Chapter 2. New policy approaches

The focus on stronger productivity growth is necessary, but may not be sufficient to sustain economic growth that benefits all

The financial crisis revealed the significant limits of existing economic growth models, including the assumption that growing the pie is enough to generate improvements in well-being for all. A focus on pro-growth policies that target efficiency in isolation has led some governments to follow policy options that have brought about unintended social consequences. The debt-to-assets ratio of the bottom wealth quintile reached on average 123% in 2014 across OECD countries. Similarly, the average gap between the bottom and top quintile leverages amounted to 117 percentage points' gap in 2014 across OECD countries. Mortgages and consumer loans contracts have often not been sufficiently secured or compiled with other assets through securitisation, particularly for the low-income groups (André, 2016).

It is important to reflect on the outcomes of the policy choices of the past, if we want to understand how we can move towards more inclusive growth. There is scope to better align structural and macroeconomic policies to sustain growth, for instance by ensuring that fiscal policy works counter-cyclically and that fiscal space is used for productive investments that improve opportunities of the worst-off (OECD, 2017p). Also, more could have been done to achieve these objectives by creating policy frameworks that open up markets and encourage private and public investment in people, cities, infrastructure and skills; and by helping those who may lose out from economic change to better adapt to new economic conditions, and to break the cycle of disadvantage.

The focus is on policies that promote win-win situations in terms of productivity growth and equity, because such policies can improve the perspectives of the bottom 40% of the income distribution. Well-designed packages of structural (e.g. labour and product market policies) and macroeconomic and financial market policies, as well as international coordination, could have eased the implementation of reforms and maximised their impact on growth, while promoting quality job creation and equity (OECD, 2018i). The main issue does not necessarily concern the way in which individual structural policies have been pursued to steer inclusive growth. The complexity of the inclusive growth agenda raises important challenges in terms of governance, as policy fragmentation needs to be reduced and institutional mechanisms integrated in order to design coherent policy packages and deliver them more effectively (OECD, 2016f).

An improved economic outlook provides an opportune moment to implement more ambitious structural reforms. Any short-term costs from reforms may be lower and shorter-lived when demand and job creation are stronger, especially if accompanied by complementary labour market reforms and income support that help displaced workers transition to new jobs and acquire new skills. Other actions needed to enhance inclusiveness, such as improving the participation of under-represented groups in the labour market, are also more likely to have durable benefits if implemented at a time of job-rich growth. Recent progress has, however, been modest in enacting reforms to reduce gender gaps, strengthen job creation and help workers find new jobs (OECD, 2018h).

Further efforts are also needed to exploit synergies and explore ways to mitigate trade-offs when implementing policies for inclusive growth. Some *Going for Growth* (OECD, 2018i) policy priorities cannot be unambiguously classified as pro-inclusive growth or not. Such

is the case for reforms aimed at stimulating innovation and technological progress, including measures to reduce barriers to competition, firm entry and entrepreneurship. Progress along these lines is fundamental to spur productivity growth but may put further pressure on the relative demand for skilled workers through skill-biased technical change, and hence contribute to rising wage inequality among workers. At the same time, insofar as such reforms also contribute to job creation, they are likely to counteract reform-driven increases in wage dispersion, with an overall ambiguous effect on disposable income inequality. In a long-term perspective, competition and innovation policies may also contribute to enhance equity, for instance if they lead to a reduction in firms' rents and undermine the market dominance of incumbents, while promoting social mobility (OECD, 2018i). Recent evidence suggests that intergenerational income mobility increases with the degree of entrepreneurship and innovativeness in the economy (Aghion et al., 2015; 2016).

Not every policy reform is a win-win for inclusive growth, though. Trade-offs may, for example, arise in the case of some tax and benefit reforms, such as shifting from direct to indirect taxes or reducing marginal income tax rates (OECD, 2018i). This is the case when robust empirical evidence on their income inequality impact is lacking or relatively limited, or when the impact is highly dependent on reform design. One example is product market reforms, which have been found to increase both employment and wage dispersion so that the overall effect on household disposable income inequality is ambiguous (OECD, 2018i). Reducing barriers to competition is one key policy lever to boost growth with gains materialising relatively quickly. The equity effects of product market reforms are likely to depend on reform design as well as on time horizon (OECD, 2018i).

Growth and inclusiveness cannot be achieved by governments alone

Poor access to finance and talent can undermine business potential for growth. In addition, businesses can gain from being diverse and inclusive at the level of their board and workforces (OECD, 2017n), as well as by adjusting their corporate governance models throughout the supply chain (e.g. to support training and professional development of suppliers; see OECD work on due diligence and responsible business conduct, e.g. OECD, 2018d, 2016f and 2015a). Responsible business conduct is a lever that businesses can use to promote inclusive growth; for example, by raising compliance with laws on respect for human rights, environmental protection, labour relations and financial accountability. In this context, the OECD is also developing a platform that can help align government policies and business initiatives to seize opportunities from inclusive growth (Box 2.1).

Social dialogue and collective bargaining systems are coming under pressure to adapt, but they represent an avenue to improve quality jobs, making growth more inclusive. Digitalisation, globalisation and the rise in non-standard forms of employment – along with population ageing and the decline of the manufacturing sector – are testing their ability to foster the creation of quality jobs, reduce labour market inequality and promote productivity and resilience in labour markets. Union density and collective bargaining coverage have declined in most OECD countries (OECD, 2018f), a trend sometimes accelerated by the offshoring of production to countries where social dialogue and collective bargaining are weak or non-existent. This has been linked to labour's declining share of national income relative to capital.

Concerns are growing about the effectiveness of collective bargaining in the context of greater individualisation of the employment relationship and deep uncertainties surrounding the future of work. At the same time, new and complementary forms of social

dialogue, collective organisation and bargaining are emerging to try to meet the challenges posed by new forms of work (OECD, 2018f).

Box 2.1. The role of business in inclusive growth

Rising inequality has limited the ability of some to access finance, invest in education and skills, which in turn can undermine the development of human capital and productivity growth. It can also make it difficult for employers to find people with the skills and knowledge they need.

The business case for inclusive growth is strong. On a macro level, more equal societies benefit business through a larger middle class and growing consumer purchasing power; enhanced government capacity to invest in education, health and infrastructure; and improved economic and political stability. Rising inequality has limited the ability of the bottom 40% to invest in their education and skills, undermining the development of human capital and potential productivity gains, also making it more difficult for employers to find people with the skills and knowledge they need and that are demanded by today's rapidly digitalising markets. Inequality of opportunity hurts business.

Increased diversity and inclusion, as well as female representation in C-suites and boards, have been linked to higher business performance and shareholder returns (Hunt et al., 2015). Aligning executive performance evaluation and compensation with long-term business goals, through longer equity vesting periods (Edmans et al., 2016), and with sustainability goals (Eccles et al. 2014) also leads to greater long-term profitability. Similarly, the promotion of responsible tax payment practices correlates with improved returns for some classes of shareholders (Babkin et al., 2017).

The OECD is launching the Business for Inclusive Growth Initiative with the intent to deliver: (i) a framework paper outlining the business case for inclusive growth and how governments and firms can advance public policies and business actions that promote inclusive growth in tandem; (ii) new indicators for business and investment impacts on inclusive growth and well-being; (iii) a platform through which businesses can share best practices and non-prescriptive guidelines for measuring the impact of business on well-being, sustainability and inclusive growth; and (iv) high-level policy discussions and the development of a policy network on inclusive growth including public and private stakeholders. These activities will complement and strengthen existing OECD work in this area, including responsible business conduct (RBC), quality FDI, the work on business and sustainable development, and OECD standards, such as the Guidelines for MNEs, and the work on Base Erosion and Profit Shifting (BEPS).

Sources: Babkin et al. (2017), Are Corporate Inversions Good for Shareholders? Journal of Financial Economics; Hunt et al. (2015), Why Diversity Matters, McKinsey & Company; Eccles et al. (2014), The Impact of Corporate Sustainability on Organizational Processes and Performance, Management Science, 60(11); Edmans et al. (2016), Equity Vesting and Investment, Review of Financial Studies.

Digital technologies and big data create opportunities for governments and businesses to connect with people. In this respect, there is a leeway to look into existing governance tools, such as Regulatory Impact Assessment (RIA), to develop similar exercises to ensure that policy evaluation and impact assessment are carried out through an inclusive growth lens. In general, connecting policies to people calls for a more integrated approach to decision-making that builds on integrity and transparency in public policy-making. This also means

re-assessing public and corporate governance models in the context of mega-trends and seizing the opportunities that new technologies offer.

Big data and smart technologies have a strong potential to inform this type of governance tools. For example, the ability of blockchains to secure the transfer and traceability of value and data can facilitate innovative business models and new marketplaces driven by speed, dis-intermediation and lower costs, particularly in the field of financial services, government services and supply chain management.

The opportunities to grow at a global level can be leveraged by coherent domestic and international policies

Levelling the playing field through multilateral cooperation (including the WTO Trade Facilitation Agreement and cross-border competition in services) is necessary to realise the gains from trade, but may not always be sufficient to achieve inclusive growth. At the international level, the emergence of global value chains has highlighted the need for greater coherence between trade and investment policy frameworks, enhanced international tax cooperation, as well as for common labour and environmental standards.

While they bring undeniable benefits (e.g. in terms of access to GVCs, product variety and lower prices), globalisation and digitalisation also challenge governments' ability to tax mobile assets and put downward pressure on labour, environmental and governance standards. The ability to sustain growth in the global economy will also hinge on success in reducing environmental damages and risks, as well as in curbing the reliance on natural resources. Green growth considerations can be part of the design of policies for the long-term, with appropriate combinations of reforms to address potential short-term trade-offs. It is also part of the sustainable growth agenda of the OECD (OECD, 2015d; OECD, 2017j).

Coherent climate, investment, innovation, skills and fiscal policies must work together to create new markets, provide work opportunities and ease the adjustment costs for workers and businesses (OECD, 2017j). Acting on climate change to achieve the goals of the Paris Agreement can also bring about reduced exposure of people to air pollution. Exposure to air pollution is not uniform across income groups and varies across countries; generally air pollution is higher in poorer communities. Poverty may also contribute to the depletion of and a lack of investment in environmental resources. At the same time, large inequalities may go hand in hand with unsustainable patterns of consumption and use of natural resources by the richest individuals.

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