

# The productivity and equality nexus

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**Productivity growth has slowed since the crisis and inequality of income and opportunity has been getting worse. Could they be impacting each other?**

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The linkages between the productivity and inequality challenges we face are still to be fully explored. Ultimately, each challenge may have its own solution, but the nexus of relationships that exists between productivity and inequality policies and outcomes means that there is also increasingly good reason to think that our efforts would benefit from a common approach.

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For a start, OECD research has found that high levels of inequality may impact growth negatively by causing a lack of investment in human capital among low income families. This could also affect productivity growth in our economies. At

the same time, weak competition frameworks in the digital and knowledge-based economies may unleash “winner takes all” dynamics, or worse still, persistent rent-seeking behaviour on the part of incumbents. Our analysis also suggests that wage dispersion between firms, which reflects diverging rates of productivity growth, has in many cases contributed to rising inequality of incomes between workers. On top of this, the “financialisation” of our economies may have created incentives for short-term profit maximisation, at the expense of adequately channelling resources to the more productive activities.

In the spirit of our New Approaches to Economic Challenges (NAEC) and Inclusive Growth initiatives, the OECD believes that efforts to address our productivity and inequality challenges would have a better chance of succeeding if we looked at the synergies and trade-offs emerging from the distinct policy sets targeted at each issue. This means designing policies for each of these two core challenges, bearing in mind how they might impact one another, and avoiding the “silo” perspective. It also requires an *ex-ante* approach that seeks to broaden the assets that our economies can rely on (high-quality skills, infrastructure or access to finance by SMEs), stopping individuals, firms and regions from accumulating disadvantages that prevent them from fulfilling their full potential.

*Ex-post* policies, including effective re-distribution, are also a key part of this equation to correct for those outcomes that do not deliver for people, firms and regions. Such interventions are particularly vital to stop the income inequality of one generation transmuted into the inequality of opportunities for the next.

We must also learn from previous policies. Traditional measures to boost productivity in competition, labour market, or regulatory frameworks should allow for the reallocation of resources to more productive activities, or for increasing productivity in specific sectors. But these may have an adverse impact on inequalities of income and opportunities, if workers are not equipped to cope with change due to their low skills, or initial conditions. 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 those 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 with the Inclusive Growth agenda, by focusing on well-being as an ultimate objective of policy. It builds on OECD productivity work, via The Future of Productivity report and efforts towards an OECD productivity network. It also synchronises with the OECD’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 goal is for governments to focus on an extensive range of win-win policies that can reduce inequalities while supporting productivity growth, thereby creating a virtuous circle 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—particularly of low income groups—is crucial, but not sufficient. 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 underrepresented groups such as women and youth, and to promote better health outcomes for everyone.

Second, for people to realise their full productive 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 businesses 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. Finally, adopting a more holistic approach to policy requires fundamental changes to public governance and institutional structures, 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 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.

Adapted from a blog published on [www.OECDInsights.org](http://www.OECDInsights.org) on 29 January 2016, see <http://oe.cd/1lg>

## References

Ramos, Gabriela (2014), “Inclusive growth: Making it happen” in OECD Yearbook 2014 <http://www.oecd.org/forum/oecdyearbook/inclusive-growth-making-it-happen.htm>

The Future of Productivity <http://dx.doi.org/10.1787/9789264248533-en>

More on OECD work on inclusive growth [www.oecd.org/inclusive-growth/](http://www.oecd.org/inclusive-growth/)

More on the OECD productivity network [www.oecd.org/eco/global-dialogue-on-the-future-of-productivity.htm](http://www.oecd.org/eco/global-dialogue-on-the-future-of-productivity.htm)