# Income redistribution through taxes and transfers across OECD countries

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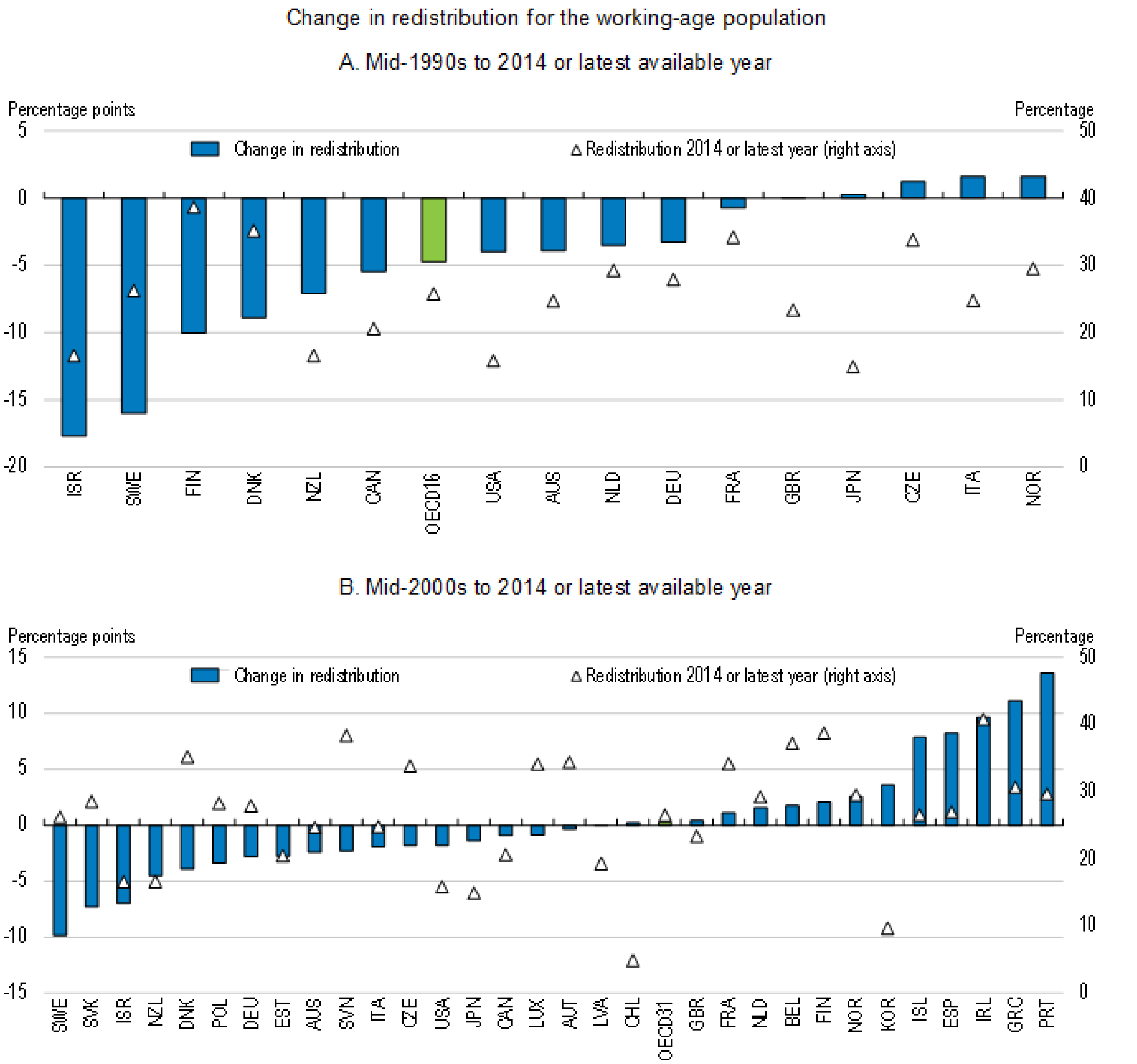
Many OECD countries have been facing a prolonged period of low growth and stagnating income of the poorest. This challenges governments' fiscal redistribution, all the more so in a context where new forms of work are calling into question the effectiveness of traditional social safety nets and population 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).

**Figure 1. A widespread decline in redistribution across advanced OECD countries since the mid-1990s**




*Note*: For Panel A data refer to 1994-2015 for the United Kingdom; 1995-2012 for Japan; 1995-2015 for Finland, Israel, the Netherlands and the United States; 1996-2014 for Czech Republic and France; and 1995-2014 for the rest. For Panel B data refer to 2003-2012 for Japan; 2003-2014 for New Zealand; 2004-2015 for Finland and the United Kingdom; 2005-2014 for Denmark, France and Poland; 2005-2015 for Israel, the Netherlands and the United States; 2006-2015 for Chile and Korea; and 2004-2014 for the rest. See note to Figure 1 for further details on redistribution measure and working-age population.

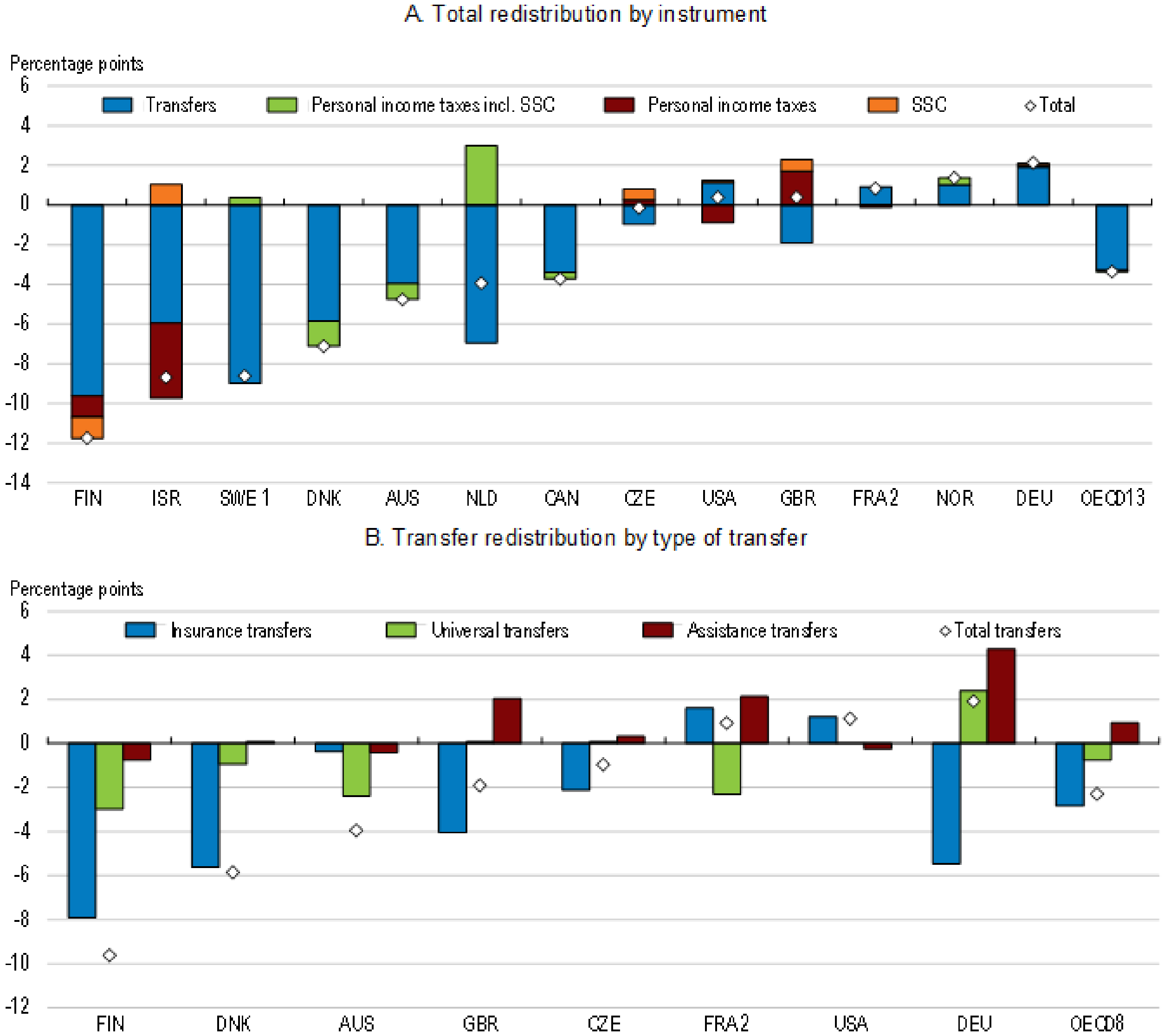
*Source*: OECD Income Distribution Database.

## 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.

**Figure 2. The redistributive effect of transfers has declined markedly across OECD countries**

Change in redistribution for the working-age population, mid-1990s to 2013 or latest available year




1. Sweden only available for 1995-2005.

2. Social security contributions not available for France.

*Note*: See Box 4 for the approach to assess the redistributive impact of individual parts of the tax and transfer systems. Data refer to 1993-2013 for the Netherlands; 1994-2010 for Canada and France; 1994-2012 for Hungary; 1994-2013 for Germany, the United Kingdom and the United States; 1995-2000 for Belgium; 1995-2005 for Sweden; 1995-2010 for Australia; 1995-2013 for Denmark, Finland and Norway; 1996-2012 for Mexico; 1996-2013 for Czech Republic; 1997-2012 for Israel and Slovenia.

*Source*: OECD staff calculations based on the Luxembourg Income Study.

## 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**

Causa, O. and M. Hermansen (2017), “Income redistribution through taxes and transfers across OECD countries”, *OECD Economics Department Working Papers*, No. 1453, OECD Publishing, Paris, http://dx.doi.org/10.1787/bc7569c6-en.