Income redistribution through taxes and transfers across OECD countries: A focus on the bottom 40 per cent

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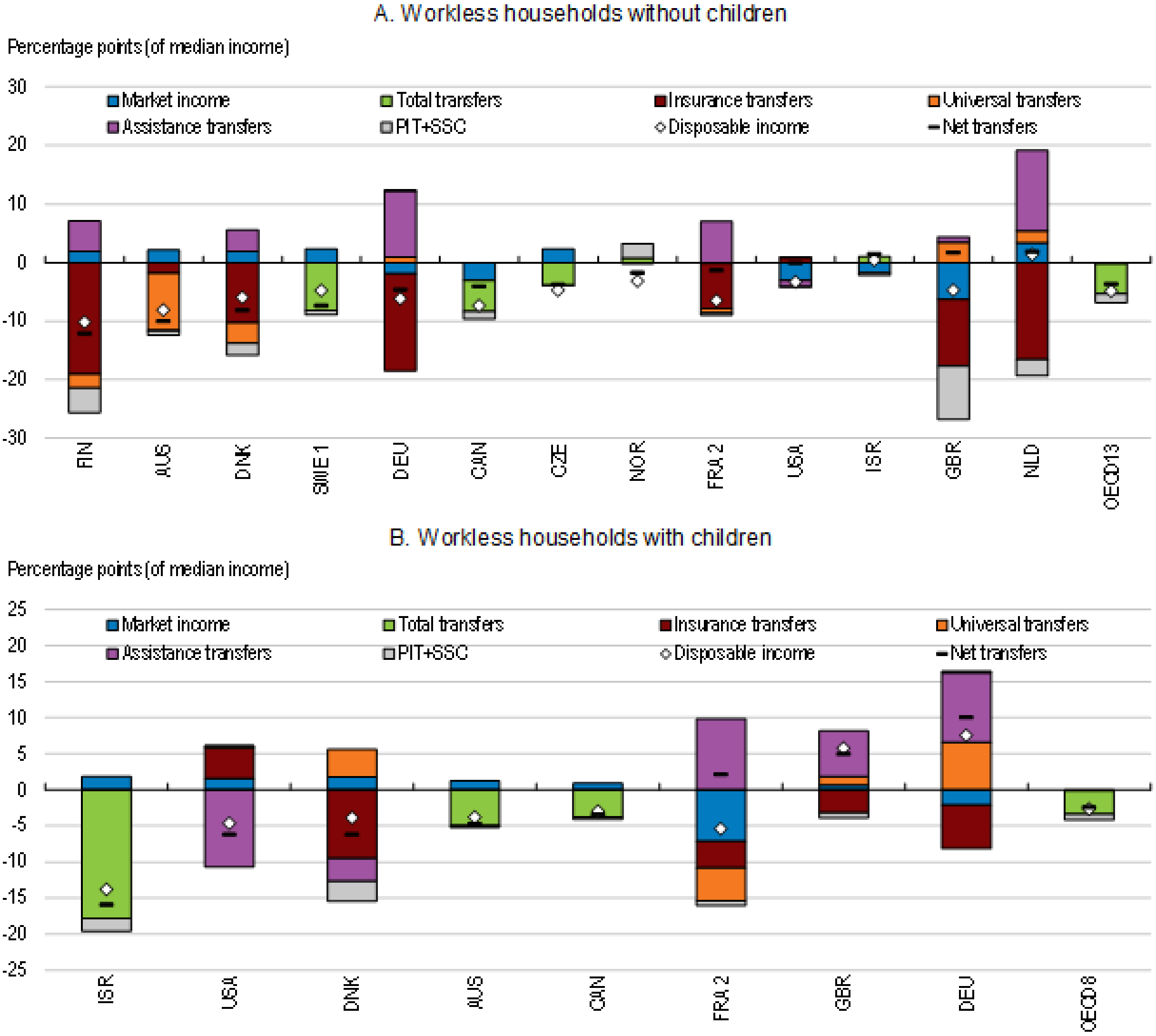
Tax and transfer systems are fundamental pillars of an inclusive growth policy agenda that aims at sharing the benefits of growth more equally and securing decent living standards for those in most need. A new OECD report by Causa and Hermansen (2017) ("Income redistribution through taxes and transfers across OECD countries") documents that redistribution through taxes and transfers has tended to decline across OECD countries since the mid-1990s. By and large, the decline in overall redistribution across OECD countries over the last decades has been primarily driven by a decline in redistribution by cash transfers. This is not surprising insofar as cash transfers account for the bulk of redistribution.

While the analysis cannot disentangle between policy and non-policy drivers of such decline in redistribution, this picture raises the concern that welfare systems are becoming less effective at ensuring income adequacy among vulnerable households. This question can be addressed by focusing on developments in market (or pre-tax and transfer) income and redistribution among households in "the bottom 40%" of the distribution. In order to isolate the effect of changes in population structure within that group, the composition of households is adjusted according to the working status of adults and the presence of children, two key parameters affecting the "need" for redistribution. This delivers the following insights, focusing on developments over the last two decades:

- Income support provided by social transfers to bottom 40% workless households has declined in the majority of countries for which data are available (Figure 1). Given the overwhelming weight of transfers relative to market income among that group, their disposable income declined markedly relative to median income. In the majority of countries for which data are available, cash transfers have become increasingly ineffective at preventing workless households from falling into relative poverty, especially in the presence of children.

Figure 1. Income adequacy implied by taxes and transfers have become less supportive of bottom 40% workless households

Change in taxes and transfers in percentage of median household disposable income, from mid-1990s to 2013 or latest available year



1. Sweden only available for 1995-2005.

2. Social security contributions not available for France.

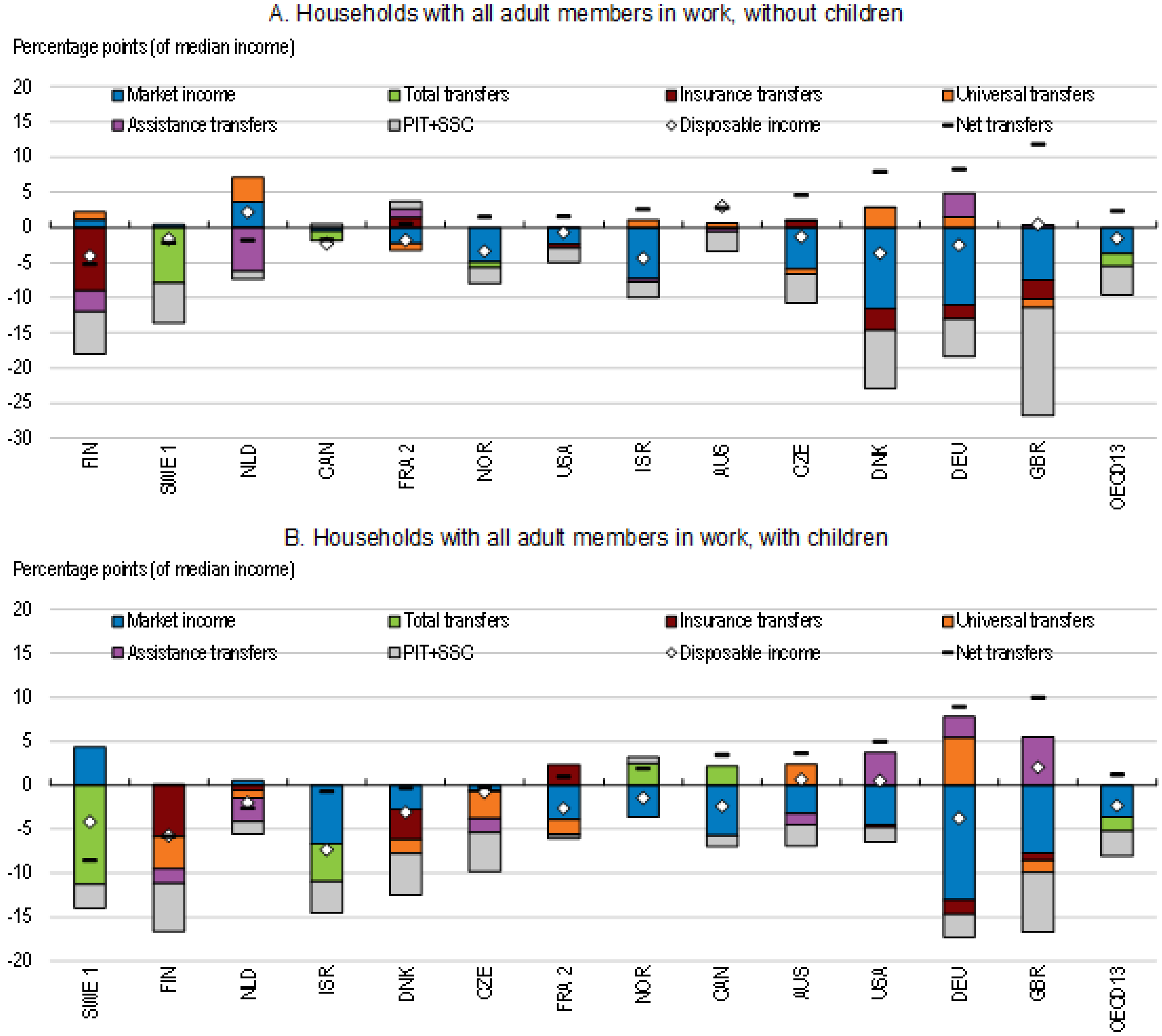
Note: Countries are sorted by net transfers received. The sample comprises all households among the bottom 40% (ranked by disposable incomes) with zero labour income. Countries with sample sizes less than 100 households have been excluded in Panel B. See note to Figure 5 for country-year coverage.

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

- By contrast with workless households, income support provided by taxes and transfers to bottom 40% working households has increased in the majority of countries for which data are available (Figure 2). The increase in net transfer support was largely driven by declines in income taxes and social security contributions that tended to mitigate widespread declines in market incomes.

Figure 2. Taxes and transfers have become more supportive of bottom 40% working households, but their incomes still fell behind the median

Change in taxes and transfers in percentage of median household disposable income, from mid-1990s to 2013 or latest available year



1. Sweden only available for 1995-2005.

2. Social security contributions not available for France.

Note: Countries are sorted by net transfers received. The sample comprises households among the bottom 40% (ranked by disposable incomes) for which all adult household members have positive labour income. See note to Figure 5 for country-year coverage.

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

The decline in redistribution may to some extent reflect the effects of tax and transfer reforms to make work pay for individuals with low earnings potential and weak labour market attachment. Concluding from this that such reforms were inappropriate would fail to consider redistribution policies as part of broader policy packages to make growth more inclusive. For example well-designed policy packages should combine tax and transfer policies to make work pay and boost jobs with policies to improve employability, skill adaptability and wage prospects. In other words, to raise job quality for less-skilled and at-risk individuals such as disadvantaged youth and immigrants, but also for older workers facing displacement in declining sectors. The policy implication is that tax and transfer reforms should be designed within an array of complementary policy instruments to address equity and efficiency objectives, taking into account country-specific context, constraints and social preferences.

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.