The productivity and equality nexus: Is there a benefit in addressing them together?

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Productivity growth has slowed since the crisis and inequality has been getting worse. Could they be influencing each other? The linkages between the productivity and inequality challenges are still to be fully explored. Each may have its own solution, but there is also good reason to think that there is a nexus between them. For instance, OECD evidence suggests that wage dispersion between firms, which reflects diverging rates of productivity growth, has contributed to rising inequality of incomes between workers. At the same time, the increased prevalence of knowledge-based capital and digitalisation may have unleashed winner-take-all dynamics in key network markets, which in turn may have led, in some instances, to an increase in rent-seeking behaviour.

OECD research has highlighted how the rise in inequality over the last three decades has slowed long-term growth through its negative impact on human capital accumulation by low income families.

Since the crisis, stalled business dynamics have seen resources, including workers, being trapped in firms where they are not using their full potential. In particular, individuals with fewer skills and poorer access to opportunities are often confined to precarious and low productivity jobs or – in many emerging countries – informal ones.

In the spirit of our integrated framework on inclusive growth and our New Approaches to Economic Challenges (NAEC) initiative, at the OECD we believe that our efforts to address productivity and inequality challenges could have a better chance of succeeding if we looked at the synergies and trade-offs emerging from policies to address them. This means designing policies for each of these two core issues bearing in mind how they might impact one another and avoiding the “silo” approach through more effective and comprehensive policy packages.

We must also learn from previous policies. Traditional measures to boost productivity in competition, labour market, or regulatory frameworks would allow for the reallocation of resources to more productive activities, or for increasing productivity in specific sectors. But this may have an adverse impact on inequalities
of income and opportunities, as workers better equipped to cope with change are usually those with higher skill sets. For instance, in the past, the drive towards flexible labour markets has benefited many employers, and particularly the most productive firms that have gained from an improved allocation of labour resources. But increased flexibility has also brought a greater prevalence of non-standard work. Recent OECD work on job quality highlights how low-skilled individuals can be trapped in precarious low wage jobs, and receive less training.

Our approach to designing policies to ensure that individuals, firms and regions that are left behind can fulfil their full potential and contribute to a more dynamic economy, draws on OECD work from diverse policy areas. It starts from the Inclusive Growth agenda, by focusing on well-being as an ultimate objective of policy. It builds on OECD productivity work through The Future of Productivity report and efforts towards an OECD Productivity Network. It also synchronises with the Organisation’s efforts to measure productivity more accurately at a time when traditional measures are ill-adapted to account for the full effects of rapid technological change and innovation centred on knowledge based capital, the increasing prominence of the services sector, and productivity in the public sector.

The ultimate outcome is for governments to focus on the extensive range of win-win policies that can reduce inequalities while supporting productivity growth, thereby creating a virtuous cycle for inclusive and sustainable growth. This calls for distinct but complementary policy interventions at the individual, firm, regional and country levels. What this entails in practice will vary for each country depending on its circumstances. But broadly speaking, a number of policy areas are worth considering:

First, a new approach is needed to boost productivity at the individual level so that everyone has the opportunity to realise their full productive potential. Expanding the supply of skills in the population through more equal access to basic quality education is crucial, but not enough. With rapid technological change, skills need to keep up with the demands of the market to avoid the skills mismatches which have contributed to the productivity slowdown.
A broad strategy is also needed to ensure a better functioning of the labour market, promote job quality, reduce informality, allow for the mobility of workers and inclusion of under-represented groups such as women and youth, and promote better health outcomes for everyone.

Second, for people to realise their full productivity potential, businesses have to realise theirs. While heterogeneity among firms is normal, the widening dispersion in productivity levels and its implications for aggregate productivity and workers is a cause for concern. According to our productivity report, the early 2000s saw labour productivity at the global technological frontier increase at an average annual rate of 3.5% in the manufacturing sector, compared to just 0.5% for non-frontier firms. The gap was even more pronounced in the services sector. The larger the share of business that can thrive, the more productive and inclusive our economies will be. Achieving this requires a reassessment of competition, regulatory and financial policies to ensure a level playing field for new firms relative to incumbents. It also requires policies to facilitate the diffusion of frontier innovations from leading to lagging firms.

Third, policy prescriptions will be ineffective unless they take regional and local circumstances into account. Inequalities that play out in regions, like housing segregation by income or social background, poor public transport, and poor infrastructure, can lock individuals and firms in low-productivity traps. This means that some policies to promote both productivity and inclusiveness are best undertaken at the regional level.

Finally, adopting a more holistic approach to policy requires fundamental changes to public governance and institutional structure to strengthen the ability of national governments to design policy that promotes synergies and deals with trade-offs. In highly unequal societies, governments also need to address political economy issues including the capture of the regulatory and political processes by elites that benefit from the status quo, and policies that favour the incumbents.
None of this will be easy, but it is nevertheless essential. At the OECD we believe it is time to develop a better understanding of the dynamics between two of the key issues of our time – productivity and inequality – in order to build a more resilient, inclusive and sustainable future.

**Useful links**

Original article: Ramos, G. (29 January 2016), “The productivity and equality nexus: is there a benefit in addressing them together?”, OECD Insights blog, [http://wp.me/p2v6oD-2nn](http://wp.me/p2v6oD-2nn).

OECD Centre for Equality and Opportunity: [http://oe.cd/cope](http://oe.cd/cope)


OECD productivity statistics: [www.oecd.org/std/productivity-stats](http://www.oecd.org/std/productivity-stats)
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