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**UPDATE ON THE INCLUSIVE GROWTH PROJECT**

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1. **There is an urgent political and economic imperative for governments to address inequalities** (Box 1). In many countries, people have not seen their real incomes rise for several years, and the gap between rich and poor has widened, with those at the top capturing the ‘lion’s share’ of growth. Increased earnings and wealth inequality have become major concerns for policy makers, but money is just one aspect of life that matters for well-being. In just about every area, whether it be educational attainment, life expectancy, or employment prospects, success is disproportionately determined by socio-economic status, wealth and assets, sex, age or the places where people live. Widening inequalities risk undermining the foundations of market economies, potentially adversely feeding back into economic growth and eroding confidence in public institutions. It is no exaggeration to say that this could put at risk the democratic process, as people may become permanently disengaged if they feel that governments of all stripes no longer work for them.

2. **Fostering Inclusive Growth will call for a major break with the past.** The traditional discussion of growth and equality presented decision makers with a binary choice: *either* we should promote growth *or* we should prioritise redistribution; *either* we should make labour markets more flexible *or* we should make them fairer; *either* we should promote welfare spending *or* we should keep taxes low to promote economic activity. But this way of looking at growth and equity has led to sterile, ideologically-driven debates, and has provided policy makers with little in the way of fresh insight. Such a debate is no longer tenable, the severity of the challenge we face is too great, and the economic, social and political risks of failure too high. There is a drastic need to reassess the way in which we design our policies to ensure that they treat growth and equity as mutually re-enforcing goals. Looking at inequalities between social groups across the different areas of life, and the implications for policy, must be at the heart of Inclusive Growth.

3. **The OECD has responded to the call to make economic growth more inclusive.** The Organisation has developed a novel approach to Inclusive Growth which aims to help governments analyse and address rising inequalities, monitor material living standards and broader well-being, and design underlying policy packages (See Annex I). Building upon many years’ work on inequalities, well-being, and structural policies, the OECD’s Inclusive Growth Initiative is uniquely placed to collect international comparable data and quantify policy impacts (See Annex II). Our approach is based on the following insights:

- **The relationship between economic growth and social progress is a two-way street.** It is no longer possible for us to think about inequalities and growth separately. OECD work has shown that inequalities are themselves generated by how economic systems work, and that they can undermine growth by discouraging the poorest from investing in education and skills. Indeed, there is mounting evidence to show that countries where income inequality is decreasing grow faster than those with rising inequality.
- **People need to be put at the heart of economics and improvements in societal well-being should be placed closer to the core of policy making.** Whilst ensuring that our economies grow remains essential, it is not everything – how well people are doing in other areas like jobs, education, and health matters too. GDP growth should no longer be viewed as an end in itself, but as a means to enhance well-being.
- **The distribution of the benefits of growth matters for future prosperity.** Growth is essential, but the benefits must be broadly shared to generate sustained improvements in living standards. Any sensible model of economic progress cannot assume that all growth contributes to well-being equally, regardless of who benefits. This calls for the reassessment of our measurement tools, as simply looking at the average fails to capture the wide disparities among social groups. In particular, this means looking not only at how policies affect the statistically constructed

‘average person’, but also looking at how they affect different social groups like the middle class, the bottom 10%, 20% or 40%, youth, women or any other social groups.

- **Inequalities of opportunities and inequalities of outcomes are two sides of the same coin.** Policy choices made today do not just affect us here and now, but also set the stage for tomorrow. This means there is a need to look at outcomes important for the present – such as how much disposable income a household has, or an individual’s risk of unemployment – but also to consider future opportunities, like the scope for upward social mobility and the potential to live a long and healthy life. Looking at the inter-temporal dimension brings home that, from a policy perspective, whether the focus should be on inequalities of opportunity or inequalities of outcomes may not be so relevant, as the unequal outcomes of one generation tend to become the inequality of opportunity of the next.
- **The effects of policies on growth, income, and other outcomes, e.g. health and jobs, should be assessed simultaneously.** There are clear win-win policies such as investment in education and skills, but there might also be trade-offs. For instance, pursuing a particular set of growth policies may raise income, but at the same time lead to higher air and water pollution, with unclear net effects on health status and overall living standards. Higher health spending can support a healthier population with potentially positive effects on employment and incomes, but it might also imply higher taxation and hence less material consumption.
- **Policy making for Inclusive Growth requires a *whole-of-government* approach that leverages informed decision making and gives all stakeholders a voice.** Fragmented systems of governance hinder inclusiveness, leading to avoidable trade-offs and co-ordination failures. Public governance institutions, tools and processes should be designed to improve coherence across sectors and levels of government while empowering the implementation and evaluation of Inclusive Growth policy packages. We should also recognise that the political and institutional structures that govern the economy need to ensure they better reflect – in terms of gender and socioeconomic make-up – and serve all segments of society. The political economy of going for Inclusive Growth calls for a decision making process that is open and informed by all stakeholders. This will help not only in overcoming vested interests but in achieving policy outcomes that reflect the realities and aspirations of communities.

4. **The OECD has developed an analytical framework that takes these insights into account.** It emphasises the importance of the distribution of outcomes across the population and allows decision makers to better understand the main trade-offs and to see how particular structural policies affect specific groups. It also establishes quantitative links between different outcomes and policy variables.

5. **The Inclusive Growth Initiative will build on OECD strengths to help Members deliver better policies for fairer societies and stronger, sustainable growth.** Being able to analyse the broader consequences of policy choices in a more rigorous fashion – whilst making explicit the importance that communities attach to different dimensions of well-being – will enable policy makers to take better-informed decisions. The Initiative will deliver a report to the 2016 Ministerial Council Meeting (MCM) drawing together the conclusions of the project. The report will also set out a strategy for mainstreaming the work across the Organisation. It may also result in proposed *Recommendations on Policies to Promote Inclusive Growth*.

### Box 1. *Did you Know?*

#### **The incomes of those at the very top have soared**

- **Income inequality has grown rapidly in OECD countries over the last three decades.** In 2011, the average net income of the top 10% of earners was around 10 times that of the bottom 10%, up from 7 times 30 years ago.<sup>1</sup>
- **It has also increased in traditionally egalitarian countries.** In Germany, Norway and Sweden, the average income of the top 10% expanded from less than 5 times that of the bottom decile in the 1980s, to more than 6 times today.<sup>2</sup>
- **And it remains high in emerging economies and developing countries.** In Chile, the income ratio of the top 10% of earners to the bottom 10% had fallen to under 27:1 in 2011. Whereas in Mexico, despite falling from the early to mid-2000s, by 2012 the income of the top 10% had once again risen to over 30 times that of the bottom 10%. In South Africa, the level of income inequality did not fall, with the average income of the top 10% estimated to be around 100 times that of those in the bottom decile.<sup>3</sup>
- **Those at the very top took the lion's share of pre-tax income growth from the mid-1970s to the period immediately preceding the crisis.** Between 1975 and 2007 the top 1% benefitted disproportionately from greater income growth. In the United States 47% of total income growth over that period went to the top 1%, in Canada it was 37%, and the figure stood at around 20% in Australia and the United Kingdom.<sup>4</sup>

#### **Beyond income, inequalities affect all areas of life**

- **Those with the best educations live longer.** Data from 14 OECD countries show that on average people with better education live six years longer than their poorly educated peers.<sup>5</sup>
- **Socio-economic standing strongly influences self-reported health status in OECD countries.** In 2012, the proportion of people who reported their health to be 'good or very good' was higher everywhere amongst the top 20% of income earners than the bottom 20%.<sup>6</sup> The difference between the two groups in the proportion of people reporting good or very good health stood at over 20 percentage points in a number of OECD countries, including: Belgium, Germany, the United Kingdom, and the United States.<sup>7</sup>
- **Access to jobs is also unequal, perpetuating income discrepancies.** Non-standard work arrangements make up a third of total employment across OECD countries.<sup>8</sup> Moreover, in-work poverty now affects 8% of the workforce in OECD countries.<sup>9</sup>

#### **Inequalities have a spatial dimension**

- **Life expectancy varies between regions.** In 2011, life expectancy in the United States varied across states, on average, by six years.<sup>10</sup>

<sup>1</sup> OECD Income Distribution Database: <http://www.oecd.org/els/soc/income-distribution-database.htm>.

<sup>2</sup> *Ibid.*

<sup>3</sup> *Ibid.*

<sup>4</sup> OECD (2014a), "Focus on Top Incomes and Taxation in OECD Countries: Was the Crisis a Game Changer?", OECD Publishing, Paris, <http://www.oecd.org/els/soc/OECD2014-FocusOnTopIncomes.pdf>.

<sup>5</sup> OECD (2013a), *Health at a Glance 2013: OECD Indicators*, OECD Publishing, Paris, [http://dx.doi.org/10.1787/health\\_glance-2013-en](http://dx.doi.org/10.1787/health_glance-2013-en)

<sup>6</sup> *OECD Statistical Database*: <http://stats.oecd.org>.

<sup>7</sup> *Ibid.*

<sup>8</sup> OECD (2012), *Jobs, Wages and Inequality: Progress Report*, OECD Publishing, Paris, [DELSA/ELSA/WP1\(2012\)4](http://www.oecd.org/els/wpi/DELSA/ELSA/WP1(2012)4).

<sup>9</sup> OECD Income Distribution Database: <http://www.oecd.org/social/inequality.htm>.

<sup>10</sup> OECD Regional Well-Being Database: <http://www.oecdregionalwellbeing.org/>.

- **Risk of unemployment is unevenly spread.** In 2013, the difference in the unemployment rate between the best and worst performing regions in the OECD area was 32 percentage points – almost twice as high as the difference between the best and worst performing OECD countries.<sup>11</sup>
- **There are high regional differences in income inequality in many OECD countries.** In Mexico, the range in the Gini coefficient of disposable household income between the states of Tlaxcala (0.41 in 2012) and Guerrero (0.53 in 2012) is similar to the difference between Mexico (0.48 in 2012) and New Zealand (0.32 in 2011).<sup>12</sup>
- **On average, income inequalities tend to be higher in larger cities.** Most of the income inequality experienced in a country reflects income differences among individuals living in the same regions.<sup>13</sup>

**Rising inequalities can have a profound impact on economic growth**

- **The long-term increase in income inequality may have curbed economic growth significantly in a number of OECD countries.** Between 1990 and 2010, rising inequality is estimated to have knocked more than 10 percentage points off growth in Mexico, nearly 9 points in the United Kingdom, Finland and Norway and between 6 and 7 points in the United States, Italy and Sweden.<sup>14</sup>

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<sup>11</sup> *Ibid.*

<sup>12</sup> *Ibid.*

<sup>13</sup> *Ibid.*

<sup>14</sup> OECD (2014b), "Focus on Inequality and Growth - December 2014: Does Income Inequality Hurt Economic Growth?" OECD Publishing Paris, <http://www.oecd.org/els/soc/Focus-Inequality-and-Growth-2014.pdf>.

## ANNEX I. THE INCLUSIVE GROWTH INITIATIVE: BACKGROUND INFORMATION

### Origin of the OECD Inclusive Growth Initiative

1. Inclusive Growth is increasingly coming to dominate national economic agendas, as governments are hard pressed to kick-start economic growth and deal with the social fall-out of persistent inequalities. The OECD launched work on Inclusive Growth ([www.oecd.org/inclusive-growth](http://www.oecd.org/inclusive-growth)) in 2012 against the backdrop of rising inequalities, persistent high unemployment, and falling living standards worldwide; trends which had been exacerbated as a result of the financial crisis. It was born from the dual recognition that inequalities extend beyond income to affect many areas of people's lives essential for their well-being, and that the persistently high levels of inequality present in many countries have taken a substantial toll on the social fabric of communities, place a profound economic cost on future growth, and reduce trust in government and institutions.

2. The preliminary phase of the Inclusive Growth Initiative built on the Organisation's **ongoing work on growth, inequalities, well-being, structural reforms and development** to identify and better understand policies that simultaneously deliver improvements in living standards and in outcomes that matter for people's quality of life (e.g. good health, jobs and skills, clean environment, efficient institutions). It was set up further to the New Approaches to Economic Challenges (NAEC) objective of developing a strategic policy agenda for Inclusive Growth<sup>1</sup> to foster jobs and growth and address inequalities, to promote political and economic stability, strengthen social contracts, and improve welfare.

Figure 1. Inclusive Growth Initiative Programme of Work (2013-14 and 2015-16)



<sup>1</sup> See document [C/MIN\(2013\)23](http://www.oecd.org/min(2013)23).

## Main achievements during the preliminary phase of the OECD Inclusive Growth Initiative

3. The preliminary phase of the Inclusive Growth Initiative developed a **multidimensional approach to Inclusive Growth** providing a Framework to assess, promote and monitor inclusive growth. *The Report on the OECD Framework for Inclusive Growth* (OECD, 2014c), presented at the Ministerial Council Meeting (MCM) 2014 as a background document, describes the Framework and key preliminary empirical findings (Annex II).

4. The preliminary phase also delivered a flagship publication: *All on Board: Making Inclusive Growth Happen*, which offers a description of trends in income and non-income outcomes and introduces the Framework. It discusses win-win policies to deliver stronger growth and greater inclusiveness in areas such as macroeconomic policies, labour market policies, education and skills, competition and product market regulation, innovation and entrepreneurship, financial markets, infrastructure and public services, and development and urban policies. It also includes a discussion on inclusive institutions and the underlying governance requirements for the design and implementation of Inclusive Growth policies.

5. An **outreach campaign** supported the development and dissemination of the Framework through consultations with external stakeholders. Two international conferences with the Ford Foundation and a regional consultation in Latin America and the Caribbean with the United Nations Economic Commission for Latin America and the Caribbean were held. Several workshops were convened at the country level, including meetings with the Chinese National Development and Reform Commission (NDRC) to prepare the first Inclusive Growth National Case Study, *All on Board: Making Inclusive Growth Happen in China*; as well as seminars at the OECD to brief Paris-based constituents such as BIAC and TUAC. In addition, an informal Advisory Group of international experts was formed to discuss the research and analytical work that underpins the Framework.

## Inclusive Growth Initiative: Proposed Programme of Work for 2015-16

6. **Ministers at the 2014 MCM** underscored the need to advance the Inclusive Growth agenda, highlighting that inequalities are multidimensional and that tackling them should be achieved through better access to employment opportunities, as well as to health and education services. They mentioned the need to link pro-growth policies with equity objectives, highlighting policies to boost productivity, ensure fair competition, promote efficient labour and product markets, address tax evasion and avoidance, and stimulate investment, innovation and entrepreneurship. The 2014 MCM Chair's Summary [[C/MIN\(2014\)16](#)] noted the OECD Inclusive Growth Framework Report and encouraged further work in this regard.

7. The Inclusive Growth programme of work for 2015-16 will build on the findings from the preliminary phase and focus on four main pillars (**methodological, sectoral, national and regional**). The work will be carried out in conjunction with experts across the OECD. A final report on Inclusive Growth will be presented to Ministers in June 2016, which will build on research undertaken during 2015-16 and refinements to the Inclusive Growth Framework. It will be delivered at the 2016 Ministerial Council Meeting.

8. The guidance and oversight is ensured by the four core Committees (e.g. CSSP, ELSAC, EPC and PGC). Sectoral work will be overseen by the relevant sectoral Committees, e.g. RDP, EPOC, CTSP, etc. In addition, the draft intermediate and final reports will be discussed and endorsed by the NAEC Group and Council. To facilitate co-ordination of substantive inputs, a core group of Inclusive Growth focal points comprised of the four core Directorates (ECO, STD, ELS, GOV), and the core group of Inclusive Growth Directors, meet on a regular basis. A broader group of Inclusive Growth focal points from most OECD Directorates also meets on a quarterly basis, or when needed.

### *Pillar 1: Methodological*

9. The objective of the first pillar is to refine and strengthen the methodological elements of the Framework as well as the policy mapping tool. The methodological work will focus on refining the multidimensional living standards measure. In this area, work will be done to incorporate other non-income dimensions that matter for well-being (e.g. education, environment) and new countries into the analysis, as well as to test the robustness of the Framework.

#### *Statistical refinements*

- The robustness of the methodology will be tested in particular with respect to the unemployment and employment variables with the objective to improve the jobs dimension of the methodology.
- There will be work done to complement the shadow price calculations used in the methodology to include subjective and model-based techniques.
- The methodology will be extended to include health inequality and education. The work on education will specifically examine the welfare return to education (in terms of life-expectancy).
- The geographic and temporal coverage of the OECD Inclusive Growth and inequalities databases, will be broadened to include a select number of emerging and middle-income countries, such as Brazil, India, and China. This work will be carried out by the OECD Centre on Opportunities and Equalities (Box 1).

#### **Box 1. OECD Centre on Opportunities and Equalities**

The **Centre on Opportunities and Equalities** is a new platform for promoting and conducting policy-oriented research on the trends, causes and consequences of inequalities in society and the economy and discussing how policies can best address such inequalities.

The scope of the Centre is three-fold. It is:

1. **Global**, focusing on various dimensions of inequality in developed, emerging and developing countries.
2. **Cross-cutting**, reflecting significant inequalities in a number of socio-economic outcomes, from income and wealth to employment, education, health, housing, access to public services, energy and financial markets, as well as across people with different characteristics, such as gender, age, socio-economic backgrounds or living in different sub-national regions.
3. **Comprehensive**, providing policy-relevant information and analyses that consider policy complementarities and trade-offs faced by policy makers, both in the different sectors and different parts of national and local governments. The Centre will build on the OECD's unique capacity to produce and coordinate cross-country and cross-sectoral policy analysis and comparative data.

#### *Mapping policies to outcomes*

10. The policy mapping work will pursue the analysis of the main drivers of the key dimensions – based on a production function approach – and the identification of robust empirical relationships. To complete the work undertaken in 2014, the impact of structural policies on household income, including through their effect on productivity and employment, will be examined across the whole distribution. Also, the links between policies and employment (or unemployment) will be provided in the context of ongoing work on the quantification of the impact of structural reforms on economic performance.

*Pillar 2: Sectoral*

11. The second pillar of work in 2015-16 will look at mainstreaming the Inclusive Growth Framework across the OECD. A mapping of ongoing and future activities related to Inclusive Growth by theme – with direct and indirect links – was undertaken, and a sampling of examples is provided below.

- **Health:** Work on health will develop an in-depth analysis of the complex interrelationships between the distribution of health outcomes and other components and determinants of living standards, including, but not limited to, determinants of investments in health capital stock and in other dimensions of human capital. It will involve an assessment of how different policies are likely to impact differently on health inequalities, based on a selection of specific country examples, and further identify how the insights from the Inclusive Growth Framework should be used to inform health policy making.
- **Education & Skills:** Work on education and skills will primarily document the potential for improving inclusion of children and youth at risk in education and training and fostering educational investment of disadvantaged learners through Inclusive Growth policies. It will build on OECD work on education indicators (INES), students' learning outcomes (PISA), early childhood education and care (ECEC), skills (PIAAC), and youth employability in the OECD (i.e. The Youth Action Plan), and in developing countries (i.e. Youth Inclusion).
- **Innovation for Inclusive Growth:** Work on innovation for Inclusive Growth will analyse the impact of innovation on income distribution, and analyse and provide evidence on the distribution of innovative activities across firms, universities, regions, and how it impacts the distribution of income; and analyse the impact of innovation policies on the distribution of innovation activities.
- **Competition and Finance:** There will be several work streams on competition and finance over the course of 2015-16. Part of the work will be to provide empirical evidence that competition policy can contribute to reducing inequality in OECD and non-OECD countries. Another stream will look at how to improve financial literacy and consumer protection.
- **Inclusive Regions and Cities:** The measurement of well-being at the local level can help policy makers prioritise public intervention where improvements are most needed, better assess and monitor spatial concentration of outcomes, and improve policy coherence. The work on Inclusive Cities will expand the OECD work and database on measuring well-being in regions to assess well-being outcomes in the OECD urban regions and review policy options for building inclusive and resilient cities. The work will extend the multidimensional living standards measure at the sub-national level to highlight territorial disparities in international comparisons. In addition, it will support ongoing efforts to “map” policies to outcomes at the regional level.
- **Governance:** This work stream will focus on enabling the design and implementation of effective inclusive growth policy packages through better governance tools and processes. It includes better understanding and forecasting demand, building a solid evidence base to inform decision making, aligning spending decisions and performance levers with distributional outcomes, institutionalising multilevel and horizontal coordination with essential service providers and assessing impact, particularly of social policies and programs. In addition, work on inclusive institutions will be deepened so that governments can leverage inclusive problem identification and decision making to achieve outcomes that reflect the realities and aspirations of the communities they serve.

- **Urban Air Quality:** Work on air quality will look at how to improve urban air quality and to reduce the social costs of air pollution. It will focus on the economic valuation of morbidity impacts of air pollution and the associated welfare effects.
- **Tax design:** Work on tax design for Inclusive Growth will focus on identifying tax reforms in OECD countries that have been successful in achieving inclusive and sustainable economic growth. The aim is to further develop the “tax design for inclusive, sustainable and resilient economic growth” narrative in order to offer better-targeted tax policy advice to countries which would allow them to face their current and future challenges.
- **Youth Inclusion and Social Protection:** Work on Youth Inclusion and Social Protection is key to the Inclusive Growth agenda in developing countries. Work in this area will be undertaken by the Development Centre within the context of ongoing activities address youth inclusion issues in national policies and in development co-operation activities, including policy-relevant, country-level analyses training to support the capacity of national stakeholders. It is also linked to work on social protection.

### *Pillar 3: National*

12. A third pillar will focus on testing and applying the Inclusive Growth Framework at the national level in Member and some non-Member countries. At the request of countries, national case studies will be carried out.

13. **OECD Inclusive Growth National Case Studies** are comprehensive analyses of national trends in inequalities and multidimensional living standards, which examine the effects of policies across society and furnish governments with a prospective policy roadmap to foster Inclusive Growth. They provide the commissioning country with a deeper understanding of the trends in inequalities most salient to their national context, empowering them to develop effective Inclusive Growth strategies that boost growth and ensure a better distribution of benefits to citizens.

14. The case studies seek to adapt the Inclusive Growth Framework to countries at all stages of development. The Inclusive Growth Initiative can be enriched by considering the challenges of emerging and developing economies as the policy brochure produced for China on Inclusive Growth demonstrated.

### *Pillar 4: Regional*

15. The fourth pillar looks at how the Inclusive Growth Framework resonates at the regional level and what adjustments are necessary to the Framework to most effectively address regional specificities. Consultations at this level allow for debate amongst decision makers on the policies that are required to deliver inclusive growth and foster exchange on the specific needs and circumstances of the region. OECD regional consultations engage participants throughout the process, provide important background information on inequalities trends in the region, and result in a summary document that can inform a regional Inclusive Growth agenda.

16. Work under this pillar will build on the regional consultation in Latin America and the Caribbean conducted in 2013 with the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), which underscored the importance of flexibility in an Inclusive Growth Framework to capture the dimensions most relevant to the region. While participants noted that the broad dimensions assessed by the OECD Inclusive Growth Framework are relevant to Latin America and the Caribbean, they also stated that there were other dimensions that were more important to the region. Education (access, quality, gaps,

enrolment rates), informal work, gender, transportation, housing, and access to infrastructure were identified as key dimensions for the region.

17. The next regional consultation will take place in **Southeast Asia**; a region that has experienced brisk growth over the last quarter of a century but has also seen inequalities widen. The consultation will take place in partnership with the United Nations Economic Commission for Asia and the Pacific (ESCAP) and the Asian Development Bank (ADB). It will focus on the trends and drivers of inclusive growth in the region; a relevant concept of Inclusive Growth; and policies for Inclusive Growth, including social protection and human capital as well as trade and investment.

## ANNEX II: MEASURING AND ANALYSING INCLUSIVE GROWTH

### The basic idea behind the Inclusive Growth Framework

1. The OECD considers Inclusive Growth as growth that (i) translates into improvements in a range of outcomes that *matter most to people's lives*; and (ii) ensures that these improvements benefit all groups in the population, not just a few. To analyse Inclusive Growth and the policies that foster it, the OECD has developed a measurement and conceptual Framework that is based on multidimensional living standards for households at different points of the income distribution. The aim of this Framework is not to furnish a new gauge for ranking countries and assessing their relative performance. Rather, multidimensional living standards should be seen as one of the new analytical tools developed in the context of the OECD New Approaches to Economic Challenges (NAEC) Initiative, the aim of which is to allow the analysis and quantification of the *net* effects of a particular policy or set of policies on households' well-being. Such a tool may be particularly useful to guide policy makers in arbitrating among policies that have an impact on economic growth and/or another outcomes, such as income and its distribution, health, unemployment, environmental quality etc., that matter to people. Governments face this type of dilemma every day, however they often lack an explicit framework and specific analytical instruments to understand and manage policy trade-offs. The OECD Inclusive Growth Framework aims at filling this gap by building evidence on how people's living standards can be enhanced and where the policy effort should be put to maximise the net impact of governments' action.

2. What follows focuses on living standards as defined by three important dimensions of people's lives: income, jobs and health. *The Report on the OECD Framework for Inclusive Growth* (OECD, 2014c) points to empirical evidence that these are dimensions that matter a lot to people's life assessments; they are also policy-actionable. In addition, living standards are measured at different points of the income distribution. When aggregated across income groups, an overall measure of multidimensional living standards can be derived that is reflective of income and non-income outcomes as well as of distributional aspects.

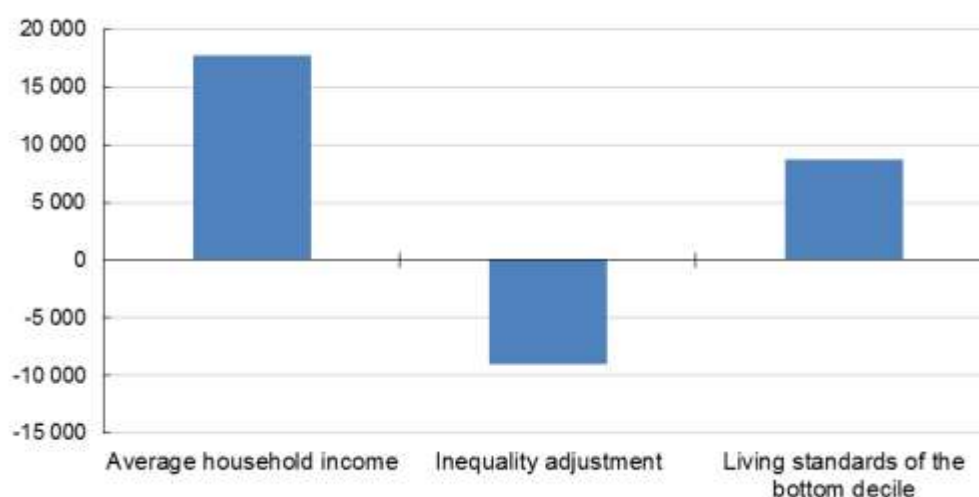
3. The sections below begin by analysing the simplest case where living standards are defined in terms of income alone, and includes some policy findings about trade-offs that pure pro-growth policies confront. The analysis of living standards is then extended to consider two additional dimensions: jobs and health. The discussion also focuses on how policy analysis may be developed in the future to assess the net impact of particular policies on the income and non-income dimensions of living standards. Finally, some areas of ongoing research and development within the statistical pillar of the OECD Inclusive Growth Initiative are discussed.

### Simplest case: Household income

4. In the simplest case, living standards are defined around one dimension only, income or consumption. A **measure of income-based living standards** reflects the evolution of real household income where a particular income group is emphasised.<sup>1</sup> As an illustration, this analysis shows the income-based living standards of the poorest.<sup>2</sup> As shown in Figure 1, this income-based measure can be decomposed as the average household income in the population and an *inequality adjustment*. The latter captures the difference between the income of the bottom 10% of the income distribution and the average income. Such a measure shows that, on average across OECD countries, the poorest households live on around the half of average income.

**Figure 1. Income-based living standards of the bottom decile in the OECD**

US dollars 2005 constant PPPs, 2012



Note: The chart shows the average of income-based living standards of the bottom decile across 31 OECD countries. Income is measured as household disposable income per capita, i.e. it accounts for taxes paid and subsidies received by households but does not include social transfers in kind such as free health, education or housing services.

Source: OECD calculations based on OECD Income distribution Database and OECD Annual National Accounts.

5. The OECD approach to Inclusive Growth offers an **explicit analytical link to key structural policies and their effects** on various segments of the income distribution. In practice, the effects of structural policies on average household income and on the inequality adjustment component can be estimated simultaneously, while the net effect proxies the policy impact on household income of a specific point of the distribution. In the case of income, the analysis links back to the main source of household income, the domestic production process. GDP and its determinants (labour, capital, innovation) are thus recognised as a fundamental determinant of household income. Analyses and policy recommendations

<sup>1</sup> Income deciles are aggregated with a generalised mean (Atkinson, 1970), that assigns varying importance to income deciles depending on the “aversion to inequality” of a given society. For illustrative purposes, in the OECD Inclusive Growth Framework analysis, the parameter of aversion to inequalities has been set such that the obtained generalised means correspond approximately to the average incomes of the bottom decile and of the median (see OECD, 2014c).

<sup>2</sup> See OECD (2014c) and OECD (2015).

regarding GDP growth that have been developed by the OECD (*Going for Growth, Jobs Strategy*) remain broadly valid but are put in a broader perspective to understand how pro-growth policies affect income inequalities, therefore joining the OECD's long-standing work on income distribution (*Divided We Stand, Growing Unequal*).

6. The central message is that GDP growth does not necessarily translate into growth of living standards. The ultimate effect will depend on the distribution of labour and capital income, how primary income is distributed between households and other sectors and how taxes, benefits and social transfers translate into disposable household income. Work is being carried out by the OECD's Economic Department to quantify the effects of structural policies on GDP and subsequently on different parts of the household income distribution (Table 1). Preliminary results suggest that many structural reforms have a stronger traction on household incomes – especially those at the low-end of the distribution – than on GDP per capita. For instance, reducing barriers to competition, job protection, unemployment benefits for all categories of jobseekers and labour taxation are found to lift incomes of the lower-middle class more than GDP per capita. Table 1 summarises some of the quantifications carried out in this work. The preliminary analysis reported in the table focused on the bottom half of the distribution. Further investigation is ongoing to better understand how policies influence the channels of transmission from income generation (through productivity and employment) to household income, across the entire distribution.

**Table 1. Effects of policy reforms on GDP per capita and household incomes, on average and across the distribution**

Example of specific structural policy reform	Change in policy parameters to deliver a 1% long-term increase in GDP per capita	Effects on long-term GDP per capita (%)	Effects on long-term average household income (%)	Effects on long-term household incomes across the distribution (%)		
				The median	The lower-middle class	The poor
Relax hiring and firing procedures / Reduce labour market duality	Reduction in the employment protection legislation index approximately equivalent to the stringency of regulation prevailing currently in Finland compared with Estonia (*)	1.0 (*)			1.4	1.9
Reduce the level or duration of unemployment benefits	Untargeted reductions in benefit replacement rates by 3 percentage points	1.0	1.3	1.5	1.5	1.5
Reduce the level of unemployment benefits for the long-term unemployed	Reductions in benefit replacement rates targeted to the long-term unemployed by 4 percentage points	1.0	0.8	0.8	-1.5	-2.4
Reform the tax structure by reducing the share of direct (corporate and income) taxes and increasing the share of property or indirect taxes	Reductions in the share of personal income taxes in tax revenue by 1.3 percentage points	1.0	0.5	0.5	0.5	0.5
Reduce marginal tax rates on labour	Reductions in average statutory marginal tax wedges on labour by 3.5 percentage points	1.0	1.3	1.3 (*)	1.3	1.3
Encourage educational upskilling and equity in access to education	General increases in average years of schooling by 0.25 years	1.0	0.9	0.9	0.9	0.9
Reduce barriers to entry for foreign firms -- FDI inflows	Increases in the stock of inward FDI as a share of GDP by 4 percentage points	1.0	1.0	1.0	1.3	1.3
Reduce barriers to exports / Encourage exports among domestic firms	Increases in export intensity by 3 percentage points	1.0	1.1	1.1	1.1	1.2
Encourage innovation and raise the effectiveness of R&D support	Increases in the share of ICT in overall investment by 4 percentage points	1.0	0.7	0.7	0.7	0.7

(\*) These simulations are produced because the corresponding coefficients are below but very close to statistical significance (at a level of confidence of 12% for the GDP per capita effect of employment protection and 13% for the median income effect of marginal tax wedges).

Source: Causa, de Serres and Ruiz (2014), "Can pro-growth policies lift all boats? An analysis based on household disposable incomes," OECD Economics Working Paper No 1180, OECD Publishing, Paris.

## **Including health and jobs in multidimensional living standards**

7. People are not only interested in income. Building on the OECD's Better Life Initiative, multidimensional living standards are also defined over two other crucial dimensions of life, health and jobs, which are also critical policy areas for all countries. As argued in OECD 2014c and OECD 2015, health<sup>3</sup> and jobs<sup>4</sup> also lend themselves to being introduced in the OECD analytical framework because they can be measured with reliable and timely indicators and because their link with economic growth and policy is already relatively well understood.<sup>5</sup>

8. As with the analysis of household income, including health and jobs, in the Inclusive Growth Framework requires an explicit analysis of the determinants of jobs and of health. Indeed, some of the structural policies that affect household income will also bear on jobs and health.<sup>6</sup> The effects of structural policies on income, jobs and health may operate in the same direction or may be partly offsetting. Table 2 includes examples of policy packages with ambiguous net effects on the living standards of the various segments of the population. For instance, while Green Growth policies and stricter environmental regulations may curb household income growth (via lower economic growth) during the transition towards a greener economy, co-benefits in terms of pollution reduction and progress in longevity may partly compensate, or even fully offset the income loss.

9. In the same vein, the introduction or the extension of a minimum health insurance financed by additional contributions from employers or households may be detrimental to the average and median household income as well as to employment in general, but it may benefit the poor in the form of higher longevity and higher in-kind transfers due to health services. Finally, reducing the level of unemployment benefits for the long-term unemployed may reduce household income for the middle class and the poor, but may raise their employment prospects with an ambiguous net impact on living standards.

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<sup>3</sup> In this work health is measured with life expectancy, a standard measure of health "quantity". Although life expectancy misses healthiness and other health quality aspects, it is one of the most important indicators in both health policy analysis and monitoring tools (e.g. Sustainable Development Goals).

<sup>4</sup> Jobs are measured with unemployment rate, one of the most relevant measures of job deprivation (see OECD, 2011). Obviously unemployment is not the only aspect that matters and ideally one would want to consider also aspects of job quality. As stressed in OECD 2013 and OECD 2014d, however, job quality is a much more complex construct and available measures are less well-established than those of job quantity. In this respect the ongoing project on job quality will help in advancing the statistical agenda on this issue and provide some standardised measures of job quality that may be considered for future integration in the Inclusive Growth Framework.

<sup>5</sup> On health see for instance Joumard et al., 2008; on unemployment see more recent evidence from Murin et al., 2014.

<sup>6</sup> Accounting for health also implicitly captures an important adverse effect of environmental degradation. It thus provides a channel through which environmental outcomes and policies can be taken into account in the Framework.

**Table 2. Effects of policy reforms on household incomes, health, employment and living standards**

Example of specific structural policy reform	Effect on long-term household income			Effect on health	Effect on employment	Net effect on living standards	
	Average	Median	The poor			Median	The poor
Stricter climate change mitigation policy	-	-	-	+	?	?	?
Extension of minimum health insurance financed by additional taxation	-	-	+	+	-	-/?	+/?
Reduce the level of unemployment benefits for the long-term unemployed	+	-	-	?	+	?	-/?

Source: Causa, de Serres and Ruiz (2014), "Can pro-growth policies lift all boats? An analysis based on household disposable incomes," OECD Economics Working Paper No 1180, OECD Publishing, Paris. De Serres and Murtin (2015), "Your Money or Your Life: Green Growth Policies and Welfare in 2050". Environmental and Resource Economics, online article.

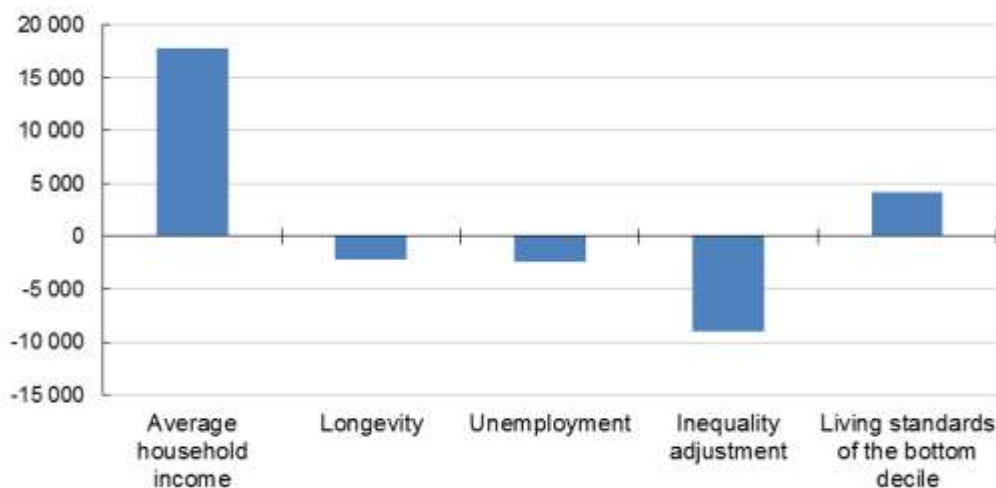
10. In order to evaluate the net impact of a policy package that influences more than one dimension at a time, the Inclusive Growth Framework relies on a measure of multidimensional living standards that, for every group of households, adds the sum of monetised values of health and jobs to household disposable income.

11. Monetisation of health and jobs is needed to express the impact of policy on jobs and health in a common scale. Importantly, the "shadow prices" or weights used to convert non-monetary dimensions into US dollars **reflect people's preferences**, because they are inferred from data on subjective well-being and living conditions through statistical analysis. In particular, these estimates, that have been corroborated with alternative estimation techniques,<sup>7</sup> show that one extra year of life expectancy is valued by individuals at around 5% of their disposable income, a value consistent with existing estimates of the Value of a Statistical Life used by National Agencies (such as the US EPA). As a consequence, the monetised progress in longevity between 1995 and 2012 accounts for about the same increase in living standards as the rise in real household income (1.6% per year on average in the OECD). In this regard, Figure 2 shows the OECD average loss in living standards associated with unemployment and longevity gaps with respect to best performer (i.e. Japan). It also shows the inequality loss which is calculated and shown in Figure 1. When longevity and unemployment losses in living standards are added up they represent as much as 25% of household average income.

<sup>7</sup> See OECD (2014c).

**Figure 2. Multidimensional living standards of the bottom decile in the OECD**

US dollars 2005 constant PPPs, 2012



Note: The chart shows the average of multidimensional living standards of the bottom decile across 31 OECD countries.

Source: OECD calculations based on OECD Income distribution Database and OECD Annual National Accounts.

### Work ahead: Refining the Framework and quantifying the effects of structural policies on jobs and health

12. To date, two important elements are missing for full analysis of key structural policies on multidimensional living standards: *their effects on unemployment and health remain to be quantified*. Work on this has started in the OECD's Economics Department and in the Directorate for Labour, Employment and Social Affairs. At completion of this work, the indicator of multidimensional living standard will be used to simulate the net impact of various types of policy packages (e.g. those described in Table 2) on the welfare of various household groups.

13. Another important extension of the Framework is the *introduction of health distributions*. The Statistics Directorate, jointly with the Directorate for Employment, Labour and Social Affairs, is working on the development of health inequality data to calculate mortality rates by age, gender and education. This will permit capturing the joint distribution of longevity and income which tend to be correlated and so paint a richer portrait of the sources of inequality.

14. In parallel to these work developments, educational policy variables (such as public expenditure for education, training) will enter the Framework as variables that affect the level or composition of educational attainment and skills with further impact on income, employment and health. From this analysis, it will also be possible to gauge the value of education through its co-benefits on these dimensions. To the well-established income return to education are added the returns from increased longevity and from reduced risk of unemployment. The part of overall living standards that is explained by educational attainment can then be identified. This yields a novel measure of the "welfare return on education", a richer concept than the "income return on education".

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