51. Greater fairness through selected government policies

One important responsibility of governments is ensuring that the benefits of economic growth and development are shared across society. Income inequality in the population increased in almost two-thirds of OECD countries between the mid-1980s and mid-2000s. There is no agreement, however, on how much equality or inequality in income distribution is "optimal". Complete equality in the distribution of economic resources is neither attainable nor beneficial in terms of economic growth, and non-market mechanisms for income redistribution can reduce incentives to work and save. On the other hand, more unequal countries generally have higher poverty rates and worse aggregate educational and health outcomes, and higher levels of inequality can threaten long-term growth prospects.

Most OECD countries operate social protection systems aimed at reducing inequality via a mix of redistribution between rich and poor, income maintenance or insurance in the face of adverse risks (unemployment, disability, sickness), and redistribution across the lifecycle, either to periods when individuals have greater needs (*e.g.* when there are children in the household) or would otherwise have lower incomes (such as in retirement). The main features of social protection systems are cash transfers and progressive taxes. In-kind public expenditures on education and health are also important policy instruments for reducing inequality.

In 2007, cash transfers constituted some 11% of GDP on average. In-kind transfers for health and education represented 6% and 5% of GDP, respectively. Nordic countries spend most on in-kind transfers while countries such as Austria, Italy and Poland rely more heavily on cash transfers.

Except for Chile, most OECD countries have a progressive income tax system to a certain extent, with Poland and Estonia differentiating less between income levels than countries such as Ireland and Israel. The effect of government tax and transfer policies on inequality can be assessed by looking at the Gini coefficient before and after taxes and transfers. By this measure, Belgium achieves the most redistribution (a reduction of about 45%), while Chile achieves the least (less than 2%).

Methodology and definitions

The main indicator of income distribution used is the Gini coefficient. The values of the Gini coefficient range between 0, in the case of "perfect equality" (*i.e.* each share of the population gets the same share of income), and 1, in the case of "perfect inequality" (*i.e.* all income goes to the individual with the highest income). Redistribution is measured by comparing Gini coefficients for market income (*i.e.* gross income including public cash transfers and household taxes) and for disposable income (*i.e.* net of transfers and taxes).

The tax data, derived from the OECD Taxing Wages framework, use tax rates applicable to the tax year. For Australia, New Zealand and the United Kingdom, the tax year is not the calendar year. The data show the difference between two scenarios: a single person without dependents earning 67% of the average wage, and a single person without dependants earning 167% of the average wage. The average rates are expressed as a percentage of gross wage earnings. Average wage (in national currency), measures the average annual gross wage earnings of adult, full-time manual and non-manual workers in the industry.

Further reading

OECD (2008), *Growing Unequal? Income Distribution and Poverty in OECD Countries*, OECD Publishing, Paris.

OECD (2011), *Society at a Glance 2011: OECD Social Indicators*, OECD Publishing, Paris.

OECD (2011), *Taxing Wages 2010*, OECD Publishing, Paris.

Figure notes

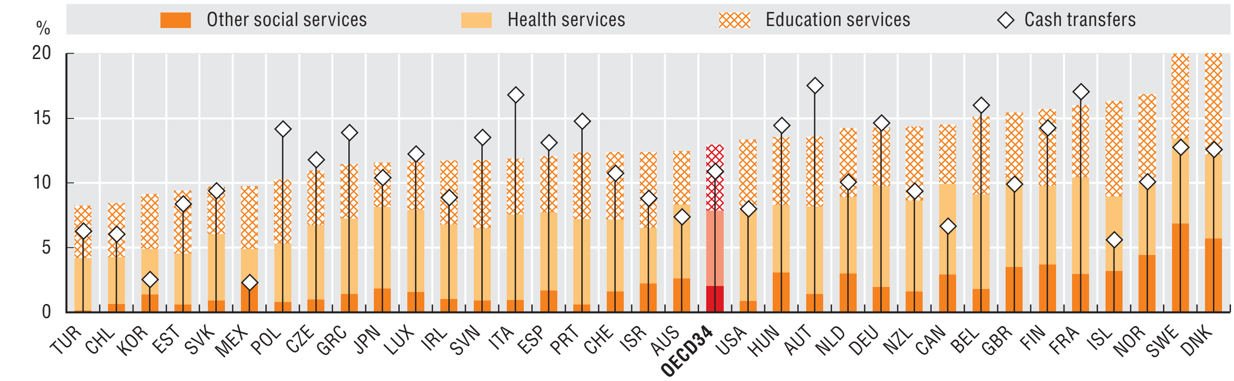
51.1: Data on education services for Greece, Luxembourg and Turkey are for 2005. Expenditures on other social services, health and education represent in-kind transfers. The following services are included in cash transfers and other social services: assistance to the elderly, survivors, disabled persons, families and the unemployed, as well as those related to housing and social assistance.

51.2: The difference for Chile is 0.1%.

51.3: Before and after data are unavailable for Greece, Israel, Estonia, Hungary, Mexico, Slovenia, Spain and Turkey.

Information on data for Israel: *http://dx.doi.org/10.1787/888932315602*.

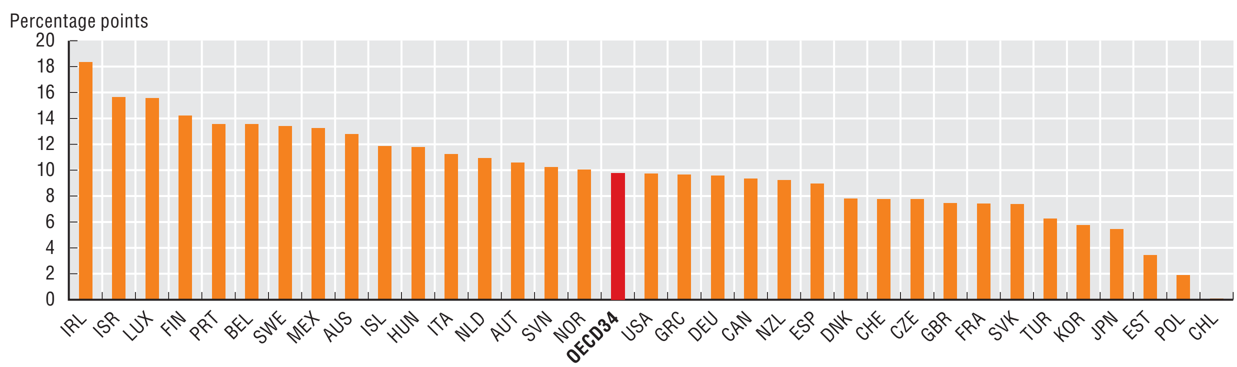
51.1 Public expenditure for in-kind and cash transfers as a percentage of GDP (2007)



Source: OECD Social Expenditure Database (*www.oecd.org/els/social/expenditure*) and OECD Education Database (*www.oecd.org/education/database*).

StatLink http://dx.doi.org/10.1787/888932391393

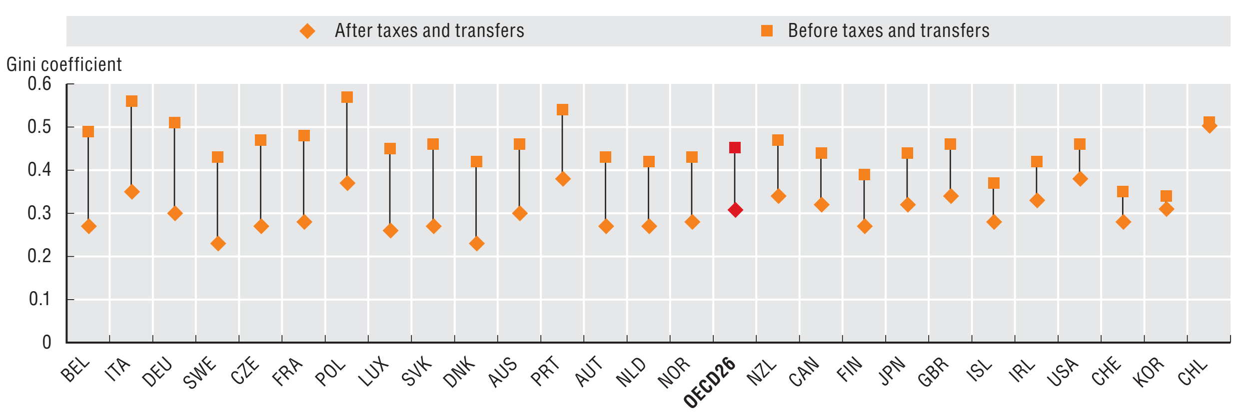
51.2 Difference between average tax rate on single persons earning 167% and 67% of average earnings (without dependents) (2010)



Source: OECD (2011), *Taxing Wages 2010*, OECD Publishing, Paris.

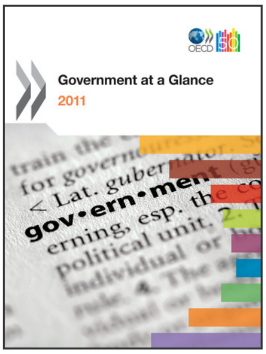
StatLink http://dx.doi.org/10.1787/888932391412

51.3 Differences in income inequality pre- and post-tax and government transfers (mid-2000s)



Source: OECD (2008), *Growing Unequal? Income Distribution and Poverty in OECD Countries*, OECD Publishing, Paris.

StatLink http://dx.doi.org/10.1787/888932391431



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