

Structural policies and distributional consequences

by

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In a majority of OECD countries, growth over the past three decades has been associated with growing disparities in household income. This suggests that some of the forces driving GDP have also fuelled inequalities. As a result, gains in household disposable incomes generally have not matched those in GDP per capita and the gap has been particularly large among poorer households and the lower-middle class. An important policy question is whether some of the policy changes driving GDP may in addition play a “hidden” role on inequality. New empirical evidence produced by the OECD on the effects of structural policies on household incomes across the distribution scale has identified potential policy trade-offs and complementarities between efficiency and equity.

Labour market policy reforms are often designed to boost aggregate employment through behavioural effects such as labour supply incentives, and through this channel, GDP per capita. At the same time, these policies also affect income inequality through their impact on the earnings distribution. For some reforms, these two impacts on measures of inequality may be offsetting each other. For example, reducing unemployment benefits and lowering statutory minimum relative to median wages are associated with both higher wage dispersion and higher employment rates among low-skilled workers, which may result in a very small net change on inequality among the working-age population, while the impact on overall inequality is uncertain. For other reforms, however, wage and employment effects may reinforce each other, resulting in both stronger growth and less inequality. This could be the case of policy reforms aimed at easing the strictness of job protection on regular contracts as a way to tackle labour market duality, i.e. the existence of separate segments where comparable workers enjoy differential wage conditions and job protection in contrast to others.

Many tax policies raise well-known trade-offs with respect to growth and equity objectives. Economic theory and empirical evidence suggests that the tax structure influences macroeconomic efficiency. In particular, that direct taxes have relatively more distortionary effects by reducing incentives to work and invest. One of the highest ranked growth-friendly tax reforms, shifting the tax burden away from income taxes to consumption and property taxes, may in principle have adverse effects on inequality through various

channels. For instance, reform-driven positive employment effects can be counterbalanced by increased income dispersion resulting from lower tax progressivity. Also, empirical evidence suggests that consumption taxes can be regressive, at least in the short run. There is ambiguity with respect to the distributional effects of property taxes. On the one hand, depending on how they are designed, recurrent taxes on immovable property can be regressive with respect to disposable incomes; on the other hand, inheritance and capital gains tax clearly reduce wealth inequality.

Relaxing anti-competitive product market regulation can bring productivity and employment gains in the long run, therefore spurring economic growth. However, the impact on income inequality is uncertain and empirical evidence generally inconclusive. This is because employment gains may be at least partly offset by changes in the wage dispersion, as more intense product market competition tends to reduce the bargaining power of workers. Recent evidence has shown, however, that reducing barriers to competition is found to lift incomes of the lower-middle class by more than GDP per capita. Research also shows that linking well-tailored employment and product market reforms could bring additional gains on growth and equality.

There is some consensus, in both developed and, to a lesser extent, developing countries, that globalisation is a growth-enhancing force. But there is no consensus, and mixed empirical evidence, about the distributional implications. Economic globalisation involves increased exposure to international trade and financial and capital movements, increased mobility of production factors (i.e. workers and capital) and increased fragmentation of the production process in Global Value Chains (GVCs). The effects of globalisation on overall income inequality have mainly focused on the earnings dispersion channel as opposed to the employment channel. Available evidence would seem to suggest that globalisation-induced inequality effects are mainly driven by greater wage dispersion, in particular arising from changes in the skill and industry composition of labour demand.

Stronger export intensity based on sound and dynamic competitiveness is found to boost long-run GDP per capita and

average household disposable income. Such effects hold across the distribution of household income, with stronger estimated gains for the poor – implying reduced inequality. Overall, these findings signal synergies across policy objectives, i.e. that reforms enhancing competitiveness aimed at encouraging exports among domestic firms could boost efficiency and equity.

Globalisation may also affect income distribution insofar as increased trade and international capital flows facilitate the diffusion of technology, thereby increasing wage dispersion via mechanisms such as skill-biased technological change. To the extent that skill-biased technological change shifts demand of labour towards higher skills, and especially when this increase in demand is not matched by a sufficient increase in the supply of skilled workers, technical progress may increase wage inequality. The implications of this hypothesis for inequality have found empirical support for many OECD countries. Going further, recent evidence strongly suggests that skill-biased trade specialisation is associated with higher wage inequality, even accounting for technological change.

Technological progress, as measured by the share of investment in communication technology (ICT) in overall investment, is found to boost long-run GDP per capita and average household disposable incomes. Average household income gains hold across the distribution and as a result, there is no evidence of inequality effects.

Taking these findings into account, the OECD is following up designing general, but also country tailored, policy frameworks which avoid and minimise trade-offs in the short and long run. This encompasses the right mix and sequence of employment and product market reforms, etc., together with science, innovation, education and redistribution systems with taxes and benefits in cash or kind.

Useful links

Original article: Kastrop, C. (3 March 2016), “Structural Policies and Distributional Consequences”, OECD Insights blog, <http://wp.me/p2v6oD-2pM>.

Economic Policy Reforms: Going for Growth reports:
www.oecd.org/eco/goingforgrowth.htm

OECD work on labour markets, human capital and inequality:
www.oecd.org/eco/labour

Ruiz, N. (1 March 2016), “Connecting the dots on income inequality: what do official sources suggest when adjusted for top incomes?”, OECD Ecoscope blog, <https://oecd ecoscope.wordpress.com/2016/03/01/connecting-the-dots-on-income-inequality-what-official-sources-suggest-when-adjusted-for-top-incomes>.



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