Income redistribution through taxes and transfers across OECD countries

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Many OECD countries have been facing a prolonged period of low growth and stagnating income of the poorest. This challenges governments’ fiscal redistribution, all the more so in a context where new forms of work are calling into question the effectiveness of traditional social safety nets and population ageing is putting pressure on public finances. Yet, the system of taxes and transfers that underpins social protection is a fundamental pillar of an inclusive growth policy agenda that aims at sharing the benefits of growth more equally. A new OECD report by Causa and Hermansen (2017) (“Income redistribution through taxes and transfers across OECD countries”) takes stock of the extent to which tax and transfer systems mitigate market income inequality today, and how this has changed over a period of rising globalisation and rapid technological change.

Redistribution through taxes and transfers has tended to decline across OECD countries since the mid-1990s

Since the mid-1990s, the redistributive effect of taxes and transfers has declined in the majority of OECD countries for which data are available (Figure 1, Panel A). The trend towards less redistribution was most pronounced over the pre-crisis period, and was temporarily reversed during the first phase of the crisis, reflecting the cushioning impact of automatic stabilisers and fiscal discretionary measures. The decline in redistribution was particularly pronounced in some Nordic countries, which are among the most egalitarian OECD
countries. Admittedly, the extent of the decline observed in these countries was amplified by high levels of redistribution prevailing in the mid-1990s due to high unemployment. The steadily improving labour market outlook during the subsequent decade reduced the need for redistribution. The inequality-reducing effect of redistribution also declined among the least egalitarian of OECD countries, especially Israel, but also Australia and Canada. Trends in redistribution were more heterogeneous over the most recent decade, with increases in around half of OECD countries, in particular those hardest hit by the crisis (Figure 1, Panel B).
The decline in redistribution was largely driven by insurance transfers to working-age households

By and large, the decline in redistribution across OECD countries has been primarily driven by a decline in redistribution by cash transfers, which is not surprising insofar as cash transfers account for the bulk of
redistribution. Personal income taxes also contributed but played a less important and more heterogeneous role across countries (Figure 2, Panel A). In turn, the decline in transfer redistribution was largely driven by insurance transfers (e.g. unemployment insurance, work-related sickness and disability benefits). This was partly mitigated by more redistributive assistance transfers (e.g. minimum income transfers, means- or income-tested social safety net) in some countries such as Germany and the United Kingdom (Figure 2, Panel B). Assistance transfers are in many OECD countries less redistributive than insurance transfers, for instance due to low take-up but also due to relatively low benefit amounts, so that their size is generally smaller than insurance transfers.
Policy implications

One finding highlighted in Causa and Hermansen (2017) is a fairly widespread shift in transfer policy from out-of-work to in-work support, at least partly driven by reforms to make work pay, especially for workers with weak labour market attachment. While this is likely to have mitigated market income inequalities by spurring employment growth, it could
have contributed to the decline in redistribution. This should not lead to the conclusion that countries have no choice but to trade more efficiency for less equity. The reason is that redistribution policies should be considered as part of broader policy packages to make growth more inclusive. For example, well-designed inclusive growth packages should combine tax and transfer policies to make work pay and boost jobs with policies to improve employability, skill adaptability and wage prospects. To the extent that such packages have not been broadly deployed by OECD countries, potentially reflecting budgetary constraints, reductions in market income inequality induced by such reforms have not been sufficient to prevent disposable income inequality from rising.

References