Improving fairness through selected government policies

One of the major tasks of government is to level the playing field for citizens by ensuring fairness in both the processes it follows – procedural justice – and the results it achieves – distributive justice. A key element of the latter is to allow income differences to exist to the extent that they acknowledge and reward performance, accepting individuals' differential contributions to economic and social well-being. At the same time, governments should seek to minimise economic and social harm that can arise from inequality and take into account the societal consensus. These twin objectives lead to reduced income inequalities through progressive taxation and the use of cash transfers (e.g. pensions, unemployment insurance).

Since the 1980s the income gap between rich and poor has widened (OECD 2011, *Divided We Stand: Why Inequality Keeps Rising*) in the majority of OECD member countries, demonstrating that the benefits of economic growth have not been equally shared among individuals. Globalisation, technological change, regulatory and institutional reforms have all been identified as main drivers of rising income inequalities. The global economic crisis further accelerated these developments by unevenly affecting different groups of the population, with the majority of the burden of the crisis being borne by the unemployed and the underemployed.

Most OECD member countries have adopted a mix of public policies in order to reduce income inequality in society and its long-term costs on economic development. Social protection and insurance systems have worked through a combination of cash transfers and progressive income taxation. In addition, specific fiscal stimulus packages were created to boost demand and cushion poorer households to reduce the impact of the crisis. These measures aimed at addressing income inequality by redistributing income between rich and poor and also on an intergenerational basis, in order to provide support to age groups in greater need.

The Gini coefficient is considered the main indicator assessing the level of income inequality in a country. The impact of the social protection system enacted by central governments through transfers and taxes can be measured by comparing the coefficient before and after taxes and transfers. On average, income inequality levels before taxes in a pool of OECD member countries have not changed in magnitude between 2005 and 2010 (0.47). Nonetheless, some countries have observed a consistent increase in their pre-tax and transfers inequality in the last five years, as in the case of Ireland. Government intervention proved essential in these situations, reaching a reduction in the Gini coefficient of about 0.26 (versus an average of 0.16). On the other hand, Chile remains the country achieving the least redistribution in both years, with an impact of 0.02 on the Gini index. All countries seem also to retain a progressive income tax system, with Poland and Chile holding fewer different tax rates than Ireland.

Methodology and definitions

The values of the Gini coefficient range between 0, in the case each share of the population has the same income, and 1, in the case where the richest individual has all the income. Gaps between poorest and richest are computed as the ratio of average income of the bottom 10% to average income of the top 10%. Redistribution is measured by comparing Gini coefficients for market income (i.e. gross income not adjusted for public cash transfers and household taxes) and for disposable income (i.e. net of transfers and taxes). The disposable household income definition does not take into account in-kind transfers. The data have been drawn from the *OECD Income Distribution Database*, whose information has been collected through a network of national data providers in order to benchmark countries' performance in income inequality.

The tax data, derived from OECD *Taxing Wages*, 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 measures the average annual gross wage earnings of adult, full-time manual and non-manual workers in the industry.

Further reading

OECD (2013), *Taxing Wages 2013*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/tax_wages-2013-en*.

OECD (2011), *Divided We Stand: Why Inequality Keeps Rising*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264119536-en*.

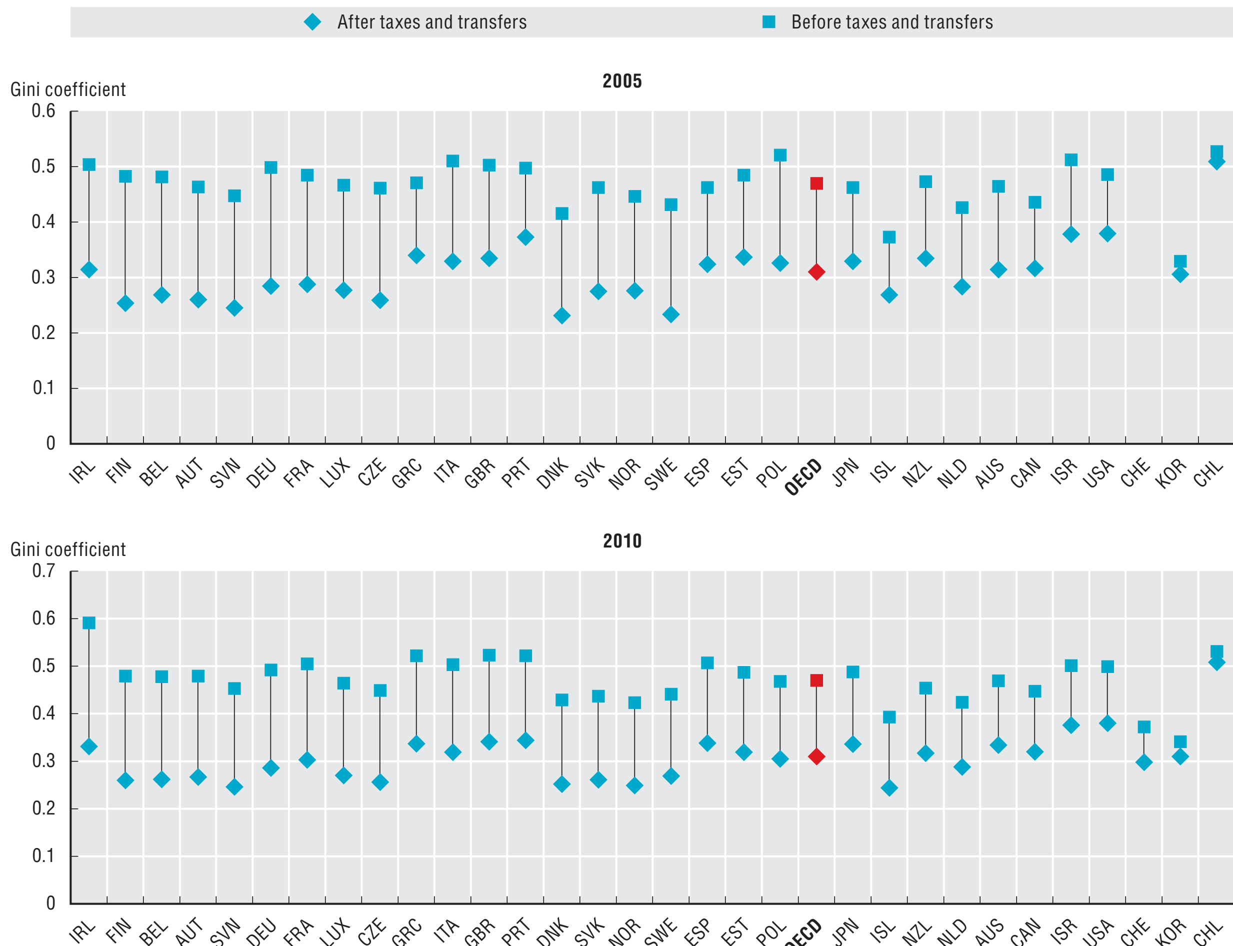
Figure notes

2.3: Data for Hungary, Mexico and Turkey are not available. Data for Switzerland are not available in 2005. *2005:* Data for Australia, Finland, Germany, Italy, Norway and Sweden are for 2004. Data for Chile, Japan and Korea are for 2006. Data for New Zealand are for 2003. *2010:* Data for Chile, Ireland, Japan, New Zealand and Switzerland are for 2009.

2.4: Wage figures for Turkey are based on the old definition of average worker (ISIC D, Rev. 3). Data refer to personal income taxes plus employee contributions to social security (as % of gross wage earnings). In Chile average earnings are exempt from income taxation and consequently the income tax has a small incidence on total tax revenues.

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

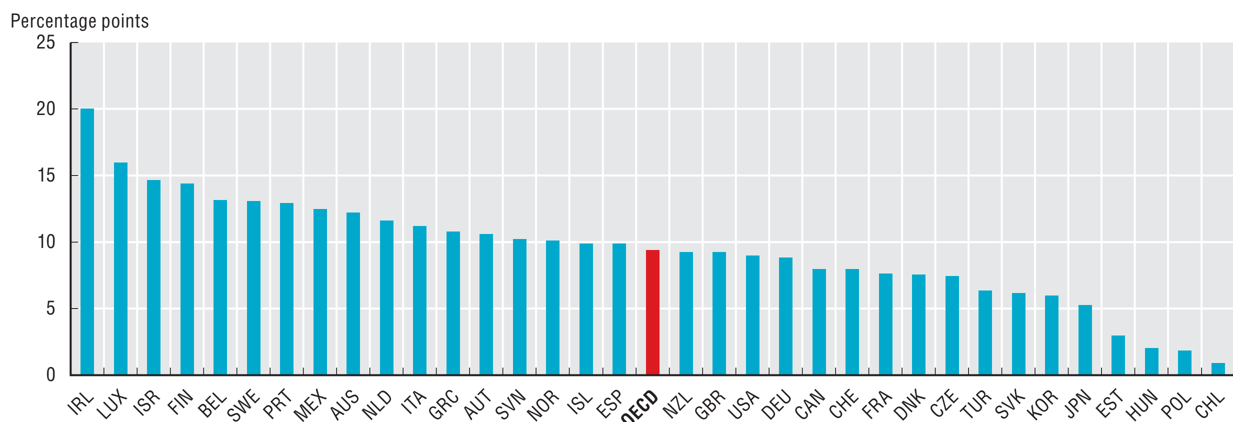
2.3. Differences in income inequality pre- and post-tax and government transfers (2005 and 2010)



Source: OECD Income Distribution Database, *www.oecd.org/social/income-distribution-database.htm.*

StatLink http://dx.doi.org/10.1787/888932940949

2.4. Difference in average income tax rate of single persons earning 167% and 67% of average earnings (without dependents) (2012)



Source: OECD (2013), *Taxing Wages 2013*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/tax_wages-2013-en.*

StatLink http://dx.doi.org/10.1787/888932940968

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