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GOING FOR GROWTH AND INCLUSIVENESS?

An OECD primer

"Going for Growth" is one of the flagship publications of the OECD Economics Department. It contains a country specific list of "what-to- reform" in order to improve employment and productivity performance. The novelty in the 2017 version of this report, released on the 17th of March, is that the dimension of "inclusiveness" is integrated for the first time. Or, as the opening paragraph of the relevant chapter says: "Higher growth is not systematically associated with rising living standards for the vast majority of citizens".

To integrate inclusiveness, the OECD applies the same method as it is using for the two other pillars of "Going for Growth" (employment, productivity). First, a dashboard of indicators on income inequalities, labour market performance (both quantity as quality of jobs) and non-income dimensions (health outcomes and inequalities) allows detecting performance weaknesses (see summary figure attached). In a second step, these gaps in performance are matched with weaknesses in related policies. After checking with country experts, policy recommendations are formulated.

Striking numbers

- While the average OECD Gini coefficient on household income (after taxes and transfers) remained stable from the mid-2000's, this result is influenced by the fact that the 5 OECD countries where inequality went up were the most populated ones. In the US for example, all income groups suffered a decline in real disposable income, except for the most affluent households.

- Meanwhile, the risk of falling into poverty has increased in 2 out of 3 OECD countries and in more than half of OECD countries, the poor have fallen further below the poverty threshold.

- "The bottom line is that in many advanced countries poorest households have been falling behind the rest of society, to a large extent reflecting adverse developments in market incomes at the bottom of the distribution but also, over the most recent period, a weakening of governments' income redistribution".

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Interesting recommendations….

These insights then get translated for a number of countries in interesting recommendations (see summary in table below).

Expand access to childcare and early education	**Improve parental leave**	**Expand coverage of social benefits**	**Increase the minimum wage**
20 countries, including amongst others Germany, Japan, Korea, US	US, Slovak Republic, Finland, Czech Republic	Greece, China, Lithuania, Japan, Korea, Latvia	US, Korea

… But also disappointing ones.

However, when other policies and countries are concerned, the OECD's quest for inclusiveness takes on strange forms. Besides referring to a lower minimum wage in Colombia and Turkey, the OECD is also recommending Belgium, France, Italy and South Africa to decentralise collective bargaining to the firm level and to reduce automatic extensions. Moreover, a string of countries is also warned to reform labour market regulation in the form of loosening up the job protection for regular workers (reduce severance pay, improve legal certainty of collective dismissal or justified individual dismissal and/or reduce gap in protection between permanent and temporary workers.

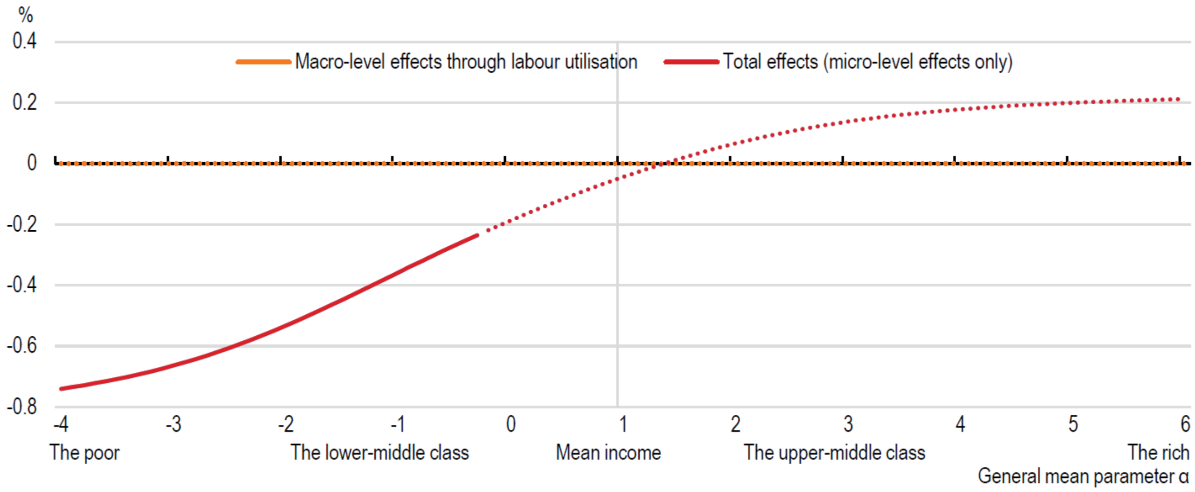
Avoid a too high minimum wage	**Promote firm level bargaining, reduce extension**	**Restructure benefits to increase work incentives**	**Reform job protection**
Colombia, Turkey	Belgium, France, Italy, South Africa	Finland, Iceland, Ireland, Latvia, Luxembourg, Netherlands, Slovenia, Lithuania	Chile,France,Japan,Korea,Netherlands, Spain,Turkey,Colombia,India,Indonesia

The latter are based on flimsy (or even no) evidence at all or on flawed arguments

- The recommendation to reduce the extent to which collective bargaining agreements are extended to workers who are not member of a trade union can be traced back to a 2015 ECO paper ("The macroeconomic impact of structural policies on labour market outcomes in OECD countries: A reassessment" OECD ECO Working Papers no 1271). However, this paper finds the negative impact of collective bargaining extension to be non-robust. By simply removing one of the following three countries (Germany, Spain, and New Zealand) from the sample, the coefficient turns positive and/or losses statistical significance. Given the lack of convincing evidence, the OECD recommendation to weaken this collective bargaining institution in several countries is therefore not-credible.

- To the extent that the recommendation to 'restructure benefits to increase work incentives' refers to the long term unemployed, other work by the OECD (Causa, Ruiz, Hermansen, The Distributional Impact of Structural Reforms, Economics Department Working Paper 1342) cautions against the impact of such a reduction in replacement rates for this category of the unemployed. Such a measure would hit the poor and lower-middle class households significantly, thereby increasing inequalities (see graph).

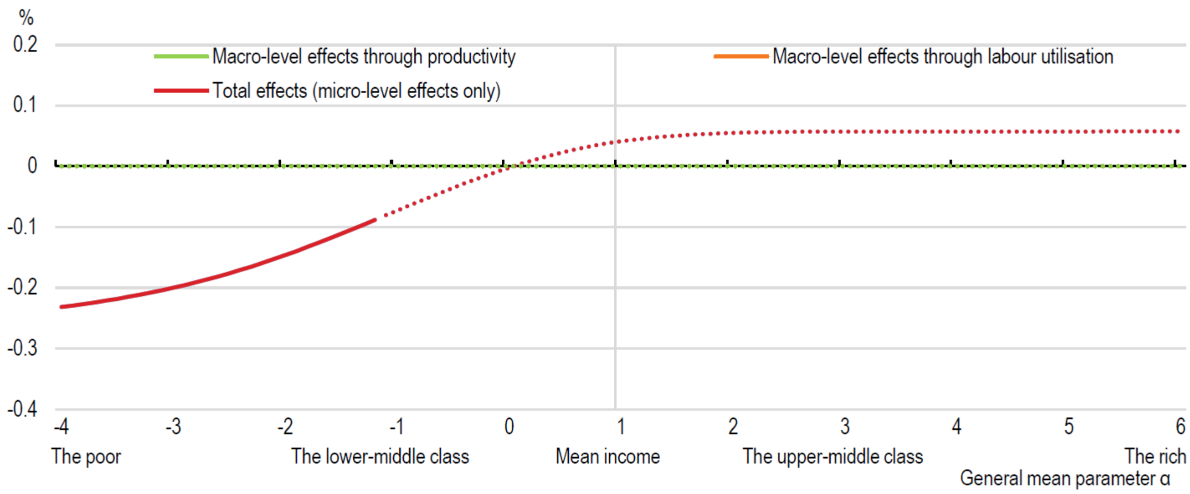
Figure 5. Effects of a reduction in UB net replacement rates for long-term unemployed on household disposable incomes



How to read this figure: A reduction in UB net replacement rates for long-term unemployed (single, 100% of average earnings, no children, 60th month of benefit receipt) by 1 percentage point is estimated to decrease household disposable incomes by 0.2-0.7% on average among the lower-middle class and the poor. This total effect comprises only the micro-level effect since the macro-level effect on labour utilisation is insignificant and thus set to zero. See Box 2 for details of the empirical approach and the definition of the effects. Non-significant estimates (at the 10% level) are indicated by dots on general mean curves.

- The same ECO working paper found that a reduction in EPL for regular contracts would hit the household disposable incomes of the poor and of the lower middle class, thus unambiguously increasing inequality (see next graph). This is because the OECD cannot detect any robust effect from job protection on employment or productivity performance while, as is explicitly recognized in the same OECD (paragraph 23), job protection legislation tends to protect wages of low skilled workers with little bargaining power to a larger extent than those of high skilled workers. The combined effect of an increased dispersion of wages which is not offset in any way by better job performance is that reducing job protection tends to widen household income inequality.

Figure 9. Effects of a reduction in EPL for regular contracts on household disposable incomes



How to read this figure: A reduction in EPL for regular contracts (index 0-6) by 1% is estimated to decrease household disposable income by 0.1-0.2% among the poor and the lower-middle class. This total effect comprises only the micro-level effect since the macro-level effects on labour productivity and labour utilisation are insignificant and thus set to zero. See Box 2 for details of the empirical approach and the definition of the effects. Non-significant estimates (at the 10% level) are indicated by dots on general mean curves.

- Unable to use its own direct evidence, the OECD instead turns to the traditional 'insider/outsider' argument to make the case for loosening the protection of regular contracts. Speeding up employment turnover would boost productivity and growth (by improving labour market reallocation) but also make growth more inclusive. The latter would operate by increasing the probability for (long term) unemployed to find a new job (hence lower income inequality between workers and non-workers), by reducing labour market dualism (hence less precarious contracts that have lower wages and unequal access to social protection) and by increasing transition from non-regular contracts to regular contracts.

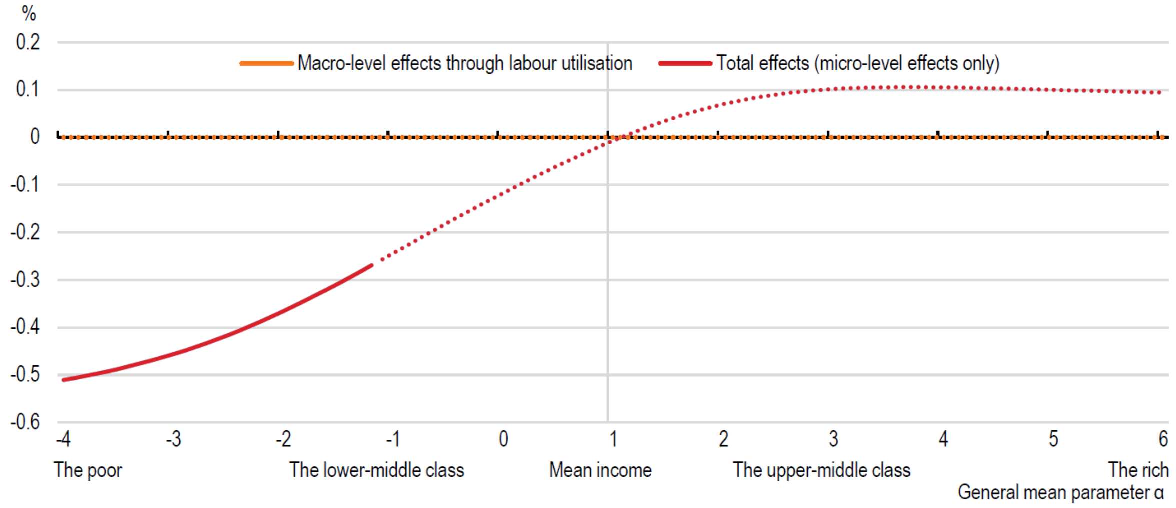
However, in doing so, the OECD is only looking at those effects that are potentially beneficial while ignoring the costs of job protection reform. "Easy firing" would perhaps increase the probability for unemployed to find a new job. At the same time, workers would also stand to lose their jobs more rapidly, making the net positive impact on the incidence of unemployment and on inequalities doubtful. Likewise, 'easy firing' of regular workers may reduce somewhat the incentive for employers to hire on a fixed term basis but there is also the risk that this does not solve anything as rights and bargaining position for all workers get weakened, thus leading to lower wages and precarious working conditions for all workers, not just those under fixed term contracts.

In short, it is not clear how a labour market that functions as a continuous 'revolving door' and where workers enter through the front door only to get thrown out through the kitchen window can be efficient, let alone equitable.

Recommendations that are being overlooked

The same working paper from the OECD's economics department (no 1342) also estimates the impact of trade union density and of coordinated collective bargaining on jobs and inequalities. It finds that the incomes of the poorest households suffer from a decline in trade union density and that this is not accompanied by any job gains.

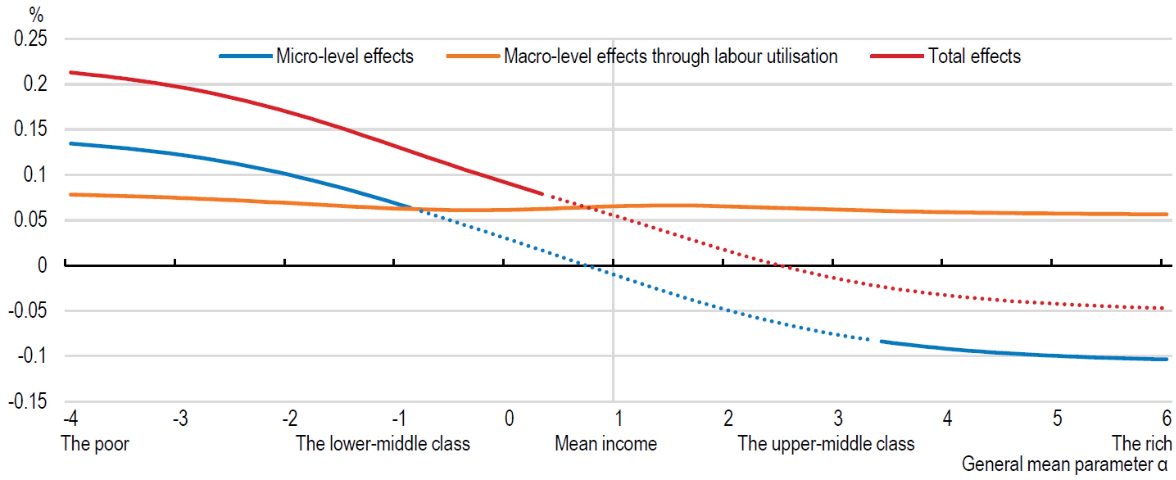
Figure 10. Effects of a reduction in union density on household disposable incomes



How to read this figure: A reduction in union density by 1 percentage point is estimated to decrease household disposable incomes by 0.3-0.5% on average among the lower middle-class and the poor. This total effect comprises only the micro-level effect since the macro-level effect on labour utilisation is insignificant and thus set to zero. See Box 2 for details of the empirical approach and the definition of the effects. Non-significant estimates (at the 10% level) are indicated by dots on general mean curves.

Coordination of collective bargaining, however, does both: It boosts jobs performance across the entire range of households while, on top of that it increases incomes for the poor and the lower middle classes.

Figure 12. Effects of an increase in the degree of coordination of wage-setting on household disposable incomes



How to read this figure: An increase in the degree of coordination of wage setting coverage (index 1-5) by 1% is estimated to increase household disposable incomes by 0.1-0.2% on average among the poor and the lower-middle class. This total effect can be decomposed along a micro-level effect and a macro-level effect through labour utilisation. See Box 2 for details of the empirical approach and the definition of the effects. Non-significant estimates (at the 10% level) are indicated by dots on general mean curves.

Conclusion

Over the past years, a series of OECD reports have documented the worrying trend of high and rising inequalities. The inclusion of the dimension of 'inclusiveness' in the Economics' Department flagship 'Going for Growth' publication gives policy makers the important message that economic policy should start taking equity concerns on board. This is to be supported, as well as some of the practical country specific policy recommendations such as increasing child care investment or raising the minimum wage.

At the same time, there is room for substantial improvement as the OECD continues to hold a bias against labour market institutions such as collective bargaining extension and regular job protection. The OECD, as documented in this note, is unable to base these biased policy recommendations on robust evidence. In fact, the evidence produced by the OECD itself, is showing the opposite. Reducing regular protection is bad for inclusiveness while improving union density or the coordination of collective bargaining increases jobs for all while improving the incomes for the poor and lower middle classes.

Attachment : Inclusiveness dashboard

Figure 1. The *Going for Growth* dashboard of inclusiveness indicators