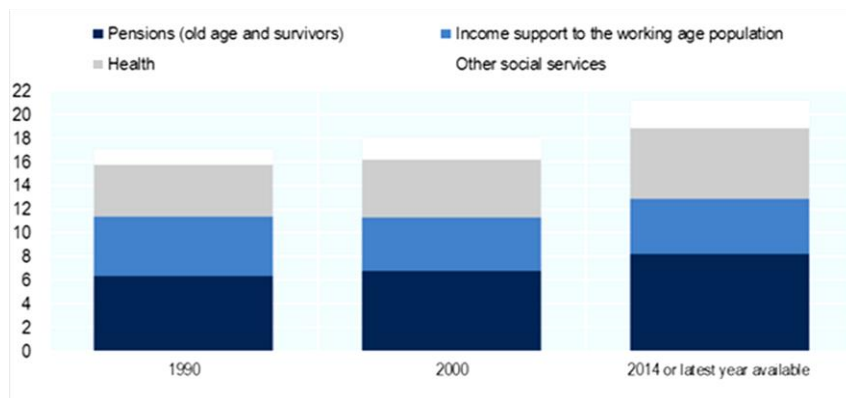
### 2.2.3 Rising inequalities may pile further pressure on public social budgets, though more work would be needed to exactly assess these effects

59. **Because of ageing the pressure on public social budgets has increased over the past 25 years and growing inequalities may further add to this pressure.** Since 1990, public social spending on average across the OECD increased from 17.1% in 1990 to 21.2% in 2014 (Figure 20). The increase is not on income support for the working-age population, but rather on health, old-age and survivor pensions. With the population ageing, health and pension spending can be expected to increase further, as on long-term care (as grouped under other social services). If increased inequalities will translate into greater

joblessness and more demand for in-work benefits, growing income inequality will further add to the growing pressure on public budgets with a social purpose, and/or require policy choices vis-à-vis current expenditures against investment expenditures for long-term growth, e.g childcare, retraining, R&D and infrastructure. More work will be needed to quantify those effects more specifically.

**Figure 20. The pressure on public social budget has increased over the past 25 years**

Public social spending by broad policy area, OECD unweighted average, 1990, 2000 and 2014 or latest year available, in per cent of GDP



5. Income support to the working-age population refers to spending on the following SOCX categories: Incapacity benefits, Family cash benefits, Unemployment, active labour market programmes and other social policy areas.

Source: OECD Social Expenditures Database (SOCX), [www.oecd.org/social/expenditure.htm](http://www.oecd.org/social/expenditure.htm).

#### ***2.2.4 High inequalities may also be hindering trust and constraining governments' capacity to act***

60. **Rising inequality and growing concern about the fairness of society may also be contributing to undermine trust and confidence in governments, constraining their ability to implement reforms.** While people's trust in other people has been shown to be a key determinant of economic growth and social cohesion (Arrow 1972; Fukuyama 1995; Putnam 2000; Guiso et al. 2011), their trust in public institutions is a crucial requirement for implementing policy reform and a necessary condition for the legitimacy and sustainability of any political system (Klijn, Edelenbos and Steijn, 2010; OECD 2014). Confidence in governments is driven by many factors (see also Chapter 3), but there is an increasing body of research showing that inequalities are a very large determinant (Stiglitz et al., 2017). Worryingly, trust and confidence in national governments have declined markedly since the crisis on average across the OECD (**Figure 21**), making it more difficult for governments to pursue and sustain the reforms required to achieve strong and inclusive growth. These tensions lead to less predictable outcomes, including on progress in implementing policy reforms.

**Figure 21. Average trust in governments has declined over time in the OECD**

Percentage of the population reporting confidence in the national government, 2006-2016



Source: Gallup World Poll (2017). The OECD average is based on 29 countries, as it excludes countries with more than two consecutive time-points missing in the series (i.e. Iceland, Luxembourg, Norway, the Slovak Republic, Slovenia and Switzerland). Among countries where a single time point is missing in the time series, the average of the two adjacent years is taken. The OECD 29 average is population-weighted.

### ***2.2.5 Further research efforts are needed to understand the drivers and consequences of inequalities***

61. **While considerable efforts have been made, including by the OECD, to advance our understanding of drivers and consequences of inequalities, this remains a very complex research question that the OECD is committed to pursue.** Major progress has been made to identify the main determinants of rising inequalities as well as their consequences.<sup>15</sup> However, the inequalities remain difficult to grasp empirically, partly because causes and consequences of inequalities vary across countries and time, but also because, more fundamentally, many of the factors that drive inequalities are also affected by inequalities themselves. Typically, the relationship between productivity and wage and earnings dispersion is two-ways and therefore very challenging to identify. Also from a policy-perspective, it is more relevant to understand how policies affect that relationship rather than how drivers and consequences of inequalities are interrelated *per se*. It is indeed along those lines that the OECD has developed work to assess the impact of policies on both economic growth and inclusiveness (see for instance *Going for Growth 2017* and the forthcoming *Reassessment of the Job Strategy*). Under these premises, the OECD plans to conduct further work to deepen the understanding of the Nexus in the context of its Inclusive Growth Initiative.

15 A review of OECD works is available at: [www.oecd.org/inclusivegrowth](http://www.oecd.org/inclusivegrowth).

## CHAPTER THREE

### POLICIES FOR INCLUSIVE GROWTH

**The cross-cutting challenge presented by the persistence of multidimensional inequalities and stagnating productivity underlines the need for a profound reappraisal of the policy making process.** This reappraisal ought to entail a renewed look at the rules which govern our economies and the role of national governments in designing and enforcing those same rules. Such an exercise should span across an array of domains essential for promoting growth and helping all individuals and firms to fulfil their potential: from making financial markets work better as channels of capital to productive activities, to looking again at the role of public policies for enabling and promoting innovation, and to reinvigorating market competition to unleash business dynamism and level out the playing field for all firms.

**A central pillar of this new policy setting concerns the role that national governments should play to enable individuals to flourish throughout their lives.** If the governments is to rise to the challenge of addressing unequal outcomes and to prevent disadvantage cascading down generations, whilst acting as a catalyst for stronger productivity growth, it needs to be reconfigured to serve its citizens as a launch pad. In practical terms, this will call for a re-orientation away from a risk-only approach to welfare provision, towards a lifelong enabling platform that works with the private sector environment to furnish individuals with capacity enhancing assets in the form of human and social capital, good health and active support in labour markets and build strong foundations for learning and adaptation for life and through life.

**At the same time, implementation challenges will mean that the policy making process also needs to be rethought, necessitating the adoption of a more systemic approach.** Adopting such an approach, centered on the unifying objective of supporting people in fulfilling their potential and empowering them to lead meaningful lives, will better enable policy makers to deploy coherent policy sets covering a range of areas: from life-course focused education and skills policies, to product market regulation and fiscal structure. This will require institutional reforms that will help policy makers to reach beyond silos and better equip them to deal with cross-cutting challenges that impact several traditionally distinct policy domains. Institutional redesign is equally crucial to ensuring that policy makers at distinct levels in the hierarchy of governance (the local, national and global levels) have a capacity to act that is properly matched with the scale of the challenges they face.

**This chapter discusses how a more comprehensive policy approach to inclusive growth can be implemented.** It acknowledges that there is no single best model or policy mix that works for all countries and that each country will have to design its own strategy, depending on the main sources of inequalities in opportunities and outcomes in different national contexts. However, it also recognises that there are many common building blocks behind successful inclusive growth strategies and explores these in what follows.

### 3.1 Enabling People to Create Prosperity and Flourish in a New World

62. **Governments have a vital role to play in creating an empowering environment that promotes people-centered economies and societies.** Through setting incentives, targeted social investment, redistributive fiscal policy and comprehensive labour market support, there is much that governments can do to enable individuals fully deciding upon their lives – a feature which has all too often been lost, feeding discontent with globalisation. The first years of life are critical for building the foundations people need to be active creators of new forms of prosperity in a world that is becoming increasingly global and digitalised. Education systems must provide children and youth with the wide range of skills necessary to navigate and manage change in interconnected and digitalised economies and societies. Children from low socio-economic backgrounds must be the focus of educational, cultural and health policies, in order to fill opportunity gaps that may further widen in today’s changing world. While early and life-long investment in human capital is key, it is equally important to ensure that labour markets have plenty of opportunities for people to contribute, adding economic and social value to our societies and deriving fair benefits from their contribution. While business has a big role to play in that respect (see Section 3.2), governments must help individuals to be resilient to disruptions. Activation strategies are indeed fundamental to ensure that people who fall out of employment can swiftly get back into it, while enhanced social protection systems are key to minimising displacement costs and to assist non-standard workers, whose share is increasing partly in connection with new platform economies. Governments must also ensure that labour markets are fully inclusive; youth and women remain two priorities for further policy action.

#### *3.1.1 Coherent education and skills policy interventions across the life-course can serve to furnish individuals with capacity enhancing assets, putting in place the enabling conditions for success*

63. **Targeting education and skills interventions early on in life and at critical junctures throughout the life course is essential to ensuring that everyone is equipped to lead meaningful and productive lives.** A comprehensive set of policy interventions that focus on tackling lifelong educational inequalities and on empowering individuals from disadvantaged backgrounds to climb the socio-economic ladder are necessary to create more sustainable and inclusive economic growth and social cohesion (OECD, 2015; OECD, 2017b). Dealing directly with the root causes of income inequality such as education and skills inequality at an earlier stage is more effective than trying to fix the symptoms of inequality at later stages of life through redistribution policies like taxes and transfers (OECD, 2015). This strategy of investment versus mitigation is also fiscally sound. Countries that ensure children from socio-economically disadvantaged backgrounds have a strong start early in life and provide continued and targeted learning support as they grow up are more successful in reducing the gap in learning outcomes between advantaged and disadvantaged students (OECD, 2017).

64. **In particular, early childhood is a key phase for later life development and success.** Research shows that the cognitive, social-emotional skills developed during the first years of life set the basis of future potential (OECD, 2015; OECD, 2017c). Social-emotional skills are critical in determining the well-being and life outcomes of children and young people, affecting the extent to which they will be successful in school, gain employment, achieve economic security, enjoy good health and contribute positively to their community (OECD, 2015; OECD, 2017c). Although early learning deficiencies can be overcome, inadequate learning environments and a lack of support can impede various developmental needs and have lasting impacts on individuals later in life (OECD, 2015; OECD, 2017c). As children from low socio-economic backgrounds are far less likely to benefit from high-quality home learning environments and early childhood education and care services (ECEC) than their more affluent peers, the following targeted policies need to be considered in order to ensure quality learning opportunities for children from disadvantaged backgrounds:

- **Removing barriers to ECEC:** Children from disadvantaged backgrounds are more likely to experience many barriers in accessing quality ECEC facilities. These barriers include costs, proximity, availability of quality ECEC facilities, and lack of information on ECEC services.

Although some OECD countries have been successful in implementing various measures to remove these barriers, some countries including Chile, Ireland, Poland and Turkey have not been very successful in providing access to ECEC for children from the most disadvantaged socio-economic backgrounds. In these countries, more efforts need to be made in removing various barriers that children from disadvantaged backgrounds are facing in accessing ECEC services (see **Table 1.1**).

- **Supporting family and community-based interventions for helping parents in achieving their goals for children development:** Evidence-based parenting programmes, home visits for troubled families can help disadvantaged families connect to the resources they need to improve the learning environments they provide for their children and achieve their goals for child development (OECD, 2011). These programmes can help parents develop parenting skills that foster children's self-enhancement and sculpt long term behaviours (e.g. by affecting children's time preferences, Becker and Mulligan 2007).
- **Providing opportunities to develop socio-emotional and cultural skills:** The role of parents is crucial in the development of children's socio-emotional skills. Programmes that focus on supporting parents to improve parent-child interactions and parenting styles have been successful in improving young children's socio-emotional outcomes, particularly for disadvantaged families. These programmes such as Sure Start in the United Kingdom and the Seattle Social Development Project provide guidance on parenting style and enhance the relationship between parents and children. Children participating in these programmes show more positive social behaviours, and greater independence and self-regulation than their peers who did not participate in the programme. These programmes often provide professional counselling sessions for mothers and other family members as well, which helped reduce parental stress and in their responsiveness to children's needs and help parents find the resources they need to engage with child development. Teachers can be trained on how to assess and develop these skills and information can also be shared with parents, particularly those from disadvantaged backgrounds, on the importance of these skills and how to support their children in developing them effectively (OECD, 2015).

65. **For educational investments made during early childhood to be productive, continued support throughout schooling is crucial, particularly for those disadvantaged students who have had little to no pre-school experience.** Some countries - including Austria, Belgium, France and Italy - stand out in providing access to early childhood education for children from the most disadvantaged socio-economic backgrounds at no - or affordable - cost, but fail to fully translate this initial success into equally impressive learning outcomes for the same disadvantaged students at later stages in life. In addition, despite disadvantaged schools being among those most in need of high-quality resources and support, in most countries they are often more likely to experience both financial and human resource constraints. Disadvantaged schools also tend to have a disproportionately high number of students who are considered to be low-performers and at-risk of dropping out (OECD, 2016b). To address this situation and ensure that schools are set up to equip all individuals to succeed by building on the foundations put in place during early years education, there are a number of policy measures that governments can pursue:

- **Tackling poor performance:** Poor performers need to be identified early so that teachers and parents can provide early, regular and timely support to those who are at risk of falling behind. Sorting and segregation mechanisms such as academic tracking and ability grouping can perpetuate educational inequalities in schools. These practices are often very costly and ineffective in raising educational standards. In particular, disadvantaged students are far more likely than more advantaged students to be sorted into non-academic tracks, such as vocational education and training programmes. Therefore, academic selection should be delayed and grade repetition avoided for greater equity. Instead, all students should receive the support they need to foster high academic commitment and positive attitudes and behaviours.

- **Providing opportunities to develop socio-emotional skills:** The latest PISA results show that disadvantaged students have less achievement motivation, sense of belonging at school and with their teachers, and less satisfaction in life than advantaged students in almost all countries and economies (OECD, 2017c). The good news is that socio-emotional skills can be learned. Schools, parents and communities must work together to integrate programmes and initiatives that can help students from disadvantaged backgrounds develop the socio-emotional skills in students' everyday life activities. Schools can undertake a range of measures to support the development of a broad suite of skills, such as engaging effectively with others, self-confidence, persistence and organisation skills by integrating them into the school curriculum and into learning resources and activities. For example, subjects like physical, health, civic, citizenship, moral or religious education can explicitly incorporate activities that can improve socio-emotional skills. In England, personal, social, health and economic education (PSHE) is offered in lower secondary schools to help students build their personal identities, confidence and self-esteem, make smart career choices and understand their decision making processes. In Korea, curricula in primary and secondary education incorporated learning components that enhance creativity and socio-emotional skills across all educational activities, together with the 2009 amendment of the national curriculum (OECD, 2015).
- **Supporting disadvantaged schools:** Allocation of sufficient financial and human resources to disadvantaged schools is essential to compensate for lack of high quality education and training for students from disadvantaged backgrounds. Ontario, Canada for example has implemented an equalisation funding-based programme since 2006 to provide extra funding to low-performing schools. The Ministry of education has also developed guidelines on spending the extra funding with emphasis on using it more on professional development of teachers, education materials or on literacy and numeracy tutors (OECD, 2017b). Monetary or professional-level incentives can also be used to attract high-quality school leaders and teachers to disadvantaged schools. The United Kingdom created a programme to recruit top principals and place them in disadvantaged schools. In return, participants in the programme receive special mentoring and training, personal relocation costs and extra grants for the schools (The Future Leaders Trust, 2016). Principals that are responsible for disadvantaged schools are generally paid higher salaries than their colleagues working in higher-performing or more advantaged schools in New Zealand and France (OECD, 2008). In Shanghai or Singapore, school leaders are encouraged or even required to spend a certain amount of time in a disadvantaged or low performing schools in order to advance in their career (OECD, 2017b). Targeted support should also be given to school leaders and teachers in disadvantaged schools and efforts need to be made in connecting them to other school leaders and teachers, which can help them share knowledge and support with each other.

66. **More research is needed to understand how policies could affect parental networks and their impact on children's opportunities.** Evidence suggests that children's outcomes and capabilities are very much affected by parental networks and engagement with school and extra-curricular activities (Putnam, 2016). While it is fundamental to affirm family's primacy on those matters, policies that promote social diversity and social mix in schools and in housing may have a potential for helping families from lower-background to connect to the resources they need to help supporting child development, ultimately improving social mobility (Causa and Johansson, 2010). Similarly, cultural policies aimed to integrate children and families from poorer backgrounds could possibly reduce gaps in accessing extra-curricular activities. More work is however needed to assess the effectiveness of these policies in reducing socio-economic gaps.

67. **The cost and funding of tertiary education is another critical area for enhancing social mobility.** While there is no evidence that countries with low tuition fees display lower entry rates in tertiary education (OECD, 2016b), private investment in tertiary education depends on opportunity costs as well and therefore more generally by funding policies (Oliveira et al., 2008). The presence of credit constraints may indeed hold back investment in tertiary education for individuals from disadvantaged or low-income families and thereby be an obstacle to upward social mobility. The design of student loan and

support systems can help mitigate these constraints. In countries where such funding is available to all students, the probability for an individual from a lower-educated family to achieve tertiary education is higher compared with the probability observed in countries relying on other types of funding and loan systems. This suggests that government-supported loan or grant systems may reduce students' dependence on their families for financing their post-secondary studies and alleviate financial constraints, thus promoting intergenerational social mobility (Causa and Johansson, 2010).

68. **Beyond formal education, action is also necessary to ensure skill upkeep and development, especially among low and middle-skilled adults and migrants.** Low or outdated skills are a common barrier for both the unemployed to find work and for employees to keep up with the evolving needs of the workplace. For most adults, the opportunity cost of going back to formal education institutions is high, making a return to the classroom more difficult. In this context, work-based learning and job-related training more generally can help individuals obtain and sharpen the labour market-relevant skills on a more systematic and targeted basis through their employers or public employment services. While many adults in OECD countries have access to these types of training, the participation rate is significantly higher for high-skilled adults compared to mid to low-skilled adults (**Figure 22**) (Grotlüschen. et al, 2016). In particular, low-skilled adults who are unemployed, or of immigrant background, participate much less in training than their more skilled counterparts, despite very large potential gains. A number of policy options are open to governments to address these issues:

- **Targeting the improvement of basic skills to enable participation in further learning:** Many adults who have dropped out of school early may only have a basic level of literacy and numeracy skills. This is a great obstacle to entering the job market or participating in training later in life. It is therefore crucial that these adults are provided with adequate opportunities to improve their basic skills. Many countries have basic skills programmes in place and provide them entirely free of charge or through financial incentives (OECD, 2017d). Free programmes are generally enacted through specialised centres or through a system of vouchers which individuals may use in training centres of their choice. Financial incentives are often provided to the unemployed under mutual obligation requirements. It may also be useful to combine basic skills programmes with other types of assistance, including identifying individuals' level of skills and qualifications at the start of the programme, drawing up a personal learning development plan, providing career advice, referring individuals to vacancies, and ensuring follow-up.
- **Providing financial incentives for adult learning to disadvantaged groups:** Targeted financial subsidies are the most direct way to tackle low participation in adult learning. Targeting disadvantaged groups is best achieved through subsidies for individuals, rather than through subsidies for employers. That said, subsidies for employers are sometimes needed when training programmes include a work-based learning component and employers are reluctant to take on individuals whose productivity is perceived to be lower. Australia, Austria, France and Norway provide financial incentives to encourage employers to take on individuals from vulnerable groups as apprentices. Japan provides employers with subsidies for training individuals on non-regular contracts. Individuals with such contracts are less likely to receive training from their employers given that their employer may not be able to capture the full benefit of any productivity increase resulting from their training if the individual leaves prematurely.
- **Providing innovative and flexible learning opportunities to overcome access barriers for the most vulnerable groups:** Young adults who are not in education, employment, or training (NEETs), single parents and immigrants with low levels of educational attainment are likely to face more challenges to participating in learning activities. Since these groups are the most likely to be vulnerable to economic changes and labour market conditions, investing in maintaining and enhancing their skills should be a priority. Removing financial, scheduling and resource barriers to participation in learning programmes is crucial. For instance, innovative and effective adult learning programmes, such as online learning and family-based programmes are good options for single parents with low education levels. Language and integration programmes for immigrants

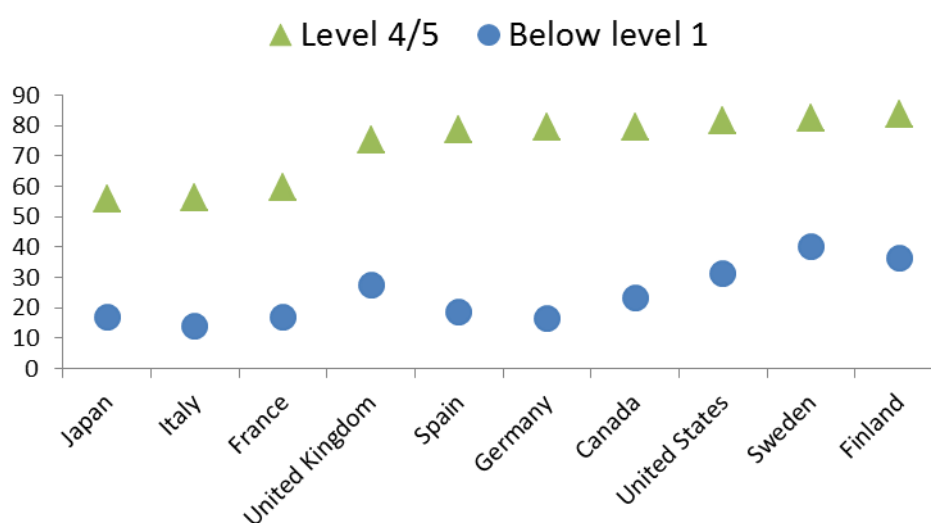


who already have some level of training and experience in their home countries are also beneficial. Making programmes as flexible as possible, through modular approaches, online courses and part-time work participation may also reduce non-financial barriers to the participation of disadvantaged adults.

- Combining adult education, job training and career guidance to reintegrate unemployed adults into the labour market:** Enrolment in programmes which combine adult learning, guidance and job or vocational training is one of the most effective ways to reintegrate low-skilled unemployed adults into the labour market (see also Section 3.1.4). Experience from across the OECD shows that governments would need to provide financial incentives for employers to take on unemployed adults as trainees and set up simple and transparent administrative procedures to ensure that sufficient places are available. Denmark, for example set up 13 guidance centres called “VEU centres” (Voksen- og EfterUddannelse) throughout the country in 2010. These centres are described as a “one-stop entrance” for adult education and training and provide free one-on-one career guidance sessions as well as a variety of educational programmes (EC, 2015). Some of these centres also run second-opportunity programmes for adults who were early school leavers, while other centres offer intensive VET and technical skills training (Euroguidance Denmark, 2014).
- Design new life-long training schemes that are up to the task of the challenges raised by the future of work and that touch or impact low and middle-skilled individuals in greater proportions.** Digitalisation and the platform economy, as well as other structural factors, are changing the outlook of jobs, starting from the non-contractual nature of labour relationships, significant restructuring and organisational changes, more frequent job changes, etc. to which low-skilled individuals are likely to be the least resilient. Schemes such as “Personal Worker Accounts” (for instance the French *Compte Personnel d’Activité*) that centralise training entitlements in one portable account that follow citizens and workers (and not jobs) may offer a promising way to upgrade the effectiveness of upskilling and re-skilling policies in the context of a new world of work.

**Figure 22. The least skilled benefit less from training**

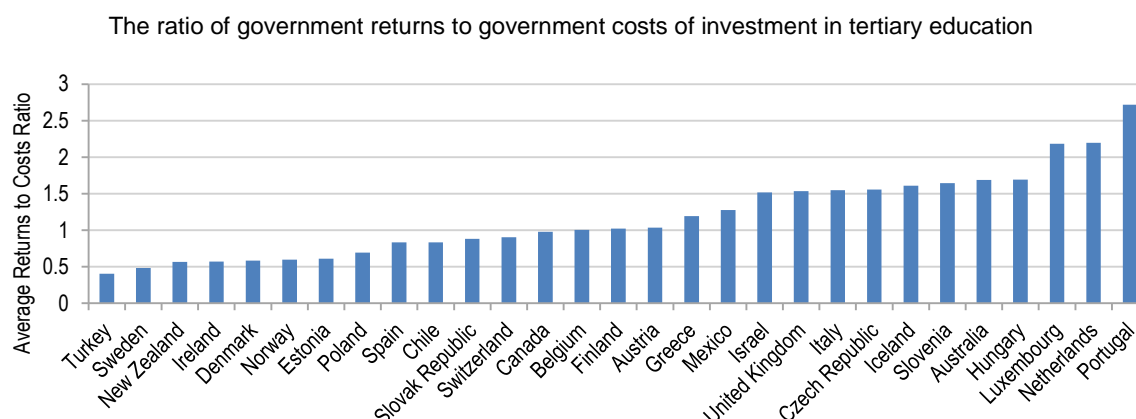
Participation in education and training, by level of literacy proficiency, % of adults



Source: OECD (2013), OECD Skills Outlook 2013: First Results from the Survey of Adult Skills, OECD Publishing.

69. **The comprehensive investment in education outlined above can offer strong returns for coffers in the long run.** New OECD research suggests that spending on skills yields substantial returns to governments in terms of personal income tax revenue as raising the skills of those on lower incomes raises their wages (OECD, 2017d, Taxation and Skills, OECD Tax Policy Study, No.24). In most cases it ensures that skills investments made by government are self-financing in terms of personal income taxes alone (**Figure 23**), hence failing to invest sufficiently in education and the upkeep of skills throughout life may represent significant opportunity costs for State's in the long-run.

**Figure 23. Government investment in tertiary education yields income tax revenues greater than educational costs for most OECD countries**



Source: Tax and Skills (OECD, forthcoming b). Data are for a 17-year-old single taxpayer with no children, who undertakes a four-year course of non-job-related education.

### 3.1.2 Policy needs to ensure that good health is an asset that everyone can draw on throughout their lives

70. **Addressing inequalities in health and associated risk factors requires a range of policy reforms both to prevent diseases and to provide equitable access to care when people get ill.** Fiscal policies (i.e. policies that involve either transfers or taxes aimed at reducing health risk factors) are one of the most effective ways to promote healthier behaviours (Sassi et al 2013). Most OECD countries protect the poor (as well as children and pregnant women) from excessive cost-sharing to improve equality of access (Paris et al., 2016). In New Zealand, very low cost access (VLCA) practices serving disadvantaged populations receive government subsidies if they remove patient fees. In Canada and France, subsidies are provided for the poor to obtain complementary or supplementary private health insurance.

71. **Specific consumption taxes on harmful goods like tobacco and alcohol are highly cost-effective.** However, such taxes weigh more heavily on the incomes of the less well off (even if they also disproportionately benefit poorer populations in health terms). It is therefore important to complement fiscal policies with other health sector policies focused on the poor and other vulnerable groups. For example, public health programmes have been more effective when well targeted. In the United States, involving local community groups was associated with better recall of health messages, and having aerobic classes in Spanish improved cardiorespiratory fitness for overweight Hispanic immigrant women (Hovell et al., 2008, Viswanath et al., 2006).

72. **Beyond the healthcare system, the social determinants of health also need to be addressed.** Income, unemployment, education and other socioeconomic factors, as well as lifestyle choices and a person's living environment are all important (see James et al, forthcoming). *Poverty and low income*, particularly when persistent, have clear detrimental effects on health (see, for example, O'Donnell et al., 2013). Policies on taxation, benefits and minimum wages, as well as policies providing targeted material

support, are therefore likely to contribute to improved health outcomes. For example, studies of the Supplemental Nutrition Assistance Program, which provides food vouchers to low-income families in the United States, find evidence of positive impacts on birth outcomes and child health (US Executive Office of the President, 2015). *Employment conditions* also matter for health outcomes, with long working hours and limited choice over working hours being harmful to health (Bassanini and Caroli, 2014). A review of workplace interventions spanning Canada, Japan, the Netherlands, Sweden, the United Kingdom and the United States found that policies which improved employee control had positive mental health effects (Egan et al., 2007). *Better educated individuals and their offspring are healthier*, independent of income and employment-related effects. A large part of this difference has been attributed to healthier lifestyles. For example, people with lower education levels are more likely to smoke, be obese and less physically active, across many OECD countries (Cutler and Lleras-Muney, 2010; Mackenbach et al 2008). *Poor housing conditions* (e.g. cold and damp, inadequate safety) and certain neighbourhood characteristics such as the *risk of crime* or *air pollution* have frequently been shown to adversely affect health (Gibson et al., 2011). Across a number of OECD countries, policies targeting better housing infrastructure (home visits, removal of hazards) and rental assistance policies, have had positive health effects (Bambra et al., 2010).

73. **It is crucial that ministries responsible for housing, education, income and social protection need to be engaged in health, alongside health ministries.** Partnerships with the private sector will also be important, especially in relation to working conditions. Policies both within and beyond the healthcare system are therefore required to reduce health inequalities. One inspiring example is “Prospera” in Mexico, the cash transfer programme launched in 2014, which aims to cover multi-dimensional needs such as health, education, and nutrition, but also extending to financial services and access to jobs. This initiative has proved successful to increase school attendance, fight malnutrition and extend health coverage to poor families (OECD Economic Surveys Mexico, January 2017).

74. **Looking ahead, the health sector has great opportunity to exploit new possibilities provided by information and communication technologies (ICTs) and digitalisation.** ICTs offer the potential to unlock improved efficiency, productivity and quality of care. In addition, ICTs are increasingly used in healthcare in support of a more equitable provision of health services (**Box 6**). There is growing evidence that ICTs are essential to improve access to health services, particularly in rural and remote areas where health care resources and expertise are often scarce or even non-existent and support the development of new, innovative models of care delivery (OECD, 2016c).

#### **Box 6. The role of digitalisation in making healthcare provision more effective and equitable**

Low- and middle-income countries have perhaps the greatest potential to extend access to health care by using mobile technologies in rural and remote areas. Countries such as Bolivia, Guatemala and Peru have successfully integrated the use of mobile phones as support mechanisms in community-based healthcare systems. In particular, MHealth can play an essential role in supporting strategies to reduce maternal and infant mortality, delivering information, facilitating access to care and enabling evaluation to better deliver timely resources (OECD, 2016c). As deployment of technologies such as the Internet of Things and Artificial Intelligence extends further, additional gains are likely. For instance, medical diagnostics are likely to become more accurate and accessible with AI-enabled analyses of medical databases. IBM aims to train AI software to accurately diagnose cancer and heart disease (McMillan and Dwoskin, 2015).

Information technologies also benefit those suffering from chronic diseases and disabilities, groups in society that are often threatened by exclusion. MHealth is widely recognised as especially valuable for the management of non-communicable diseases (NCDs) such as diabetes and cardiac disease and other health conditions where continuous interaction is imperative. As an illustration, a three-year randomised control trial in England showed positive results associated with the use of telemedicine to monitor patients having long-term conditions including diabetes, COPD and heart failure. Remote monitoring of heart failure has been shown to reduce mortality and hospital readmissions (McLean et al., 2012; Steventon et al., 2012; Bashur et al., 2014). In another trial, patients with congestive heart failure were outfitted with sensors that provided continuous monitoring (Chui, Löffler and Roberts, 2010). Traditionally, patients with this condition are typically monitored only during periodic physician visits to medical facilities. In the trial, the sensors placed on the patient monitored most of these

signs remotely and without interruption, giving practitioners an early warning of conditions that would otherwise lead to unplanned hospitalisations and expensive emergency care.

Source: OECD (2016), *Broadband Policies for Latin America and the Caribbean: A Digital Economy Toolkit*, and OECD (2017), *Making Innovation Benefit All - Policies for Inclusive Growth*

### ***3.1.3 It is essential that fiscal policy is properly designed to support people***

75. **The design of fiscal systems can have important implications for inclusiveness and growth and should seek to support vulnerable groups at all points of the economic cycle.** As outlined in Chapter Two, fiscal policy is the key mechanism for redistributing market incomes and it is important that it is set up to prioritise support for vulnerable population groups at all points in the economic cycle. OECD countries have used counter-cyclical social policies of different types and to different extents, and these differences offer pointers as to how policies could be made more responsive to changing economic conditions and household needs. For instance, countries such as France, Portugal and the United States, have actively extended out-of-work benefits at the onset of the recent global financial crisis, and most countries with strong out-of-work benefits in place have allowed them to operate to the full extent by keeping them accessible to a rapidly growing number of jobseekers and so helping to stem income losses. Despite an improvement in redistribution, mainly due to automatic stabilisers, some of the worst-affected countries in Southern Europe were ill-prepared for the social consequences of the crisis. Their social protection arrangements were weak and discretionary policy measures did not significantly strengthen support for hard-hit groups such as the long-term unemployed or people with little or piecemeal work experience. Their poorly targeted and expensive benefit systems actually contributed to the deep fiscal crisis, which in turn severely constrained the scope for discretionary support when most needed (Matsaganis, 2011; OECD, 2013).

76. **Greater reliance on means-testing helps to target and protect the most vulnerable while reducing benefit expenditures.** The size of means-tested programmes is relatively small in many countries and there is room for expansion, by either making those programmes more generous or by extending their coverage. While the balance of these options may vary across countries, means-tested programmes are known to be difficult to roll out quickly and to suffer from low benefit take-up. While means testing may in principle weaken work incentives, recent OECD analysis suggests that they do not hamper employment as much as other factors such as low work-related skills or care responsibilities. Evidence also suggests that financial incentives to work are a less decisive driver of employment outcomes and overall earnings during an economic downturn when labour demand is weak (Immervoll, 2012).

77. **Means-tested programmes need to be designed carefully and in some case they ought to be targeted to non-income characteristics or behaviour rather than income.** Financial disincentives associated to means-tested programmes are a pressing issue for some population groups. In these cases, targeting behaviour or non-income characteristics is an alternative to traditional income testing that can save costs while leaving incentives intact:

- When support is directed at children, it can help to ensure more equal opportunities and reduce the likelihood that poverty is transmitted from one generation to the next. For instance, subsidised or free school meals exist in a number of OECD countries, including France, the United Kingdom, and the United States (Richardson and Bradshaw, 2012).
- Well-balanced “mutual obligations” help to target support to intended recipients while strengthening incentives to work and look for jobs (this is explored further below in Section 3.1.4. in the discussion on labour markets).
- Support that is conditional on employment, in the form of in-work cash benefits or earned-income tax credits, combines redistribution to lower-income groups, with stronger financial incentives for some population groups. In-work benefits are therefore well-placed to leverage,

rather than replace, people's initiative to improve their income situations. They have been shown to work especially well when wage disparities are substantial (Immervoll and Pearson, 2009).

- Other forms of conditional cash transfers (CCTs), such as those conditional on children's regular attendance in school, formal ECEC services, children's educational progress, and use of health services can also create positive externalities and ensure that income supplements are well-spent. They can also signal the importance of investment in human capital to beneficiary families. CCTs have been pioneered in middle and lower-income countries, but have recently been piloted in high-income regions as well, e.g., in New York City. To realise their potential as a valuable complement to more traditional forms of support, CCTs require a long-term strategy supported by a willingness to test and adapt different policy designs (Riccio, 2013).

78. **In countries where inequality is very high, there is scope to tackle it through enhancing tax progressivity via savings tax reform.** Income from savings is taxed progressively, though at lower rates than labour and with a lot of variation in taxation across asset types. Capital tax rates have fallen over recent decades, though they have risen modestly in the post-crisis period (see for example OECD, 2016d). Large amounts of savings income are more likely to be earned by those with higher incomes, and so taxing capital at higher rates may increase the overall progressivity of the tax system. There is therefore scope to increase the fairness and the neutrality of the taxation of capital income but reforms need to take into account that high-income individuals can change their tax residency and even their citizenship in response to onerous tax burdens. Policymakers could respond to these challenges in three ways: (1) by strengthening international cooperation on the taxation of mobile tax bases; (2) by removing tax expenditures that disproportionately benefit higher incomes; and (3) by strengthening progressivity of tax bases other than income including property taxes.

79. **In very unequal countries, efforts to promote progressivity in the tax system should look beyond income alone.** OECD research highlights the importance of considering the overall progressivity of the tax and benefit system as opposed to focusing solely on the top marginal rate of personal income tax (Brys et al., 2016). Proportional or even slightly regressive taxes such as the value-added tax (VAT) may increase the overall progressivity of the tax and transfer system if they finance spending targeted at those on lower incomes.

80. **Capital tax reforms are also necessary at the domestic level to reduce rate differentials across asset types that distort savings decisions and incentivise tax planning.** Different kinds of savings are taxed in different ways, increasing distortions and providing opportunities for tax avoidance. In addition, tax expenditures such as tax deductions for private pension contributions and mortgage interest expenses are regressive since higher income taxpayers tend to save and own homes. Removing such tax expenditures could simultaneously reduce inequality and make the tax system more efficient.

81. **Increased taxation of residential property could increase both growth and strengthen progressivity.** This is especially true if this taxation is used to finance reductions in more distortive taxes. Recurrent taxes on immovable property are comparatively simple to enforce and hard to avoid, and if designed well can fall mostly on high-wealth, high-income households (OECD, 2010). In many OECD countries property taxes can be designed to be more equitable and efficient (e.g. by regularly updating cadastral value). The importance of property and land taxes may rise in coming years as immovable property becomes an even more attractive vehicle for holding assets offshore. In these circumstances, new approaches such as the targeting of high-value properties with transaction taxes could be considered, even though these taxes might otherwise be considered to be distortive.

82. **Strengthening inheritance and gift taxes can support inclusive growth.** Inherited wealth is a significant factor contributing to the increase in intergenerational inequality, but taxes on inheritance have fallen in recent decades, from 0.25% of GDP in 1965 to 0.15% in 2014. Inheritance taxes can distort savings investment and work decisions but may be less distortionary than personal and corporate income taxes depending on tax rates and can help achieve intergenerational equity goals. However, tax evasion and avoidance has made these taxes difficult to collect. In order to be effective, inheritance taxes must also be

combined with taxes on gifts and wealth transfers during the taxpayers' lifetime, as well as with measures to address avoidance and evasion.

### ***3.1.4 Governments also have an important role to play in helping people to adapt to change and stay engaged in the labour market***

83. **With deep changes being wrought to economic activity, governments need to support individuals' engagement in the labour market through enhanced social protection and comprehensive activation policies.** Technological change and increased interconnectedness are transforming occupational structures, the type of tasks and skills required by jobs, and the organisation of work itself. In the long run, if this transformation continues apace, governments may have to consider a radical departure from traditional contributory welfare policy to deal with the potential fallout. One option that is currently under discussion in several countries is moving towards more universal types of income support. The most comprehensive reform in that direction would be a universal basic income (see **Box 7**). At present, however, for a given level of support, a universal basic income would be significantly more costly than traditional measures. Although everybody would be paid a basic income, it would also entail significant losses for some groups, if it replaces existing social transfers and if it is financed through tax increases. While debates of a basic income provide a useful stimulus for necessary discussions of the future of social protection, more evidence is needed on the costs and benefits of different reform options. In that light, the role of governments in helping individuals to engage in the labour market should, for the meantime, remain focussed on protecting individuals who fall upon hard times and implementing comprehensive activation strategies to help people who fall out of productive employment back into it.

#### **Box 7. Universal Basic Income: A viable policy option?**

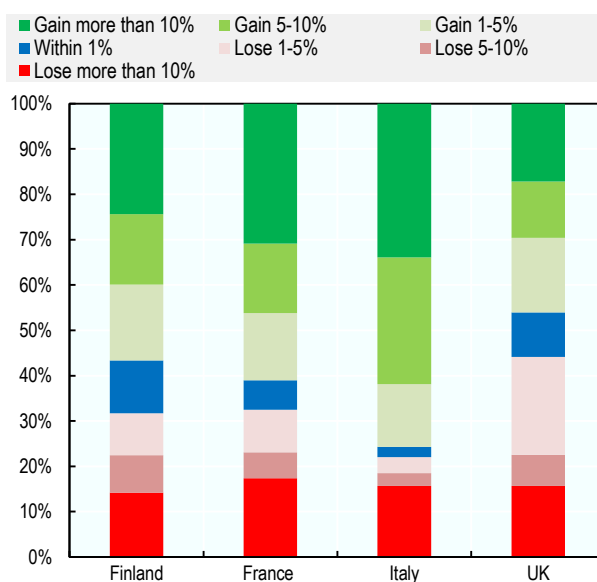
Recent debates of Basic Income (BI) proposals provides a useful spotlight on challenges traditional forms of income support are increasingly facing, and highlight gaps in social provisions that largely depend on income or employment status. Multiple pilots have been carried out in lower and middle-income countries for some time, e.g. in India (Davalá et al, 2015). More recently, some OECD countries have started or are planning pilots to evaluate the impact of specific BI programmes.

The most developed of these experiments is in **Finland**, where 2,000 current recipients of unemployment assistance benefits have been paid a BI of €560 per month since January 2017, equivalent to just over a quarter of median household income for a single person. Different types of experiment have been announced in the Netherlands. In **Canada**, the **Ontario** government has committed to testing a basic income in 2017, while the government of **Québec** tasked an expert panel to look into options to move towards introducing a guaranteed minimum income. In **France** a Senate Committee recently recommended an experiment and several presidential candidates have proposed different variants of a BI. The most high profile of these plans would initially provide a BI for young people aged 18-25, to be extended at a later stage. In the **United States**, the billionaire entrepreneur Elon Musk is proposing to conduct his own BI experiment for a small number of people, and several other innovative local and citizen initiatives have been reported in the media. In many of these cases, there are, however, currently relatively few concrete details as to the parameters of the proposed programmes.

A universal, "no questions asked" public transfer would be simple and have the advantage that no-one would be left without support. But an unconditional payment to everyone at meaningful but fiscally realistic levels would require tax rises as well as reductions in existing benefits. A new OECD study also shows that a BI replacing existing benefits would often have a strong impact on household income (**Figure 24**). However, **some disadvantaged groups would lose out when existing benefits are replaced by a BI illustrating the downsides of social protection without any form of targeting at all.** In addition UBI may disincentivise individuals from fulfilling their full potential, typically by lowering labour supply or weakening upskilling dynamics.

**Figure 24. Few people would see their incomes unaffected by a Basic Income**

Gainers and loser, in % of individuals in working-age households



Notes: Working-age households are those with at least one working-age individual. Hypothetical budget-neutral reform where a basic income would replace most existing working-age benefits, as well as the main tax-free allowance. See main text and Box 2 for details.

Realistically, and in view of the immediate fiscal and distributional consequences of a fully comprehensive BI, reforms towards more universal income support would need to be introduced in stages, and they would require a parallel debate on how to finance a more equal sharing of the benefits of economic growth.

Source: OECD (2017b, forthcoming), "Basic Income as a policy option: Can it add up?", Directorate for Employment, Labour and Social Affairs.

84. **Reforms of public transfer schemes need to reflect the aforementioned changing nature of work.** In this respect, priority should be given to expanding access to unemployment benefits to workers in non-standard forms of employment, with typically short work tenures relative to workers on permanent contracts. There are a number of ways in which governments can help to extend out-of-work benefits to previously uncovered groups, including by aligning benefit rules across different contractual arrangements and adapting existing social insurance schemes to extend them to previously excluded categories of workers. It is also important to make social protection portable, linking entitlements to individuals rather than jobs and to consider complementing social insurance with targeted non-contributory schemes. Absent policy changes in this area and a rising share of non-standard workers implies that redistribution is becoming less effective at reducing unemployment-driven increases in inequality. In other words, adapting to structural changes in the labour market implies shifting protection from workers to individuals, while addressing the balance between ensuring income protection and maintaining work incentives.

85. **Activation should be pursued as a strategic goal encompassing all labour market initiatives, having the potential to facilitate economic transitions to new sectors of growth and new forms of jobs.** Governments need to help workers to re-enter the labour market by linking benefits to active job search and participation in training and other employment-support programmes, which can ensure a good match between skills and job requirements, limit the risk of human capital depreciation associated with poverty and long-term unemployment, and reduce the chance of people dropping out of the labour force

altogether (OECD, 2014). Such activation policies should be implemented systemically, across benefit, labour regulatory and skills policy, and in conjunction with the private sector. The changing nature of the labour market will also heighten the importance of activation policies as many economies transition to new sectors of growth and create new types of jobs.

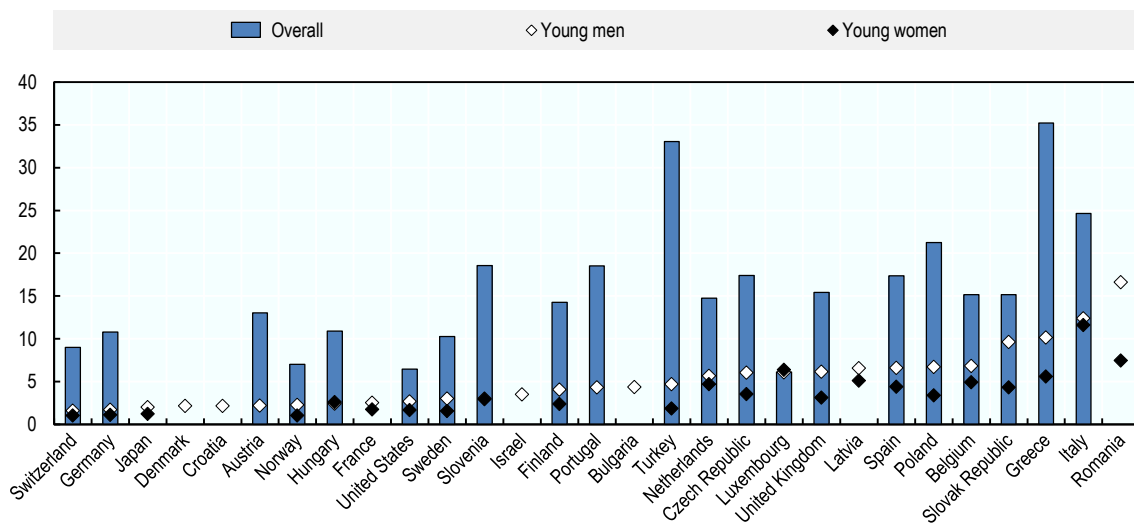
86. **There is a particular need to focus on supporting vulnerable groups like youth, who display less attachment to the labour market.** Youth are more likely than prime-age workers to have jobs that are low paid and offer limited labour market stability, social protection and opportunities for training and career progression (OECD, 2015). A number of measures can be specifically tailored to support youth, particularly during the crucial school-to-work transition. For instance, more responsive vocational education and training systems that prepare young people for work and life, while also helping them to build up self-confidence can be very effective. This is particularly true when such systems are part of a broader ecosystem of support in the form of apprenticeships, internships and entrepreneurship training (**Box 8**). At the same time, special attention must be afforded to assisting vulnerable groups, such as NEETs and migrants, and to provide pupils from poorer backgrounds with better early childhood education and opportunities to improve their prospects later on.



### Box 8. Supporting youth entrepreneurship

Entrepreneurship amongst young people helps to increase labour market inclusion at the same time as promoting innovation and growth. However, although 45% of youth express a preference for being self-employed over working as an employee and 41% believe that it would be feasible within the next 5 years (OECD/EC, 2014), few youth are self-employed (**Figure 25**). Youth face a number of barriers in entrepreneurship, notably few role models, a lack of entrepreneurship skills and entrepreneurial mindsets, little savings and poor access to external capital, limited business networks and discrimination in product and financial markets (OECD/EC, 2012). Public policy can help youth overcome many of these challenges with entrepreneurship training, coaching and mentoring, access to finance with grants, microcredit and loan guarantees, and building entrepreneurship networks. In developing policies and programmes to support young entrepreneurs, policy makers should pay attention to three key considerations. First, there is evidence to suggest that the programmes with the greatest impact in terms of business survival and growth use strong selection criteria in determining which projects are supported. This is particularly true for initiatives that provide financial supports. Successful programmes such as DEFi jeunes in France provide incremental amounts of financing in stages to youth who can demonstrate that their project is viable. Second, integrated packages of support tend to have a greater impact than single, one-shot instruments. For example, the Prince's Trust Enterprise Programme in the United Kingdom offers a package of support for disadvantaged youth, including grants, loans, coaching and networking support. Programme evaluations show that the programme created approximately 150 additional start-ups in 2005 and more than 400 start-ups in this year started sooner and on a larger scale (DTZ, 2007). Thirdly, if the policy objective is successful business creation, it is preferable to provide more intensive support to fewer young people over thinly spread support that reaches large numbers. Youth tend to operate in highly competitive sectors with low barriers to entry (OECD/EC, 2015), so policy makers can have a greater impact by providing sufficient financial support and more intensive business development services to help youth entrepreneurs start businesses outside of these sectors.

**Figure 25. Youth self-employment rates, 2015**



Source: OECD (2016), *Entrepreneurship at a Glance*, OECD Publishing; OECD (2016), *OECD Labour Force Statistics*.

87. **Priority should be given to policies that offer unemployed workers a “springboard” to new jobs.** In particular, measures should be implemented with a view to helping people adjust faster to job loss, reducing the risk of long-term unemployment spells and the resulting depreciation of skills and employability (OECD, 2017b; Trebilcock, 2014). Springboard policies put individuals back in control and help mitigate the sometimes large income losses that follow permanent layoffs, reducing the need to resort to compensatory redistribution policies. First and foremost, springboard policies involve job search assistance and retraining support for jobseekers. These measures are especially effective when the public employment service (PES) begins to offer counselling and other forms of re-employment assistance during

the notice period before workers become unemployed. Another key to effectiveness is to assure that the measures offered are well targeted to specific participant groups. This is particularly the case for older and long-tenure workers for whom displacement costs (in terms of earnings losses after displacement) are typically high relative to those of younger job losers. Well-designed requalification and training programmes are a key to limiting displacement costs for such workers. Several examples of effective measures to assist displaced workers to re-integrate into the labour market are described in **Box 9**.

#### **Box 9. Two examples of effective measures to assist displaced workers back into suitable jobs**

**HQ Sharp in Japan:** After a rapid deterioration of business conditions, Sharp announced in 2012 a plan to layoff almost 3 000 workers aged 40 and over. In response to this announcement, the local PES implemented the Support for *Sharp-related Displaced Employees Headquarters* (HQ SHARP), a co-ordinating committee consisting of managers from the participating organisations, both private and public, who were available to assist the affected workers. Its mission was to build an integrated support system to offer effective re-employment and livelihood aid for this group of displaced workers (which also included workers displaced from Sharp's suppliers). Much of the work of the HQ consisted of an extensive consultation process that was used to achieve agreement on the strategy to adopt and eventually the setting-up and implementation of action plans. The aim of HQ SHARP was to facilitate a smooth transition into re-employment and to support the living standards of workers who lost their job. As part of achieving this goal, informational meetings were organised for the workers who were slated to be displaced, to provide information about various services that were available to these workers, vocational counselling, as well as instructions about how to access these services and training. The public services that were offered by the PES and the prefectural and local governments were supplemented by the extensive private outplacement services that Sharp offered to departing workers.

**Job Security Councils (JSC) in Sweden:** JSCs were first developed in the 1970s against the backdrop of deteriorating economic conditions in Sweden, including the massive loss of white-collar jobs in the wake of the 1973 oil crisis. At that time, the Swedish PES was not regarded by employers as providing effective re-employment support for white-collar workers. The JSCs – which are based on collective agreements between social partners in a sector or an occupational field – facilitate restructuring by providing advice and consultation to employers and trade unions at an early stage, as well as transition services and guidance to any workers who are made redundant. JSC activities are financed by the employers who contribute a percentage of their total payroll that is specified in collective agreements (currently 0.3% of payroll). JSCs distribute the risk and costs of restructuring among its members, while also allowing workers displaced a few at a time, including those displaced from small and medium enterprises, to benefit from forms of early adjustment assistance that are typically only available to workers involved in mass layoffs. Around 80% of JSC participants find a solution (employment or retraining) within a period of seven months, and this high number was sustained even during the global financial crisis period of 2008-10.

Source: OECD (2015), *Back to Work: Japan: Improving the Re-employment Prospects of Displaced Workers*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264227200-en>; OECD (2015), *Back to Work: Sweden: Improving the Re-employment Prospects of Displaced Workers*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264246812-en>

88. **Sufficiently generous unemployment benefits and social-assistance systems with a wide coverage are also a key to minimising displacement costs.** These measures cushion the income losses resulting from job displacement. When designed well, they also reinforce the effectiveness of active labour market policies, because unemployment and social-assistance benefits provide the principal instrument for connecting jobless people with employment services and active labour market programs. Job losers who do not qualify for these types of benefits may lack a sufficient motivation for enrolling into programmes or simply the necessary information to seek out the most appropriate activity (Immervoll, 2012; OECD, 2015). When income benefits are combined with effective monitoring and sanctions within a “mutual obligation” framework,<sup>16</sup> jobseekers can be promptly referred to employment services that provide job-search assistance or, depending on the unemployed person's profile, more intensive services such as

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16 . Under the mutual obligation model, governments have the duty to provide jobseekers with income benefits and effective re-employment services, while beneficiaries are required to take active steps to find work or improve their employability.

training. If benefits are too low, the risk that people drop out of the labour market altogether is increased. The financial incentive to take up gainful employment and/or actively follow the assigned programme also increases as benefits increase, because the potential benefit sanctions significantly raise the cost of breaching the “mutual obligation” contract.

89. **Countries that do not have efficient active labour market programmes (ALMPs) in place should prioritize their development as a key pillar of their inclusive growth strategy.** Since the quality of spending matters and not just the quantity of spending, the provision of services should follow best-practice principles for activation while adapting them to country-specific institutional settings. Indeed, the effectiveness of ALMPs has been found to be stronger in countries with more efficient public sectors (Andrews and Saia., 2016).

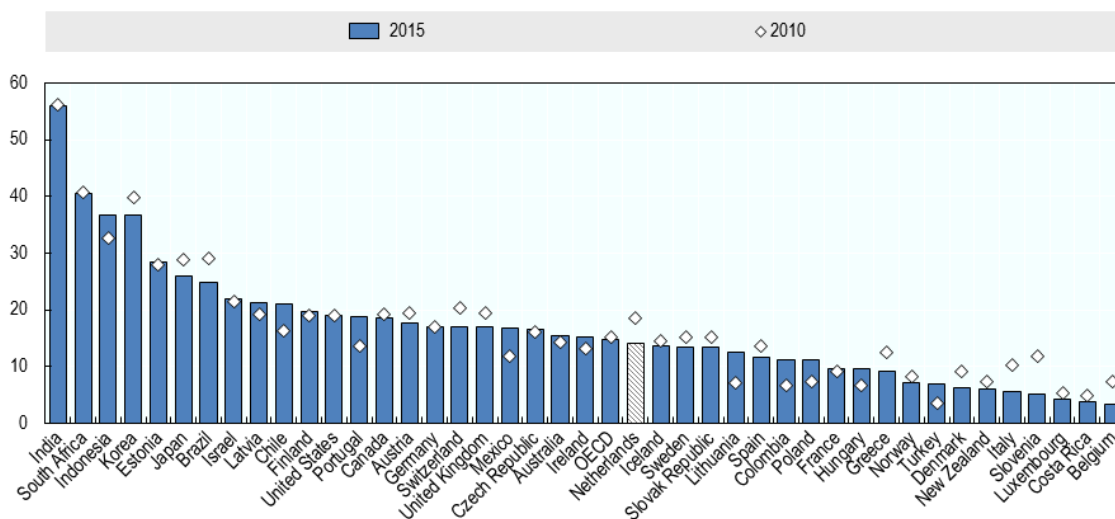
90. **New forms of public-private partnerships in funding and delivering ALMPs policies should be further explored for the delivery of effective activation policies.** While in many OECD countries the ALMPs represent a small part of social protection transfers, the financial scope for those programmes is also limited. Appropriate cost sharing mechanisms between government, employers and individuals should be further explored.

**3.1.5 Any focus on labour markets must also prioritise reducing the gender gap and promoting the integration of women in economic activities**

91. **Promoting gender equality in access to employment and job quality is a key component of inclusive growth.** While women's labour force participation rates have moved closer to men's over the past few decades, women are still less likely to be in the workforce: on average across OECD countries, 67.4% of women were in the labour force in 2015, relative to nearly 80% of men (OECD, 2017g). This is partly the result of low second earner work incentives embedded in PIT systems.<sup>17</sup> In addition, women's higher likelihood of working part-time, sex segregation in jobs and sectors, and harder to observe, factors like discrimination contribute to gender pay gaps remaining at about 15% across the OECD, on average, with little change in recent years (**Figure 26**). These inequalities are reflected in a thick glass ceiling: in 2016, women occupied only 4.8% of chief executive officer positions. In emerging economies, gaps in employment and pay are often larger and have sometimes widened (OECD, 2016e).

**Figure 26. Gender pay gaps remain sizeable across the OECD and emerging economies**

Median monthly gender pay gap for full-time employees, 2010 and 2015



17 See for instance: [http://www.oecd-ilibrary.org/taxation/the-impact-of-tax-and-benefit-systems-on-the-workforce-participation-incentives-of-women\\_d950acfc-en](http://www.oecd-ilibrary.org/taxation/the-impact-of-tax-and-benefit-systems-on-the-workforce-participation-incentives-of-women_d950acfc-en)

Note: The gender pay gap is defined as the difference between male and female median monthly earnings divided by male median monthly earnings for full-time employees. Data refer to weekly earnings for Australia, Canada, India, Ireland, United Kingdom and United States. They refer to hourly wages for Denmark, Greece, Iceland, New Zealand, Portugal and Spain. Data refer to 2014, instead of 2015 for Australia, Austria, Belgium, Brazil, Denmark, Estonia, Finland, Germany, Greece, Iceland, Indonesia, Ireland, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, the Netherlands, New Zealand, Poland, Portugal, Slovenia, Spain, Switzerland and Turkey. Instead of 2010, data refer to 2011 for Brazil, Chile, Costa Rica, to 2007 for Israel.

Source: Employment Outlook 2017 for OECD countries; Encuesta Permanente de Hogares for Argentina; Pesquisa Nacional por Amostra de Domicílio for Brazil; Gran Encuesta Integrada de Hogares for Colombia, Encuesta Continua de Empleo for Costa Rica, National Sample Survey for India, National Labour Force Survey (Sakernas) for Indonesia, General Household Survey for South Africa.

92. **Gender gaps in the labour force worsen with childrearing, as women carry out a disproportionate share of unpaid childcare and housework.** Mothers are more likely than childless women to work fewer hours, earn less than men, or opt out of the workforce entirely, while men, in contrast, are more likely to work after becoming fathers (OECD, 2017h; OECD, 2017i). Trying to better manage work and family commitments may also be a motivation for women to become entrepreneurs and governments frequently use targeted policies and programmes to close the gender gap in entrepreneurship by addressing market and institutional failures affecting the entrepreneurial aspirations and entrepreneurial success of women (see **Box 10**). To enhance gender equality in education and employment, as well as in entrepreneurship and public life, OECD Member countries and a number of non-Member countries adopted the OECD's 2013 Gender Recommendation and the 2015 Recommendation on Gender Equality in Public Life which call on adhering countries to promote gender equality through actions including legislation, policies, monitoring and campaigns.

### **Box 10. Recent developments in policies to promote women entrepreneurship**

An important challenge is to strengthen entrepreneurship skills and attitudes to entrepreneurship among women. Indeed, across a broad range of OECD members and partners, women typically appear less prone (36%) than men (48%) to take the risk of creating their own business, preferring to work as employees, independently of a country's economic context and overall attitude toward entrepreneurship (OECD Entrepreneurship at a Glance 2015). Women are also less likely than men to report that they have the skills and experience to start a business. This is typically due to a lower likelihood of having experience in self-employment, and having less developed management skills and smaller business networks (Shaw et al., 2009; Marlow and Carter, 2004; Collins-Dodd et al., 2004). Common government policy responses in recent years include promotional campaigns, entrepreneurship training courses, entrepreneurship coaching and mentoring programmes and the provision of business consultancy services. Some countries have recently launched targeted initiatives for specific groups of women, such as entrepreneurship training for unemployed women in Belgium and Arab and Haredi women in Israel, or for specific types of businesses, such as start-ups in science and technology fields in Australia and Costa Rica. In some countries with a longer history of dedicated support for women's entrepreneurship, such as the United States, New Zealand and Korea, women-specific incubators and accelerators have been launched to support women entrepreneurs that operate high-growth potential businesses.

Another significant challenge for women entrepreneurs is accessing start-up financing. Women entrepreneurs are often more reliant on own-financing (Coleman and Robb, 2016; Shaw et al., 2009) and are less likely to report that they could access the necessary financing to start a business (OECD/EC, 2017 forthcoming; OECD Entrepreneurship at a Glance 2016; OECD/EC, 2015). This gap can be partially explained by differences in the nature of the businesses that women tend to operate and the sectors that they operate in. Yet several studies have observed gender-based differences in credit terms despite controlling for various structural characteristics (e.g. sector, business size), including higher collateral requirements (Coleman, 2000) and interest rates (Fraser, 2005). One explanation offered by researchers is that decision making by financial institutions is biased by gender stereotypes (Carter et al., 2007). A wide range of supports have been launched to support women in accessing finance for business start-up. For example, many countries have launched loan guarantees programmes to improve access to bank financing, including Belgium, France and Turkey, and others have launched women-specific loans programmes, including Canada, Costa Rica, Japan, Mexico, Poland and Sweden. Other new initiatives include grants for women entrepreneurs in Portugal, interest rate subsidies in Russia and microcredit initiatives in Germany. A number of countries have also implemented programmes to stimulate venture capital investment in women entrepreneurs, including the United Kingdom and Australia.

Another important policy area where governments are increasingly active is supporting women entrepreneurs in public procurement markets. Korea and the United States have been leaders in this area, but there is still scope to go much further. For example, the United States only reached its goal of awarding 5% of the value of public tenders (worth USD 17.8 billion, or approximately EUR 15.8 billion) to women-owned businesses in 2015 (Beede and Rubinovitz, 2015) and many other countries are still to become active in setting targets or development initiatives to support women entrepreneurs in public procurement.

93. **Governments have implemented a range of policies that attempt to address the inequalities associated with parenthood**, as highlighted by the Report on the Implementation of the OECD Gender Recommendations. Paid maternity leave is offered nationally in all OECD countries except the United States (Adema et al, 2015), and paternity leave and (shareable) parental leave are increasingly common (OECD, 2016f). Father-specific leave is important for ensuring that equal caregiving patterns are set at an early stage, for helping mothers return to work, and for reducing employer discrimination against women (who currently are much more likely to take leave or work part-time than men). Equitable and high-quality childcare is a key driver of female employment, and many OECD countries invest heavily in childcare services. In 2013, public expenditure on early childhood education and care exceeded 1% of GDP in Denmark, Finland, France, Iceland, Norway, and Sweden, but in many other countries childcare places remain in short supply, especially for children under age three, with parents facing high out-of-pocket costs. Flexible workplace practices are also important for ensuring that mothers and fathers can combine work with family responsibilities.

94. **About two-thirds of OECD countries have introduced new policies aimed at gender pay equality since the adoption of the 2013 OECD Gender Recommendation.** Pay transparency legislation exists in at least seven countries, where companies are required to share the gender disaggregation of

wages in their workforce with employees, auditors, or the public. Other strategies include the introduction of pay gap calculators, which are often available online, and that help employees understand what type of salary they should be receiving given their job, sector and locality. In some countries, there also exist government certifications for companies showing good practice in pay equality.

### *3.1.6 Setting up comprehensive policy approach to prevent ageing unequally*

95. **To prevent inequalities from rising over the life-cycle, countries will need to put in place a comprehensive policy approach to help individuals overcome disadvantage that could cumulate over their life course and result in low-income and poverty at old age.** The pillars of an action plan to prevent ageing unequally include: i) preventing inequalities (through early-life interventions, smoothing the school-to-work transition and breaking the links between socioeconomic disadvantages and health status); ii) mitigating inequalities throughout the working lives and by promoting active ageing; and iii) coping with inequality at older ages in the design of the pension and long-term care systems.

## **3.2 Giving All Businesses the Chance to Thrive**

96. **Efforts to ensure that all individuals have the opportunity to lead meaningful and productive lives are reliant on a thriving business sector.** Businesses are uniquely placed to provide employment opportunities, foster individual well-being at the work place, contribute to the development of skills, and promote the creation and dissemination of knowledge and technology. Yet, to fulfil this role, businesses need an environment that ensures a level and competitive playing field, enables them to access the skills they need and finance at fair cost, whilst providing regulatory clarity and consistency. At the same time, government policy also has a part to play in setting up the framework conditions to promote innovation, supporting responsible business conduct, engendering respect for labour rights and the environment, and ensuring that companies pay their taxes.

### *3.2.1 Policies need to target the revival of business dynamism*

97. **Since the late 1990s, there has been a widespread decline in the pace of business creation and business dynamism more generally** (Calvino et al. 2016, Blanchenay et al., 2017). Moreover, the share of non-viable old firms has been increasing, particularly since the financial crisis, at the same time as the productivity of this latter group of firms has been falling rapidly relative to “viable” old firms, as well as younger firms in general. Most of these trends are observed not only at the global level, but also among firms within countries and sectors (Andrews et al., 2016). Recent evidence from 14 OECD economies (Berlingieri et al. 2017) has found increasing differences in the performance of the most productive and least productive firms. The analysis also shows how the dispersion in productivity is generally growing faster in the lower half of the distribution, particularly in the early years of the decade. As noted in Chapter Two, this dispersion between firms is large and growing and can have important implications for the inclusiveness of our economies (Berlingieri, Blanchenay and Criscuolo, 2017). Policy settings that affect the extent of productivity dispersion are therefore likely to have implications for wage inequality.

98. **The apparent decline in business dynamism is a key policy concern.** Policy has a vital role to play in boosting growth by promoting market competition and levelling the playing field, especially in services which are generally more sheltered from international markets, and in certain ICT intensive sectors characterised by network externalities, where ‘winner-takes-all’ dynamics may be at play. Competition creates better conditions for growth-enhancing reallocation through the entry of more productive businesses and the exit of less successful ones. In this context, the rise in productivity divergence between the leading firms and the rest is much more marked in sectors where the pace of pro-competition product market reforms especially in business services, was slowest (Andrews et al., 2016). Complementary evidence points to an additional beneficial role of enhanced competition through lower regulatory barriers to firm entry: it contributes to job-creation through a larger number of young companies with fast growth potential (De Serres and Gal, 2017; Criscuolo, Gal and Menon, 2014), and a stronger post-entry growth performance of firms (Calvino, Criscuolo and Menon, 2016). Those results need to be caveated by considering that, given the increased tendency to profit shifting, it remains challenging to

measure the productivity in national branches of internationally active firms and therefore to assess the policy determinants of declining business dynamism.

99. **Young and small firms would benefit from better designed regulatory frameworks.** OECD analysis suggests that young and small firms are much more affected by poorly-designed regulatory frameworks than large and incumbent firms, limiting their opportunities for growth and reducing overall business dynamism. Calvino *et al.* (2016), for example, find that the effects of less favourable access to finance, strict bankruptcy regulations, weak contract enforcement and civil justice efficiency, more strongly affect the growth dynamics of entrants than incumbents. The negative effect of these policy failures on start-up performance is particularly strong in highly dynamic sectors. Governments in a number of countries have taken initiatives to make product market regulations friendlier to young and small firms (**Box 11**).

#### **Box 11. Canada's Paperwork Burden Reduction Initiative (PBRI) & Red Tape Reduction Action Plan**

Canada has placed a great emphasis on regulatory simplification in recent times, first through the Paperwork Burden Reduction Initiative (PBRI) launched in 2004, and later through the Red Tape Reduction Action Plan, launched in 2012.

One of the main objectives of the PBRI was to measure the cost of regulatory compliance for small businesses. Three surveys were carried out between 2005 and 2011, which concluded that compliance costs had dropped by 0.3% per year over the period 2005-2011. In particular, the average "regulatory bill" was CAD 3 500 per business and CAD 370 per employee, i.e. 0.29% of business sector revenues, in 2011.

The aim of the Red Tape Reduction Action Plan was to reduce administrative burdens and improve the services and predictability of Canadian public administration for small business owners. The *Cabinet Directive on Regulatory Management* provides a framework for the development of regulatory proposals that incorporates a "One-for-One" Rule, a Small Business Lens in the regulatory process, and requires departmental forward regulatory plans. The Rule requires that the introduction of a new regulation that imposes administrative burden costs on business requires an equal amount of regulatory burden cost to be removed from existing regulations. The Small Business Lens requires regulators to demonstrate how they have minimized the impact of administrative and compliance burden costs of proposed regulations on small business. Finally, forward regulatory plans are a description of future regulatory changes and proposals that a government department or agency intends to implement; the objective is to help business owners to adjust more easily to future changes in regulations.

Source: OECD (forthcoming), *SME and Entrepreneurship Policy in Canada*, OECD Publishing.

100. **In parallel, OECD analysis shows that there is much scope for regulatory reforms, particularly to insolvency regimes to boost labour productivity.** OECD work (Adalet McGowan et al., 2017b) notes that regulatory reforms can help contribute to reinvigorated productivity growth by: i) making it more likely that weak firms exit or are successfully restructured; ii) reducing the share of capital sunk in lagging firms; and iii) spurring productivity-enhancing capital reallocation. For example, reforming insolvency regimes to OECD best practice levels is estimated to reduce the share of industry capital sunk in lagging firms by around one-half in Belgium and Italy, which is significant given that the capital share of all of these firms in 2013 was relatively high at 14% and 19% in the two countries respectively. This analysis shows that less stringent product market regulations affecting firm entry and stronger rule of law and environmental protection stringency can also reduce the resources trapped in failing firms. At the same time, productivity in established small and medium-sized enterprises (SMEs) tends to lag behind large firms (OECD, 2016g), and policies targeted at overcoming barriers to their productivity growth can also help reduce productivity gaps with leading firms, such as business development services aimed at upgrading managerial practices and business models, in-house workforce training and fostering ICT adoption. Such policies need to be designed carefully and targeted on tackling market and institutional failures.

101. **Governments should strive to ensure that business taxes and subsidies provide a level playing field for all firms.** Given substantial fixed costs associated with calculating and remitting taxes, compliance burdens tend to fall disproportionately on small firms. In some cases, tax compliance costs for small firms may even exceed their tax cash payments (OECD 2015). Compliance costs may also be shifted to employees of small businesses potentially reducing wages for employees of small businesses in addition to owners' profits. Simplification provisions of various types and digital technologies can represent powerful tools to lower compliance costs (OECD, 2014). Other aspects of business taxation, including asymmetric treatment of profits and losses, the distribution of taxation between capital and labour income and the design of R&D tax credits and incentives, can also unintentionally inhibit a level playing field between small firms and large incumbents. For instance, across OECD and non-OECD countries labour is typically taxed more heavily than capital. Tax policies tailored to SMEs may help address some of these distortions, but they should be carefully targeted to ensure that they meet their policy objectives in a cost-effective way and do not create further distortions or complexities.

### *3.2.2 Policy needs to focus on addressing skills mismatches to boost productivity growth*

102. **The use of skills in the workplace is a major determinant of cross-country differences in labour productivity.** On average across countries, roughly 15% of workers show skills mismatches, with over-skilling being more prevalent than under-skilling (OECD, 2015).<sup>18</sup> While over-skilling might be good from the point of view of a single firm, misallocation between skills and jobs lead to aggregate productivity costs because it prevents the optimal use of workers' capabilities. Indeed, a more efficient use of human talent in countries where the skills mismatch is very high could boost the levels of labour productivity by around 10%. This could close about one-fifth of the gap in labour productivity between Italy and the United States (OECD, 2015). In practice, there are several factors which constrain the firms' ability to make full use of the capabilities of their workers. These may include firms lacking the necessary flexibility to adapt jobs and tasks to the skills of new hires (OECD, 2016i) and rapidly evolving changes to the nature of the skills demanded occurring too fast for policy to keep pace.

103. **A better matching of skills and jobs will require integrated education and labour market reforms.** Particular emphasis should be placed on the aim of improving the quality of education systems (as discussed in Section 3.1.1), incorporating horizontal skills, achieving a better match between the needs of global labour markets and what students learn, and improving managerial quality. For example, increasing participation in lifelong learning programs from the lowest OECD level in Italy to the median level in Estonia would be associated with a 6 percentage point decrease in mismatch (OECD, 2015). While vocational training programmes and life-long learning may be more dynamic in addressing these changes, a profound transformation of the University system is also needed to ensure that it provides students with labour-market-ready skills. In addition, students and workers need more and better information about labour market prospects and informed advice about likely future labour market demand, which could be facilitated by comprehensive foresight exercises focussed on with future needs.

### *3.2.3 Governments also have an important role to play in investing in and incentivising research and development (R&D)*

104. **Research and development spending and ownership of intellectual property is concentrated amongst leading firms.** Evidence shows that very few firms account for a very large share of global R&D expenditure, patents and trademarks and those at the very top account for the greatest share. In 2012, among the world's 2000 largest corporate R&D investors, the top 250 firms accounted for more

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18 However, it should be taken into account that the pool of people with very low skills are more likely to be unemployed, so a large proportion of them will not be part of this picture (which only includes people at work), but this may impose serious constraints on economic growth and is without any doubt the greatest source of inequality.



than 70% of R&D and patents and 44% of trademarks amongst the group, whilst the top 100 firms the top 5% of the accounted for 55% of that group's R&D expenditure, 53% of patents and 30% of trademarks.

105. **Governments have a key role to play in providing direct support and tax incentives for all firms to carry out R&D regardless of size.** Governments support 10%-20% of business R&D expenditure in most OECD countries (OECD, 2016j) through a combination of tax incentives and direct support. In all instances, it is important to ensure that supports are designed so as to be equally accessible to incumbent, young and new firms. The need for this is particularly clear in the case of tax incentives: as many young innovative firms typically make losses in the early years of R&D projects they typically fail to benefit from offsetting fiscal support, unless it contains provisions for immediate cash refunds for R&D expenditure, or allows such firms to carry associated losses forward to deduct against future tax burdens. Another solution that has been taken up by a number of governments is to move towards income-based tax incentives such as patent boxes (OECD, 2016k). However, as well as suffering from deadweight losses and providing windfall gains to some firms, the benefits of such incentives are likely to accrue mainly to multinational incumbents, which are better positioned to find ways of using these provisions to shift profits across jurisdictions, rather than young, innovative firms (OECD, 2015).

106. **Governments also need to ensure that the patent system provides firms with the incentive to innovate, though winner-take-all dynamics may also call for a protection of property rights that is not overly strict.** In certain sectors which make intensive use of knowledge-based capital, with fragmented innovation processes, the patent system may unduly favour incumbents at the expense of young firms (Cockburn, McGarvie and Muller, 2009). Moreover, in sectors with higher firm entry and exit, stronger protection for patent holders may stifle diffusion to the extent that it is associated with larger productivity gaps between the most global frontier firms and the most productive firms nationally (Andrews, Criscuolo and Gal, 2015). Patent systems made need to be rethought to keep pace with these evolving dynamics. One key factor to ensure that patent regimes do not become a significant obstacle to entry and further technological development is the transparency of the patent system. Transparency also has additional positive effects when considering how it can facilitate the use of patents as collateral, giving young firms, with untapped resources in the form of Intellectual Property (IP) a better chance of accessing finance. All these benefits may be weighed against the increasing market concentration of some firms that would instead require a protection of property rights that is not overly restrictive.

107. **Public support for innovation remains key to long term productivity growth.** State-sponsored public research is vital a source of new know-how and technology in important areas like basic science, where the private sector is often not well-equipped or motivated to invest. Firms tend to underinvest in so called 'blue skies' research and development on account of its costs and uncertainty, the time required to obtain returns on investment, and the possibility that competitors can capture knowledge spillovers. Yet, many of today's innovations would not have been possible without the scientific and technological developments enabled by public research. Much has been made of famous contemporary examples that include recombinant DNA technologies, the GPS global positioning system, MP3 technology for data storage, and voice recognition technology such as Apple's Siri (Mazzucato, 2011). Much of this research began life in universities and public research institutes (PRIs), which are predominantly funded by governments, and often undertake longer-term and higher-risk research. Although they account for less than 30% of total OECD R&D expenditure, universities and PRIs perform more than three-quarters of total basic research (OECD, 2016). They also undertake a considerable amount of applied research and experimental development that has more immediate potential for translation into tangible societal benefits. Yet, despite this, expenditure on R&D by universities and PRIs in OECD countries began flattening out in 2010 following three decades of growth. One reason for this has been pressure on government budgets, both in the wake of the financial crisis and due to longer term structural shifts like population aging. But another factor could be that rising international connectedness and the key role of MNEs in driving frontier R&D imply that the benefits from public research and support to private R&D will become more widespread globally, weakening incentives for national governments to support these activities (Braconier et al., 2014). As a result, global mechanisms to fund and co-ordinate public investment in research are becoming increasingly desirable.

### ***3.2.4 Special attention needs to be paid to supporting SMEs access to financing***

108. **Many smaller businesses found themselves particularly vulnerable in the wake of the crisis.** After the crisis struck, SMEs were typically less individually diversified in their economic activities than their larger counterparts and found it more difficult to downsize given their smaller starting point. At the same time many SMEs also stood on a weaker financial footing with lower capitalisation and were heavily dependent on credit and they have fewer financing options and had lower or even no credit ratings (OECD, 2009). From this low point, conditions have since markedly improved, with a general trend of rebound in credit lending in 2014 (OECD, 2016). At the same time, accommodative monetary policy in most regions of the world saw SME interest rates decline in the years leading up to 2014 whilst demand-side surveys indicate a widespread easing in credit conditions with a decline in loan rejection rates. In a similar vein the number of SME bankruptcies declined in down in 20 out of the 25 OECD countries available and in nine of these countries were below pre-crisis levels 2014 (OECD, 2016).

109. **Though improvements have been made in SMEs' access to finance, policies can do more to help firms unlock funding.** As bank credit remains the main source of external finance for most small businesses, efforts should be pursued to make it easier for banks, or other funding mechanisms, to lend to SMEs. Such efforts may include measures to improve risk mitigation which make use of new technologies for underwriting risks, including credit scoring models. This should also entail a push for effective and predictable insolvency regimes to ensure creditor rights and greater transparency for credit risk assessment.

110. **Efforts should also be made to foster the development of non-traditional forms of financing.** Though traditional mechanisms and particularly bank lending remain overwhelmingly dominant, alternative financing mechanisms have grown in prominence and importance in recent years and these changes should, in accordance with the OECD-G20 Principles on SME financing (G20-OECD, 2015), be supported by policy. For instance, initiatives such as crowdfunding and business angel activities have become increasingly significant, although they remain a small proportion of overall lending, and hold further untapped potential. Hybrid instruments, which combine debt and equity features, have also grown in prominence, increasingly serving both young and established companies that seek expansion capital, but which are not suitable for public listing. In each case, making full use of these instruments will entail a greater policy focus not solely on the supply of such financing methods, but also in fostering demand via concerted efforts to raise SMEs' awareness and understanding of alternative financing instruments.

### ***3.2.5 As part of efforts to create a level playing field for firms and foster inclusive growth, governments need to promote more equitable financial markets that also serve to channel resources into productive activities***

111. **Regulation needs to ensure that the financial sector is supporting access to finance for all firms.** As outlined in Chapter Two, OECD research on *Finance and Inclusive Growth* has shown that, at today's elevated level of financial development, further expansion of bank credit, particularly for real estate, to the private sector, particularly households, is not associated with stronger growth in most OECD countries and may serve to exacerbate income inequality. In response to the financial crisis policymakers have pursued measures to reduce explicit and implicit subsidies to too-big-to-fail financial institutions<sup>19</sup>. Such subsidies appear to raise financial sector pay – a “financial sector wage premia” that contributes to market income inequality – but also to result in more and cheaper, ‘subsidised’ bank lending. Likewise, reducing the tax bias against equity would also help to make financing more equitable.

112. **Whilst greater levels of stock market financing supports growth it can, when combined with excessive short-termism, crowd out long-term investment.** Algorithmic, in particular high-frequency, trading, can crowd out long-term investment in stock markets at the expense of broader value creation, to the benefit of traders. To the extent that company financing decisions are driven by rules,

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19 For general background, see <http://www.oecd.org/finance/financialsectorguarantees.htm>

regulations or tax treatment, removing biases in terms of financing choice (bond vs. bank vs. equity), financing duration (short-term vs. long-term), and payout strategies (dividend vs. M&A vs. stock buyback) should be a public policy concern and a focus for new OECD research.

113. **The digitalisation of finance offers opportunities, as well as risks.** Digital banking, innovation in digital payments, P2P currency exchange and lending platforms can offer financial services to the underserved and underbanked, who still exist even in OECD countries. Financial digitalisation can also boost the entry of new players, which may reduce the market power of too-big-to-fail financial institutions. As a result, such financial innovation also has the potential to enhance economic productivity and ultimately foster a more inclusive and resilient financial system with positive spill-overs on economic growth. Digitalisation also carries risks. It can serve as an effective tool to reduce some types of operational risks, but it is also a new source of vulnerabilities such as for example cyber risks. More generally, its potential benefits might be overestimated. Also, the unbundling of many types of financial services and the re-bundling of them in different forms might lead to some non-traditional financial service providers becoming systemically important, and it is important that public authorities ensure that such entities internalise the negative externalities that arise should they experience financial distress.

### ***3.2.6 Promoting business dynamism is essential to inclusive growth, but it is not sufficient, as it needs to be accompanied by comprehensive action to mitigate trade-offs***

114. **The growing body of research on the *Productivity-Inclusiveness Nexus* has shown that policies stimulating business dynamism, trade liberalisation, and the product market may generate displacement costs for individuals.** Indeed, reforms to revive business dynamism by reducing resource misallocation and encouraging the downsizing or exit of inefficient firms typically result in some jobs being destroyed, and the workers displaced from those jobs may face high adjustment cost. Such is the case of product market reforms that raise competitive pressures in particular in industries characterised by large incumbent firms, such as in network industries (OECD, 2016m), as well as of reforms to increase the efficiency of insolvency regimes (Adalet McGowan et al., 2017). This is also true of reforms that reduce trade barriers, especially in advanced OECD economies, to the extent that they expose workers to increased external competition (e.g. from low-wage countries) and, similarly of product market reforms that encourage business restructuring and resource reallocation. It should be borne in mind, however that, while reforms that revive business dynamism, may result in some jobs being destroyed, the “net job effect” is difficult to quantify given that the expected productivity gains of such reforms may enable job creation in other sectors.

115. **Compensatory policies that redistribute income also have a role to play in cushioning shocks, smoothing adjustment and lowering post-redistribution inequality.** Displacement effects associated with trade exposure are among the most salient and visible costs of globalisation in advanced OECD economies. But even here, compensatory measures can serve to mitigate the worst effects and to help individuals into more productive employment. As discussed above in Section 3.1, strong and well-designed social safety nets programmes are all the more needed in a context where: i) increased globalisation makes economies more vulnerable to external shocks and, ii) rising non-standard work excludes a higher proportion of the workforce from unemployment benefits. Broad-based social protection systems are needed to enhance both the adaptability of labour markets and equity. Reaching broad coverage of unemployment benefits and social-assistance systems also has positive consequences on the effectiveness of active labour market policies. Governments should also take advantage of the fact that a number of complementary measures can reinforce active labour market and reskilling programmes in helping displaced workers finding good quality jobs, including:

- **Structural reforms that stimulate labour demand can raise re-employment probability for workers displaced by business closures** (Andrews and Saia, 2016). Such is the case for reductions in labour tax wedges. Such reductions are likely to be most effective and inclusive when targeted at low-wage workers, a group that is disproportionately affected by business

closure and industry restructuring. Product market reforms that reduce entry barriers for new firms offer a second example (Causa et al., 2016).

- **Structural reforms that address policy-induced distortions in housing markets so as to ease geographical mobility.** Indeed, geographical mobility is a key channel through which workers who lose their jobs due to plant closure become re-employed (Andrews and Saia, 2016). Examples of such reforms include reducing stringent land-use regulations and rent controls; as well as reducing high transaction taxes on buying and selling property.
- **Supporting workers at high risk of displacement must take into account the regional dimension of displacement.** There are large regional variations in employment outcome for displaced workers (OECD *Back to Work*, 2013) that justify that the impact of displacement is managed at local level, including by fostering new job opportunities for the displaced.

### 3.3 Governance and Implementation

116. **Policies for Inclusive Growth require an integrated, coherent approach to governance, including among different levels of government.** Given the multidimensional, cross-cutting nature of an Inclusive Growth agenda, policy solutions need to be designed, implemented and reviewed in a highly coordinated manner. This raises significant challenges from an institutional perspective and requires the development of new policy mechanisms and platforms that can facilitate the task of implementing whole-of-government reforms aimed at fostering inclusive growth. Given the large spatial dimension of inequalities and the fact that the responsibility for tackling subnational disparities is often with local governments, governance coordination is necessary at vertical level too. A variety of new tools are being used by governments to respond to the new challenges faced when implementing policies for inclusive growth.

#### *3.3.1 To be inclusive, growth must improve the performance of all regions, cities and neighbourhoods, including those lagging behind*

117. **Trade is key to increasing productivity in lagging regions and localities and addressing stagnant national productivity growth.** In some countries, the top 20% of people live in regions that have productivity levels three times that of the bottom 20%.<sup>20</sup> Around one in four persons in the OECD is living in regions that experience productivity growth rates significantly below those of their national productivity “frontier” region(s). Such regions would theoretically need to quadruple their current growth rates to catch up by 2050. Productivity catching up by lagging regions, both urban and rural alike, is associated with a strong and growing “tradable” sector (i.e. goods and services exposed to international competition) (OECD, 2016a).

118. **Regional and local development policies are an opportunity to address spatial differences in income and wellbeing outcomes for people.** Regional and local development policy approaches in OECD countries aim to make targeted public investments in ways that support the place’s promising economic opportunities and the quality of life for its residents. Such policies often address local obstacles to entrepreneurship, innovation and skills development in order to increase local growth (OECD, 2016n). With respect to urban policies, more could be done to improve the functioning of individual cities, such as through better metropolitan governance, as well as to improve the network of cities to promote greater growth spillovers throughout the country. Rural development policy approaches in most OECD countries remain largely focused on agriculture, and thus need to further consider improving productivity in non-farm economic activity, recognising the diversity of types of rural regions (OECD, 2016a).

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20 As measured by GDP per worker and using a population weighted ranking of top and bottom 20% of regions.

119. **Appropriate governance arrangements (the “how”) are essential for the effective implementation of place-based policies.** Above and beyond the quality of government, the organisation of government intervention plays a considerable role in increasing the impacts of regional and local development policies for both productivity and inclusion. Reforms of subnational government are being undertaken in many countries to match policy design and delivery to the relevant scale for infrastructure investment and service provision. They also may seek to address the fragmentation of municipal jurisdictions in a metropolitan area, which is associated with penalties in terms of productivity and inclusion, notably residential segregation by income (OECD, 2015; OECD, 2016b). Of particular importance is the need to foster policy co-ordination across sectoral areas, vertically across levels of administration, and horizontally among jurisdictions at the same level of government (OECD, 2013).<sup>21</sup>

120. **Even when a city overall is economically successful, within-city inclusiveness may require complementary policies.** Cities (and their metropolitan areas) bring together both high and low-skilled workers and often include local concentrations of poverty and exclusion. Inclusion-promoting policies include strengthened local education and training investments and a better designed urban environment with respect to housing, transport and environmental investments, with the aim of increasing access to jobs and addressing the costs of urban life such as air pollution (OECD, 2016o). Mayors and other local government leaders have an important role to play in promoting inclusion in its various dimensions.<sup>22</sup>

121. **While most OECD countries have enjoyed an overall increase in educational attainment over the past 15 years, skills gaps exist – and have increased – between places.** Skills levels vary substantially across local labour market areas within countries, and are closely correlated with differences in local incomes and productivity (OECD, 2016m). Furthermore, highly skilled workers and the employers who seek them are drawn to well-off localities, exacerbating the inequalities. Skills policies must therefore recognise differences in local labour market conditions and support low skilled and disadvantaged individuals to gain appropriate training in order to move up the skills and income ladder. At the same time, local business development policies should seek to encourage entrepreneurship and innovation for example through stimulating local entrepreneurial ecosystems and job creation in the social economy (OECD, 2014). Local governments can take a leadership role in mobilising resources and stakeholders to develop a community wide vision of inclusive growth.<sup>23</sup>

122. **Access to affordable housing is a challenge for inclusion, and solutions include not only better housing policies but also better urban planning and governance of land use.** Housing costs constitute the single highest expenditure item from the household budget. Over half of the poorest quintile of renters in many OECD countries spends more than 40% of disposable income on housing costs. Explicit policies to support access to housing include housing allowances, social housing arrangements and different kinds of financial support towards homeownership (**Box 12**). The governance of land use and urban planning helps determine where and how much housing can be built, and thus influences its supply and cost, in addition to a wider range of policies that affect the incentives for different land uses (OECD, 2017j). Governance of land use and urban planning should be better managed. In addition, it will be important to move away from a number of distortive and regressive income support for homebuyers. More

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21 The *OECD Recommendation on Effective Public Investment Across Levels of Government* and its accompanying toolkit for implementation <https://www.oecd.org/effective-public-investment-toolkit/> offer examples for improving the outcomes from these investments.

22 Such as, for example, those actions associated with the *Champion Mayors for Inclusive Growth initiative* <http://www.oecd.org/inclusive-growth/champion-mayors/> along four priority policy pillars: inclusive education, inclusive labour markets, inclusive housing and urban environments, and inclusive infrastructure and public services.

23 For example, in the United Kingdom, Local Enterprise Partnerships are bringing together local authorities and employers to determine local economic priorities and promote an inclusive job creation agenda. They work with Jobcentre Plus (i.e. the Public Employment Service in England) and further education providers to help local unemployed people into jobs (OECD, 2015).

research needs to be done to assess the balance of benefits of owning versus renting housing, particularly in light of changing premium on individual and household mobility to pursue best skill matches and job availability.

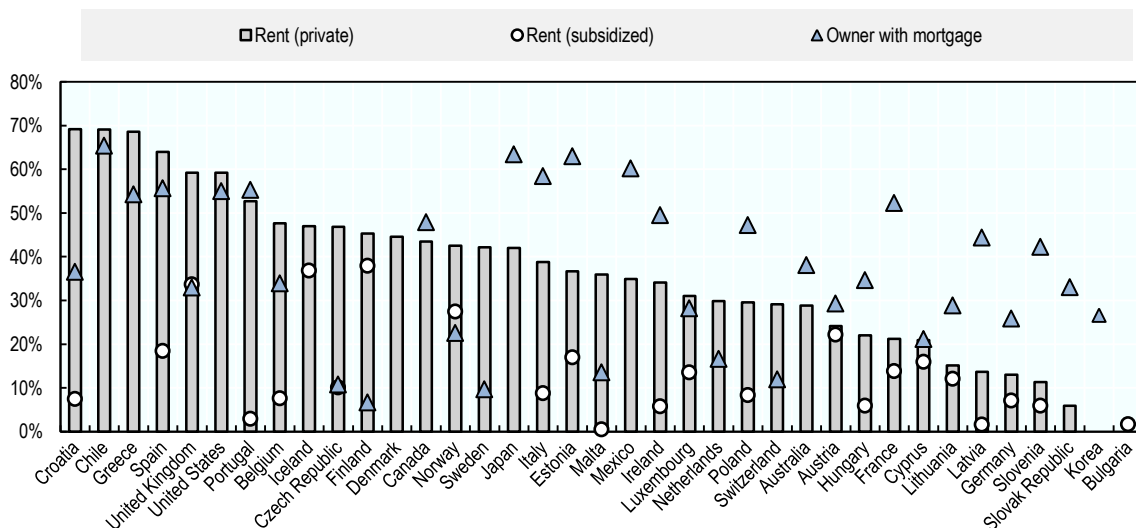
**Box 12. Affordable housing: a key step on the inclusive growth path**

Access to good-quality affordable housing is a fundamental need and key to achieving a number of social policy objectives, including reducing poverty and enhancing equality of opportunity, social inclusion and mobility. Housing needs are frequently unmet and too many households live in low-quality dwellings or face housing costs they can ill afford.

Housing costs constitute the single highest expenditure item from the household budget, and can represent a substantial financial burden particularly for low-income households in many OECD countries. For example, in Croatia, Chile, Greece, Portugal, Spain, the United Kingdom and the United States more than half of poor tenant households are overburdened by housing costs, i.e. they spend more than 40% of their disposable income on housing costs (Figure 26). Among the population servicing a mortgage, most affected by housing cost overburden is the population in countries hit more severely by the Great Recession and/or in a difficult economic situation such as Chile, Greece, Iceland, Italy and Spain.

**Figure 27. Housing cost overburden rate among low-income owners (with mortgage) and tenants (private rent and subsidized rent), in % of the population**

Share of population in the bottom quintile of the income distribution spending more than 40% of disposable income on mortgage and rent, by tenure, in percent <sup>1 2 3</sup>



1. In Chile, Mexico, Korea and the United States gross income instead of disposable income is used due to data limitations.
  2. No data available on subsidized rent in Australia, Canada, Chile, Mexico and the United States. In the Netherlands and Denmark tenants at subsidized rate are subsumed into the private market rent category due to data limitations. No data on mortgage repayments available for Denmark.
  3. Results only shown if category is composed of at least 30 observations.
- a) Note by Turkey: The information in this document with reference to “Cyprus” relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the “Cyprus issue”.
- b) Note by all the European Union Member States of the OECD and the European Union: The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the government of the Republic of Cyprus.

Source: OECD calculations based on European Survey on Income and Living Conditions (EU SILC) 2014 except Germany; the Household, Income and Labour Dynamics Survey (HILDA) for Australia (2014); the Survey of Labour and Income Dynamics (SLID) for Canada (2011); Encuesta de Caracterización Socioeconómica Nacional (CASEN) for Chile (2013); the German Socioeconomic Panel (GSOEP) for Germany (2014); the Korean Housing Survey (2014); Japan Household Panel Study (JHPS) for Japan (2014); Encuesta Nacional de Ingresos y Gastos de los Hogares (ENIGH) for Mexico (2014); American Community

Survey (ACS) for the United States (2014).

Furthermore, quality issues are of increasing concern. In general overcrowding rates increase as household income decreases, with countries like Hungary, Mexico and Poland and Romania experiencing overcrowding rates that are over 40% among poor households. The lack of sufficient living space for household members can significantly hamper wellbeing, with negative effects of overcrowded dwellings on health and on child outcomes.

Countries implement a wide range of measures to tackle increasing demand for affordable housing. Many countries have housing allowances and/or social housing arrangements as well as different kinds of financial support towards homeownership. Indeed, housing allowances are now one of the most widely used instruments of housing support. At 1.4% of GDP, public spending on housing allowances in OECD countries is by far the highest in the United Kingdom, followed by France and Finland.

The most common supply-side initiative in most countries is the provision of social rental housing (either directly or increasingly through support to not for profit housing organisations). However, in a number of countries, there has been a decline in the number of social rental housing available, partly due to the slowdown in construction and policies that support the privatisation of social housing, such as in Germany, Poland and the United Kingdom. That said, social rental accommodation still represents over 20% of total housing in Denmark, Austria, and the Netherlands.

As for supporting people in buying a home, grants, subsidised mortgages and mortgage guarantees are used by a large number of OECD countries to help low-and middle income households accessing home ownership. While Chile is the country which has the largest share of support to home buyers through grants, most countries increasingly recur to measures making it easier for households to access to mortgage credit. Tax relief also accounts for a significant share of homeownership support in a number of countries: mortgage interest deductibility alone costs 0.5% of GDP in the United States and 2.1% of GDP in the Netherlands. The extent to which measures supporting home buyers really target the neediest varies across countries and schemes.

### ***3.3.2 Ultimately, the pursuit of inclusive growth will require a whole-of-government approach that aligns vision, incentives and delivery mechanisms throughout the policy-making process***

123. **Increasing complexity and citizen demands, combined with growth in new technologies and the need to meet cross cutting global commitments, will require the public sector to work in new ways to promote inclusive growth and restore trust in governments.** Many OECD countries are deploying governance frameworks to support a more inclusive growth agenda across the policy cycle and promote trust in government (OECD, 2016). This includes giving citizens a voice in the design and implementation of public policies, including service delivery and ensuring accountability through policy evaluation. Despite some encouraging initiatives, a lot more needs to be done to coordinate efforts across government and between levels of government. In addition, while countries have increased the evidence-base for policy-making and use key national indicators to guide priority setting and policy design, more information is needed on the distributional impacts of policies across different social groups and places. Better evidence is also key to understanding the determinants of social attitudes and perceptions at the heart of the policy debate, like trust. The OECD's work on *Trust Lab* (**Box 13**) is making significant advances on this front and will help to inform a more evidence driven policy response.

#### **Box 13. Measuring trust and assessing its policy determinants: evidence from the OECD *Trustlab***

As underlined in **Chapter Two**, trust is a key ingredient of inclusive societies: playing a part in determining economic growth and social cohesion (Arrow 1972; Fukuyama 1995; Putnam 2000; Guiso et al. 2011), enabling governments to implement difficult policy reform and, perhaps most crucially, bolstering the legitimacy and sustainability of the political system (Klijn, Edelenbos and Steijn, 2010; OECD 2014).

However, trust is also an elusive concept that is difficult to measure, especially in a way that is useful to policy makers. Most of the available comparative measures of trust are based on small scale, non-official survey instruments, which allow only limited analyses of the drivers and impacts of trust. Furthermore, the policy determinants of trust have been studied only in a very limited way. Some studies have focused on the competences and values of governments (Bouckaert and van de Walle, 2003, Noteboom, 2007, Choi and Kim, 2012, Bouckaert, 2012), while others have highlighted the role of income inequality as a factor of social distance and distrust within societies (Brown and Uslaner, 2005) and others yet have pointed at the importance of diversity



in neighbourhoods (Koopmans & Schaeffer, 2015) or globalisation (Stiglitz, 2009). However, no study has examined a large number of policy determinants of trust within the same empirical model. Designing a framework aiming at restoring trust requires collecting broader and better evidence.

To improve the measurement of trust and identify its policy drivers, the OECD launched in 2015 **Trustlab**, an international programme that collects online information on people's trust and other social attitudes through cutting-edge techniques drawn from both behavioural science and experimental economics, combined with traditional survey questions, and applied to representative samples in various OECD countries. Trustlab is developed in cooperation with various academic partners and conducted over a selected number of OECD countries; evidence from Trustlab is feeding into the OECD "Guidelines for Measuring Trust", forthcoming.

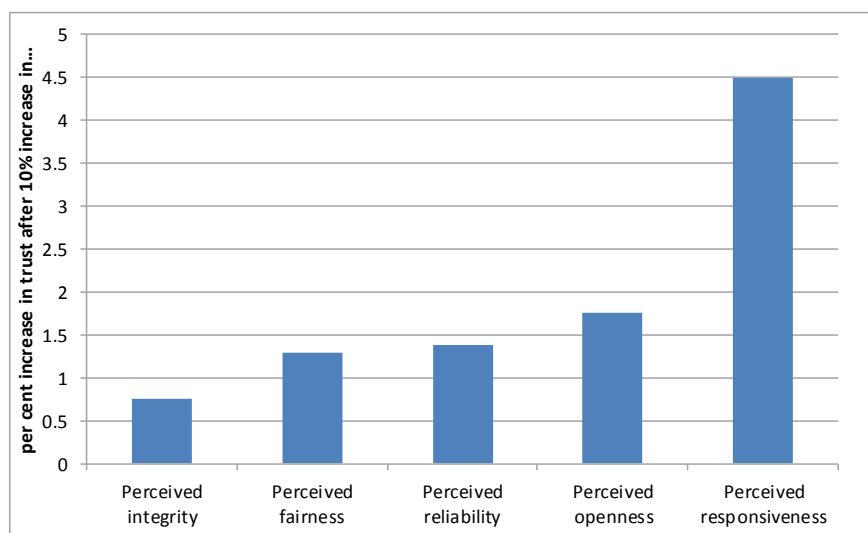
Trustlab addresses some of the measurement issues around trust by comparing experimental measures of trust obtained from behavioural games or psychometric tests with self-reported measures drawn from classical survey questionnaires. The preliminary results from Trustlab suggest that self-reported measures of trust in others mainly capture attitudes towards risk, while experimental measures of trust in others are mainly related to attitudes to cooperation. These findings underline the importance of considering various measures of trust (experimental and survey-based) as complementary, and of strengthening the comparative evidence available by extending Trustlab to cover a much broader set of countries.

Turning to trust in institutions, preliminary Trustlab results suggest that self-reported measures of trust in institutions capture a deeply ingrained sentiment of respondents. This finding supports previous claims (Easton, 1975) that respondents may under-report their trust in government, and it highlights the importance of the experimental method as a complement to self-reported measure.

Trustlab also features an extensive survey module that includes a range of questions on people's satisfaction with public services at national and local levels, their perceptions of government openness, their reliability in crisis situations, integrity at different levels of government, as well as on their views on social mobility, attitudes to ethnic diversity and immigrants integration, economic and job security, perceived benefits of globalization and political preferences. Preliminary results from the Trustlab suggest that perceived responsiveness of public services delivery is the strongest predictor of people's trust in government. As shown by the Figure below, a 10% increase in people's satisfaction with the public services provided by public institutions raises their trust in government by 4.5%, an effect that is nearly as large as that of all the other government characteristics assessed by respondents.

**Figure 28. Policy Determinants of people's trust in government in two OECD countries**

Preliminary evidence based on Trustlab



Source: Murin et al. (2017)



124. While the specific design of such mechanisms will depend on country specific characteristics, some broad lessons and associated institutional requirements for implementing an Inclusive Growth agenda emerge. For example, a number of policy instruments are available to align inclusive growth objectives with resource allocation over time. These include medium-term expenditure frameworks and performance-related budgeting as well as evaluative tools such as budget and regulatory impact assessments and expenditure appraisals for both current and capital spending. Regulatory Impact Assessments (RIA) aim to provide information on the distributional impacts of regulation which can help reveal and monitor trade-offs between the economic, social and environmental effects of regulatory responses. Evidence shows that some OECD countries are using RIA for this purpose (Figure 29). Spain for instance conducts impact assessments on gender and regional distribution and encourages social impact assessments including on equal opportunity and non-distribution. Behavioural insights have also been increasingly embedded in organisational decision-making across government bodies (OECD, 2017) with the purpose of informing design of policies that are particularly relevant from an Inclusive Growth perspective (Box 14).

**Figure 29. Types of impacts integrated into regulatory impact assessments**



Note: Based on data from 34 countries and the European Commission.

Source: OECD Indicators of Regulatory Policy and Governance (iREG), [www.oecd.org/gov/regulatory-policy/measuring-regulatory-performance.htm](http://www.oecd.org/gov/regulatory-policy/measuring-regulatory-performance.htm).

**Box 14. Leveraging Behavioural Insights for Designing Inclusive Growth programmes**

There are behavioural barriers that prevent government policies from delivering their intended outcomes or reaching targeted groups. It is not always clear why educational opportunities are not always taken up by vulnerable groups, or why certain people in society make choices that impact negatively on their wellbeing such as financial decisions (e.g. pensions, savings, etc.) or on their health. Insights from behavioural science can assist to address some of these issues. For instance studies have shown that people are willing to contribute financially towards the greater good if they feel everybody else is also. However they will take negative consequences, such as financial costs, if they feel they have been treated unfairly (OECD, 2014). These lessons can be critical for the

design and functioning of factors that impact upon inclusive growth, such as revenues for social causes and equity and justice across society.

The OECD has collected over 100 case studies from around the world that show how public bodies are applying behavioural insights in policies, many of which contribute to inclusive growth. For instance, this include direct interventions reduce unemployment and assist jobseekers (OECD, 2017i). In Canada nudges to Job seekers improved the online traffic flow of job seekers on the Job Bank posting page from 67% to 122% more (p276, OECD2017). In Singapore a behaviourally informed job seeker programme found that 49% of job seekers that underwent this programme found work within 3 months, compared to the normal rate of 32% (p.289, OECD2017). In addition there are many behavioural elements in other inclusive growth policies that should be used by governments such as the impact of poverty on cognitive ability (Anandi Mani et al, Science 341, 976 (2013DOI: 10.1126/science.1238041), which has profound impacts for how governments should respond to addressing issues such as policies for certain socio-economic groups. The pioneering work on the impact of neighbourhoods on social mobility (<http://www.equality-of-opportunity.org/>) also shows the importance of social networks and geography that are determining factors in economic progression and are fundamental in actual achievement of inclusive growth. This cutting edge behavioural research and others can have a profound impact on how inclusiveness is viewed and what governments can do to enable growth that is inclusive.

125. **The use of digital technology and partnerships with non-government actors are also useful for attaining inclusive growth objectives.** However, to fully exploit these tools, the government needs to ensure that the public sector has the right skills and competencies to deliver. Key among these are strategic planning and partnership management, supported by better data on access to services. The number of cross-ministerial policy initiatives has significantly increased since 2008 in OECD countries (OECD, 2015) and with it the need to adopt capacities to forecast future scenarios and ensure leadership is focused on mobilising a broad range of actors. Adopting such systems approaches will help governments confront problems that span administrative and territorial boundaries (OECD, 2017). The centre of government can play a strong convening and steering role in ensuring that these new management tools and practices support the inclusive growth agenda.

126. **Co-ordinated action is necessary across policy silos to achieve cross-cutting objectives like inclusive growth.** The number of cross-ministerial policy initiatives has significantly increased since 2008 in OECD countries (OECD, 2015) and with it the need to adopt capacities to forecast future scenarios and ensure leadership is focused on mobilising a broad range of actors. Adopting such systems approaches will help governments confront problems that span administrative and territorial boundaries (OECD, 2017). The centre of government can play a strong convening and steering role in ensuring that these new management tools and practices support the inclusive growth agenda.

### ***3.3.3 Strengthening global governance of the borderless economy is essential to fostering inclusive growth***

127. **Whilst the economy has become truly global, governance and policies remain rooted at the national level, giving rise to co-ordination challenges that are particularly pertinent for cross-cutting macro goals like promoting inclusive growth.** In many ways, 2015 was a landmark year for multilateral action, with major agreements such as the Sustainable Development Goals (SDGs) and the Paris Climate Agreement, to name a few, marking significant international consensus. At the same time, national actors and polities continue to have diverging priorities. Various country-specific norms and rules apply in different parts of the world: they may cater to specific preferences or have historical roots. Countries will need a comprehensive and integrated policy approach at both domestic and international levels to enable stronger, greener and more inclusive growth, while addressing the challenges brought about by digitalisation, demographic change, globalisation and climate change. Increased attention also needs to be placed on the interplay between the crosscutting global challenges that countries face, nowhere more so than with the need to promote green and inclusive growth (**Box 15**).

### **Box 15. Addressing the inclusiveness aspects of the green and low carbon transition**

Green growth must be fair. Broader policy alignment needs for green growth must also address inclusiveness. The success of such reforms depends on how to smooth the green and low-carbon transition by addressing up-front the distributional aspects of what such a transition might mean, e.g. to workers in “brown” sectors, and adverse impacts on low-income households. Given the economic, political and social difficulties that many countries face, ensuring that reforms are growth-enhancing, redistributive and green at the same time can be challenging. However, in order to secure public acceptance, these policies must be seen both to stimulate growth and to be fair for all households and workers.

Carefully designed policy instruments as well as policy coordination across ministries can mitigate such distributional and employment impacts of the green transition. As energy costs may increase from climate policies, households could face transitory costs for some of the new efficient equipment and infrastructure, and higher energy unit costs – e.g. where carbon pricing is the instrument of choice. The distributional effects of these changes may be regressive, but smart recycling of carbon tax revenues, for example, could offset such effects, as could better coordination with social security systems. In many countries energy access and affordability issues will have a strong bearing on policy choices to facilitate the adoption of low-carbon energy practices. A successful transition towards a green economy will necessarily reshape the labour market, creating new opportunities for workers, but also risks. Labour market and skills policies can make an important contribution to a successful transition by facilitating the structural change required to put green production practices in place. Policies should also seek to maximise the benefits of green growth for workers while assuring that adjustment costs remain acceptable.

The low-carbon transition costs are often distributed unevenly across regions and territories. Globally, the aggregate effect of the transition on jobs is likely to be modest, but reallocation across sectors and activities will be necessary. Employment in areas with a high concentration of either traditional energy-intensive and high-carbon industries or by poor economic diversification risk being hit during the transition process. Thus, development of integrated strategies for economic revitalisation of such areas is therefore an important element of the green transition. Although relatively few workers appear to be at-risk, some of the workers in these industries will need targeted assistance, such as retraining/re-skilling to be able to work with cleaner technologies, or help finding new jobs in growing green sectors. These measures will be particularly important in several European countries where coal mining or heavily polluting heavy industry are still major sources of employment. Proper social measures should be planned when restructuring and closures are anticipated. A number of local trade union initiatives illustrate that key factors include; good planning to anticipate and facilitate retraining and mobility, and an active social dialogue between government, employers and workers.

#### **The environment-health nexus: Cost of pollution is unevenly distributed across populations**

Environmental conditions have improved overall, for some parts of society, but remain worse for poorer individuals and children, affecting their health and earnings capacity. Environmental pollution leads to lost worker productivity due to illness and to increased costs of health care. The health effects on children, who are particularly vulnerable, could affect future labour productivity. For example, adults may acquire chronic respiratory illnesses after childhood exposure to air pollution. In the last two decades, concentrations of airborne particulate matter in OECD and emerging countries have dropped significantly, but global levels are still about double the WHO limits. The share of people living in areas with health-damaging levels of pollution is particularly high in China, India and, Indonesia. The global number of premature deaths linked to outdoor air pollution is expected to rise from about 1.8 million today to around 4.4 million in 2050 due to exposure to both ozone and particulate matter (PM) (OECD 2012d).

128. **In an ever more interconnected global economy, failure to cooperate on laws and regulations may generate regulatory failures, which imposes unequal costs on some firms, states and societies.** This is particularly true of tax, where inconsistencies and gaps in legal frameworks and insufficient co-operation across jurisdictions can facilitate tax avoidance and evasion. Information exchange agreements can reduce opportunities for avoidance and evasion of tax on capital income. The introduction of the Automatic Exchange of Information (AEOI) as well as the continued development of Exchange of Information on Request (EOIR) mark a step toward increased tax transparency, but there must be continued focus on the peer-review process and also the development of the network of exchange of information agreements for these new systems to maximise their effectiveness. Exchange of information should reduce the extent to which individuals and companies are able to use offshore structures to avoid and evade tax. Reducing tax avoidance and evasion restores trust in the tax system and allows countries

to collect more tax revenue. In order to reach these objectives, it is fundamental that all jurisdictions comply with internationally agreed standards in these matters.

129. **A range of approaches for international co-operation enable a level playing field to foster inclusive growth.** There are a variety of approaches that policy makers can draw on to coordinate on rules (OECD, 2013), ranging all the way from dialogues to supranational harmonisation – for example in the area of regulation.

130. **International organisations also play a key role in supporting co-operation and addressing the fragmentation that may undermine domestic action.** They provide the platform and catalyse the expertise needed to support countries in their collective policy action to manage globalisation. They enable exchange of information and experience, undertake research and analysis to provide policy advice and anticipate new common challenges, collect data from their members, and develop norms and standards for use by their constituencies. The international rules they develop are critical pillars of an effective global governance system in support of a sustainable world economy.

131. **The OECD has much to contribute to a more balanced world economy.** The OECD sees it as a strategic priority to strengthen the impact and outcomes of standards and identify areas where strengthened global standards are needed. For instance, the OECD created new international standards and best practices, through the Base Erosion and Profit Shifting (BEPS) package and created a global standard to tackle tax avoidance and evasion with the AEOI initiative. Other global economic governance issues addressed by OECD standards include transnational bribery, responsible business conduct, movement of capital, corporate governance, and international co-operation in competition<sup>24</sup>. These efforts strengthen the environment for countries to institute effective national policy, establish a level-playing field where negative spill-overs may otherwise occur, and ensure a framework for international cooperation which is essential to spur inclusive growth in a globalised economy.

### *3.3.4 The designing of inclusive growth policy strategies will ultimately have to be country-led*

132. **This chapter has discussed a relatively wide range of policies that are needed to foster inclusive growth.** It stressed the importance of focusing on policies enabling individuals and firms to make the most of new economic opportunities raised by digital and interconnected economies and to mitigate the risks associated with these new realities; and on labour market and redistributive policies that can support vulnerable individuals in case of disruptions, help them integrate swiftly into the labour market and redistribute opportunities when economies fail to integrate them fully and productively.

133. **There is no single best model or policy mix that works for all countries and the paths to Inclusive Growth must be contextualised and adapted to country-specific challenges and ambitions.** Ultimately, it is for each country to design an inclusive growth strategy that reflects its priorities, draws on its experiences and is mindful of the chief sources of inequalities in opportunities and outcomes in its own national context. Whilst this chapter has sought to sketch out some of the common building blocks underlying any inclusive growth platform, further work is required to dig down to the specificities of the individual country level. The OECD has started to undertake this task, producing a national case study of [Inclusive Growth in China](#) in 2015 and, more recently, building on OECD expertise in structural reform to expand the remit of [Going for Growth](#) to incorporate inclusiveness as a primary objective to provide policy makers with a set of concrete recommendations on reform areas identified as priorities for strong and inclusive growth. Economic Surveys and Multidimensional Country Reviews have also included country-specific analyses of inclusive growth issues and made progress in identifying realistic roadmaps of reforms and implementation that are reflective of national realities. Yet further work is required, and the OECD's

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24 OECD Anti-Bribery Convention, OECD Guidelines for Multinational Enterprises, OECD Codes of Liberalisation, G20/OECD Principles of Corporate Governance and OECD Guidelines on Corporate Governance of SOEs, OECD Recommendation on International Co-operation in Competition.

Inclusive Growth Initiative will seek to advance on this front over the coming period to engage in demand-driven discussions with individual countries, to establish priorities and plans for national inclusive growth strategies. Going forward, the OECD will also release an in depth review of social mobility – looking at the drivers of intra- and inter-generational mobility – as well as a report on the shrinking middle class which, along with the activities of the OECD Centre for Opportunity and Equality, will help advance our understanding of inequalities and ways to tackle them. The ongoing projects on the Future of Work, the New Jobs Strategy, the Gender Initiative, Integration of Migrants and Diversity will also help identify policies to promote more inclusive labour markets and societies.

## ANNEX

### OVERVIEW OF RECENT, ONGOING AND PLANNED ACTIVITIES SPECIFIC TO INCLUSIVE GROWTH

	Specific Aims and deliverables
<b>STI</b>	<ul style="list-style-type: none"> <li>• Development and extensions of the MultiProd database and methodological extensions in the area of wage dispersion across the productivity distribution.</li> <li>• STI Policy Paper on "Resource Misallocation, Wage Inequality and Productivity".               <ul style="list-style-type: none"> <li>○ The objective is to incorporate more countries and deepen the analysis based on the work with the MultiProd database carried out thus far. In addition, depending upon data availability, resources and countries' interest, the mechanisms underlying the relationship between productivity and wages and their evolution over time – in particular the increase in productivity and wage dispersion – could be analysed.</li> </ul> </li> <li>• STI Policy Paper on "Support Measures and Structural Adjustment"               <ul style="list-style-type: none"> <li>○ This stream of work would analyse the linkages between public support measures and structural change, taking into account the heterogeneous effects of those measures on different groups of firms.</li> </ul> </li> <li>• Report and toolkit on Innovation for Inclusive Growth: OECD (2017), <i>Making Innovation Benefit All - Policies for Inclusive Growth</i>, and accompanying toolkit for inclusive innovation: <a href="http://www.innovationpolicyplatform.org/inclusivetoolkit">www.innovationpolicyplatform.org/inclusivetoolkit</a></li> <li>• The OECD Horizontal Project on <i>Going Digital - Making The Transformation Work for Growth and Wellbeing</i> will include a special module on ensuring the inclusive nature of the digital transformation. This will be developed in close collaboration with the Inclusive Growth team.</li> </ul>
<b>STD</b>	<ul style="list-style-type: none"> <li>• Maintenance of the MDLS database and methodological extensions</li> <li>• Joint Working Paper with other directorates on policy determinants of Multi-Dimensional Living Standards               <ul style="list-style-type: none"> <li>○ Information will be collected from studies already carried out across the OECD and beyond, supported by new econometric analysis, to identify the key policy-drivers at work for each of the dimensions included in the MDLS metric,: these effects will be combined to evaluate the total net effects on multidimensional living standards. The main purpose of this activity is to help quantifying trade-offs and synergies that arise when policies affect various dimensions of living standards in differential ways (jointly with ELS and ECO).</li> </ul> </li> </ul>

	<ul style="list-style-type: none"> <li>• Coordination of statistical and measurement activities undertaken in the context of the horizontal project <ul style="list-style-type: none"> <li>○ This could include methodological advice to work aimed at extending the geographic coverage of the MDLS measure (e.g. to additional non-member countries).</li> <li>○ Potential for a new IG data portal.</li> </ul> </li> </ul>
<b>EDU</b>	<ul style="list-style-type: none"> <li>• As part of OECD’s Inclusive Growth initiative, EDU launched the Fostering Good Education for All project in Q4 2015 (ongoing activity). <ul style="list-style-type: none"> <li>○ <i>Opportunity for All: Overcoming Educational Inequalities over the Life Course</i> (OECD, forthcoming), is a main output of this project. It aims to examine how educational inequalities accumulate over the life course across the OECD and partnering countries and to provide policy recommendations to tackle such challenges.</li> </ul> </li> </ul>
<b>ECO</b>	<ul style="list-style-type: none"> <li>• New comprehensive research project about the effectiveness of tax and transfer systems in reducing inequality. This is an OECD horizontal project that directly feeds into the IG Initiative. It is part of the Tax and Inclusive Growth project undertaken in collaboration with CTPA and ELS. The project will proceed in two main steps and deliverables: <ul style="list-style-type: none"> <li>○ i) a first intermediate paper will be presented at the October 2017 WP1 meeting. This first paper will set the scene from an analytical perspective, presenting the data and methodology and delivering a broad picture of redistribution across OECD countries over the last decades;</li> <li>○ ii) A second more policy-oriented paper will be delivered for the March 2018 session of WP1. The paper will use the data produced in the first paper as dependent and explanatory variables in a reduced-form regression framework shedding light on drivers of the effectiveness of taxes and transfers.</li> </ul> </li> <li>• Framework for integrating inclusiveness in Going for Growth (2017 edition). The IG and GFG teams will continue enhancing and widening this framework based on new data and evidence-based analysis (in particular the tax and transfer/ redistribution project aims delivering empirical evidence on the effects of redistribution-oriented policies, which would then be incorporated in G4G future editions).</li> <li>• Ongoing work on the effects of the tax mix on growth and on income inequality, to reassess the “tax and growth” narrative under the light of equity and efficiency considerations.</li> <li>• Work on better understanding of the productivity-equality nexus, assessing the links between wage dispersion and productivity dispersion across firms, as well as identifying policy trade-offs and synergies in promoting productivity and inclusiveness <ul style="list-style-type: none"> <li>○ Starting with an analysis of decoupling of wages and productivity, which is already underway but will continue in 2017, and will also include an assessment of the role of the financial sector in contributing to the misallocation of capital and productivity dispersion across firms through barriers to entry and exit. An assessment of key obstacles to diffusion of innovation among firms, examining the tendency towards rent-seeking behaviour in certain sectors and the implications for competition policies, product market regulation (regulatory barriers to entry and exit) will also be included.</li> </ul> </li> <li>• The project on revisiting the Job Strategy (conducted jointly with ELS and with a final report to be delivered at the 2018 ministerial) will have inclusiveness as one of the dimensions of labour market outcomes and policy objectives (along with job quantity, job quality and labour market resilience).</li> </ul>
<b>DEV</b>	<ul style="list-style-type: none"> <li>• Targeted Policy reviews in developing countries on social cohesion, youth well-being and social protection to provide influential analysis and evidence base that positively influence policy making to support more inclusive societies and make growth more inclusive.</li> </ul>

	<ul style="list-style-type: none"> <li>• Working papers and reports on social protection and inclusive growth in developing countries; social protection, globalisation and inequality; youth inclusion; gender equality.</li> </ul>
<b>ENV</b>	<ul style="list-style-type: none"> <li>• A workshop in 2017, 1-2 reports 2017-2018 – TBD <ul style="list-style-type: none"> <li>○ Challenges to be explored, is the accumulation of contingent liabilities by governments as a result of climate change. A particular focus could be on the role of social vulnerability (such as poverty or age), which is often closely linked to climate vulnerability.</li> </ul> </li> <li>• It is proposed to extend the work on economic effects of environmental policies to the employment and labour implications of a transition to a green and circular economy.</li> </ul>
<b>CFE</b>	<ul style="list-style-type: none"> <li>• A High Level Meeting on Tourism Policies for Sustainable and Inclusive Growth will be held in Paris in 2017.</li> <li>• A report on increasing productivity for inclusive growth at the regional and local levels including comparative data on productivity and inclusion and an examination of policy levers.</li> <li>• Case studies and reports on: engaging employers in skills development and the future of work, taking an integrated approach to social inclusion at local level, integrating refugees in the labour market, social enterprises and job creation, and inclusive growth in cities.</li> <li>• Reports, policy briefs and case studies on policy support for entrepreneurship among under-represented or disadvantaged groups and a web-based assessment and guidance tool for policy makers.</li> <li>• Reports on the diverse contributions of small and medium-sized enterprises to inclusive growth, strengthening SME productivity, and implementation of the G20-OECD High Level Principles on SME and Entrepreneurship Finance.</li> <li>• Projects: <ul style="list-style-type: none"> <li>○ The need for a territorial approach to migration: subnational governments’ role for inclusiveness: with the aims to improve the knowledge on territorial migrant localisation and their characteristics.</li> <li>○ A specific focus will be given to multi-level governance challenges and good practices in implementing migration policies.</li> <li>○ Policies for promoting catching up among regions.</li> </ul> </li> </ul>
<b>TAD</b>	<ul style="list-style-type: none"> <li>• Will be producing numerous reports that reinforce the inclusive growth agenda including reports on Trade Facilitation, Aid for Trade, Viable supply chains for raw materials and commodities. They will be focusing on: <ul style="list-style-type: none"> <li>○ Further analysis of the supply-side capacity and trade-related infrastructure constraints faced by developing countries</li> <li>○ Reduce trade policy obstacles to closing material loops.</li> <li>○ Identify policies to facilitate sustainable employment in mining-related services.</li> <li>○ Clarify local content measures and benchmark their impacts.</li> </ul> </li> <li>• New work would explore trade opportunities generated by the digital economy, especially for SMEs, who can now more easily reach new customers or integrate into global production segments.</li> </ul>
<b>GOV</b>	<ul style="list-style-type: none"> <li>• An Analytical report on Multidimensional Policy frameworks which will compare existing multidimensional policy frameworks across OECD countries, identifying their design, operation and degree of institutionalization. This will benefit from the work of the RPC on Supporting Inclusive Growth through</li> </ul>



	<p>RIA, as well as from work on assessing budgetary impacts through the SBO.</p> <ul style="list-style-type: none"> <li>• Good practices reports focusing on: <ul style="list-style-type: none"> <li>○ Open Government and Inclusive Policy making drawing on the results of the OECD Open Government Survey, Open Government Data and the role of parliamentary budget offices.</li> <li>○ Strengthening implementation of gender equality in public life.</li> </ul> </li> <li>• Analytical report/roundtable on citizen-centred approaches in legal and justice services including work to identify citizens' legal needs and lessons learnt.</li> </ul>
ELS	<ul style="list-style-type: none"> <li>• Review of the OECD Jobs Strategy which will provide clear guidance on how to address the policy challenges countries face, including the trend increase in earnings and income inequality, the impact of ongoing technological changes on labour demand and work organisation, demographic shifts, environmental challenges and globalisation. This review will be co-ordinated with the work of the OECD Skills strategy and the OECD Innovation Strategy.</li> <li>• Country reviews will be carried out on activation policies to encourage and help people on the margins of the labour market find and remain in rewarding and productive jobs. <ul style="list-style-type: none"> <li>○ Comprehensive analysis of the key areas where policy action is required to improve labour market and social outcomes for disadvantaged youth.</li> </ul> </li> <li>• The labour market and social integration of immigrants and their children remains an area of concern and of intense policy activity in OECD countries. The permanent monitoring of integration outcomes needs to be continued and increasing attention paid to the most vulnerable migrant groups.</li> <li>• A new flagship report on inequality will focus on intra- and intergenerational social mobility and the evolution of the middle class, the policy responses to inequality and policies to promote various dimensions of social inclusion.</li> <li>• As part of the OECD's Inclusive Growth Initiative, COPE will organise and co-organise high-level events and technical seminars around the themes of opportunity and equality in collaboration with EDU.</li> <li>• With regards to the OECD's agenda on Child Well-Being: ELS, EDU and STD will pool their various data sources in order to develop a more detailed picture of what affects child well-being at different stages of childhood. A Child Data Portal, technical paper, new indicators and a new report will be delivered.</li> </ul>
CTPA	<ul style="list-style-type: none"> <li>• In order to better assess the impact of taxes on "inclusive" economic growth, CTPA are planning to carry out a joint project with the Economics Department (ECO) on <i>Tax and Inclusive Growth</i> in 2017 and 2018.</li> <li>• "Taxation and Skills" Tax Policy Study (to be published 6 April 2017); this report assesses the financial incentives for workers and government to invest in skills.</li> <li>• Paper which assesses "The Impact of Tax and Benefit Systems on the Workforce Participation Incentives of Women" <a href="http://www.oecd-ilibrary.org/taxation/the-impact-of-tax-and-benefit-systems-on-the-workforce-participation-incentives-of-women_d950acfc-en">http://www.oecd-ilibrary.org/taxation/the-impact-of-tax-and-benefit-systems-on-the-workforce-participation-incentives-of-women_d950acfc-en</a> The paper examines the impact of tax and benefit systems on the incentives for second earners to enter formal employment. The paper highlights how various tax design features create greater participation disincentives for second earners than for primary earners or single individuals. As second earners in OECD countries are more often women, these greater disincentives create significant gender-equity concerns.</li> <li>• "Taxation and Savings" report (forthcoming); this report will calculate and present effective tax rates on saving vehicles in OECD countries, presents a distributional analysis of savings as well as the distributional impact of savings tax expenditures and explores the tax policy implications of the move towards Automatic Exchange of Financial Account Information for Tax Purposes.</li> </ul>

	<ul style="list-style-type: none"> <li>• Report on net wealth taxes in OECD countries (forthcoming); the report will assess country experiences with net wealth taxes and will discuss their optimal tax design.</li> <li>• Paper on the design of health related taxes (forthcoming); to be published as an OECD Taxation Working Paper.</li> </ul>
DAF	<ul style="list-style-type: none"> <li>• Investment: Through the investment policy reviews based on the Policy Framework for Investment at regional and national levels and the work on promoting responsible business conduct through the OECD Guidelines for Multinational Enterprises and the Due Diligence Guidance represents some of the work which is continually promoting inclusive growth.</li> <li>• Competition: The OECD is exploring the linkages between monopoly and inequality. In joint work with the World Bank, the OECD has formed a network of experts who are interested in rigorous investigation of this relationship (publication Q4 2018).</li> <li>• Research work underway will take advantage of the OECD's wealth and income inequality database, data from other directorates, and has already consulted horizontally with staff of the most relevant divisions across the OECD for this work (ELS, ECO, STD). The OECD's Global Forum on Competition will continue to serve as a developer of work related to inclusiveness and social impacts of competition.</li> </ul>

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