



Policy approaches to reduce inequalities while boosting productivity growth



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Policy approaches to reduce inequalities while boosting productivity growth

Key messages

In many countries – advanced and emerging markets alike - productivity growth has slowed down over recent decades, along with declines in business dynamism and in technology diffusion. At the same time, inequalities in economic outcomes, such as in income and wealth, and in opportunities, such as access to quality education and training, are pervasive. By hampering social mobility and the efficient allocation of talents, inequality in opportunities may trigger slower growth and even higher inequalities in outcomes. Yet policies can make a difference. In seeking to make growth faster and more inclusive, governments can focus on:

- Ensuring broad access to quality education and upskilling throughout working lives and during childhood
- Lifting the quantity and the quality of jobs while addressing labour market insecurity and informality
- Boosting business dynamism and the diffusion of management practices and technology, curbing market power in products and labour markets
- Enhancing the effectiveness of taxes and transfer systems in reducing income inequality and poverty, pursuing equity and efficiency objectives
- Fostering international cooperation, for instance in trade and taxation.

Introduction: A critical conjuncture

Many countries have been struggling with weak productivity growth, stagnating, or declining living standards, and high levels of inequalities. Inequalities pervade many dimensions, including income, wealth, opportunities, and access to basic amenities such as adequate health services and housing conditions, or quality education and training. As inequality of opportunities confines significant shares of the population to precarious jobs and limits their ability to fully reap their productive potential, it can further curb productivity growth (OECD, 2018^[1]). At the current juncture, growth prospects are further challenged by structural trends such as a declining labour force, environmental disruptions, and high levels of public and private debt (Andre and Gal, 2024, forthcoming^[2]). The ongoing digital, artificial intelligence (AI) and green transitions may exacerbate these challenges, but also offer opportunities to tackle them (Guillemette and Turner, 2021^[3]; OECD, 2019^[4]; OECD, 2023^[5]; Cho et al., 2024^[6]).

The stakes are not only economic: the combination of slow growth, persistent inequalities, especially in economic opportunities, may in part explain the surge in political polarisation and the spread of populism (Rodrik, 2017^[7]; Guriev and Papaioannou, 2022^[8]; Rodrik, 2021^[9]). Associated adverse effects include the rise in protectionist measures and hostile sentiments against globalisation (Millot and Rawdanowicz,

2024^[10]; Criscuolo et al., 2022^[11]), as well as the potential further erosion of social cohesion and support for democratic institutions.

As argued in this and previous reports, well-designed policy packages can address these challenges and boost productivity and equality of opportunities through actions in a variety of complementary areas: education, training and life-long learning, labour market institutions and business regulations, place-based policies, and tax and transfer systems (OECD, 2018^[12]; OECD, 2023^[5]).

Slow productivity growth and high inequality: stylised facts

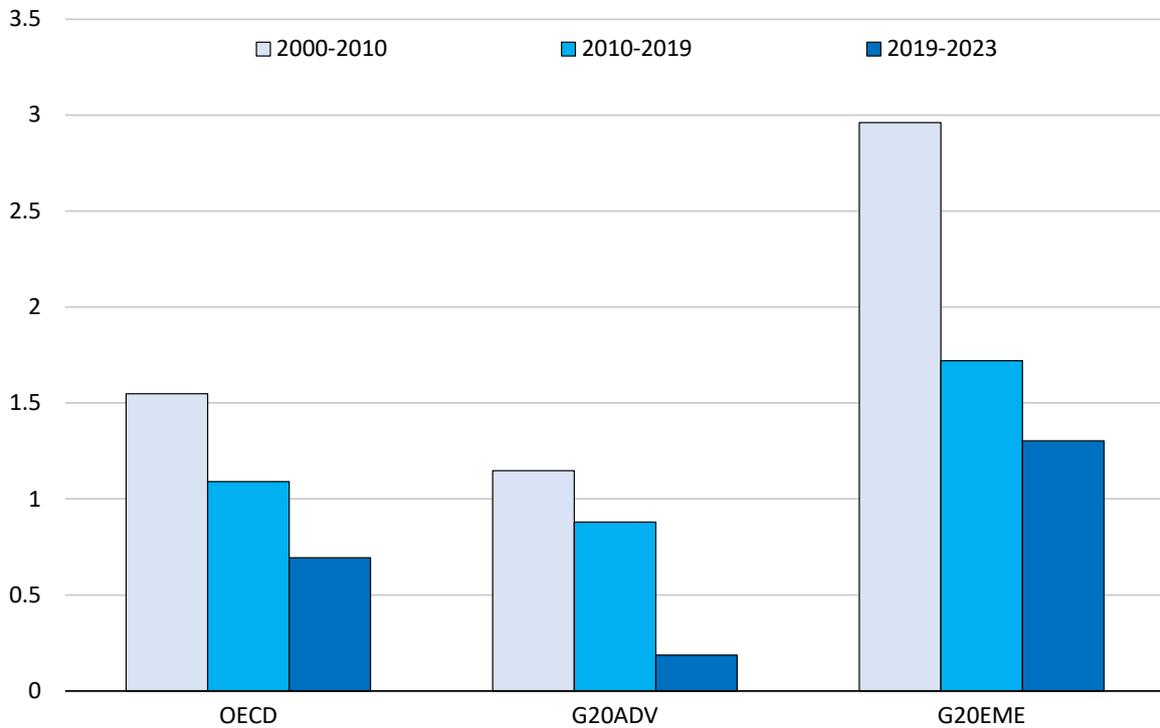
The economic literature has proposed many mechanisms through which inequality and economic growth are intertwined, albeit empirical analysis is complicated by difficulties linked to measurement, methodology and reverse causality (Banerjee and Duflo, 2003^[13]; Forbes, 2000^[14]; Brueckner, Dabla Norris and Gradstein, 2015^[15]). In the context of emerging economies, significant work links a society's initial level of inequality and the incidence of poverty with the rate of economic growth, through mechanisms such as aggregate savings and investment, the accumulation of human and physical capital, and occupational choices (Galor and Zeira, 1993^[16]; Banerjee and Newman, 1993^[17]; Aghion and Bolton, 1997^[18]; Galor and Moav, 2004^[19]; OECD, 2018^[1]). In advanced economies, the main mechanisms identified include investments (Alesina and Perotti, 1996^[20]), demand for fiscal redistribution (Perotti, 1996^[21]; Alesina and Rodrik, 1994^[22]; OECD, 2021^[23]), social and political conflict and mistrust (Esteban and Ray, 2011^[24]; Palmisano and Sacchi, 2024^[25]), and the political space for policy actions (Persson and Tabellini, 1991^[26]). The link also runs in the other direction, as economic growth is one of the main tools for poverty reduction (Ames et al., 2001^[27]; Bourguignon, Bussolo and Pereira da Silva, 2008^[28]). Empirical evidence suggests that the correlation between productivity and inequality is not univocal and depends on e.g. the sources of growth (i.e., labour productivity, employment growth) and the concept of income (i.e., wages and market income, disposable income after taxes and transfers) (Hermansen, Ruiz and Causa, 2016^[29]). Given the various channels of feedback between inequality and productivity, the focus in this report is on stylised facts and policy levers affecting both, building on previous OECD recommendations (Denk, 2016^[30]; OECD, 2023^[5]; OECD, 2018^[1]).

Productivity growth has slowed down during recent decades, at first in advanced and more recently also in emerging G20 economies (Figure 1, Panel A). As productivity at the frontier is mostly driven by patents and innovation in tangibles as well as intangibles (e.g. business practices), this trend could be due to a slow-down in the growth of innovative efforts, or a shift towards less productivity-enhancing innovations (Andre and Gal, 2024, forthcoming^[2]). Despite the slowdown in advanced economies, income gaps between these and emerging economies persist (Figure 1, Panel B).¹

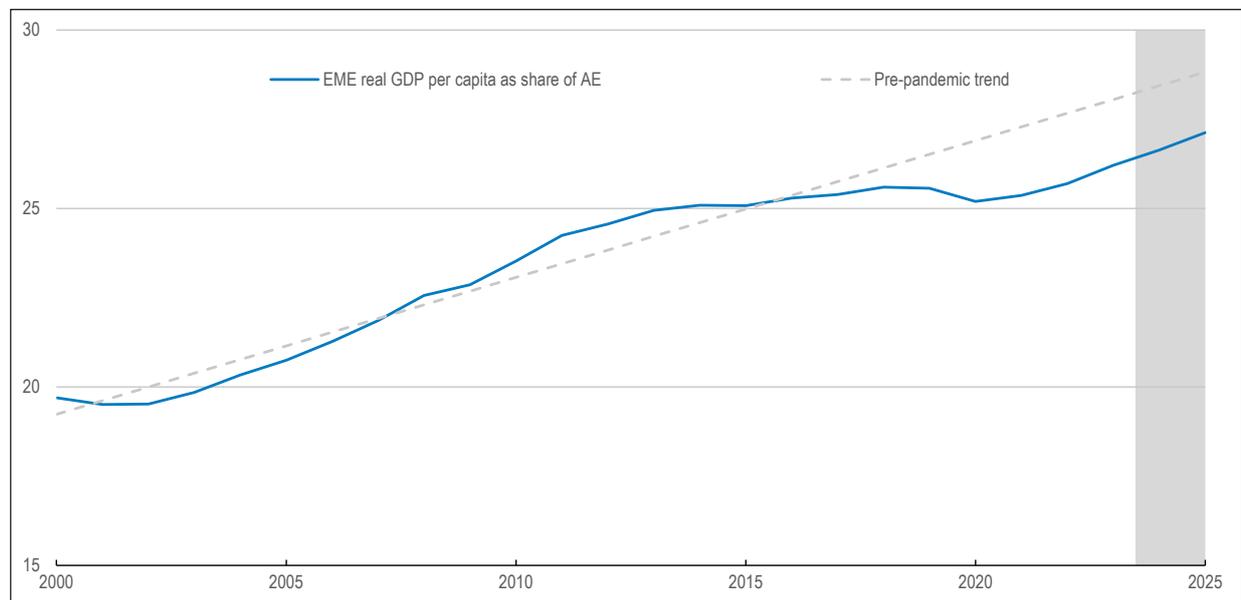
¹ See notes to the figures for a complete list of the countries in each group.

Figure 1. The slowdown in productivity growth and catch-up

Panel A. Labour productivity average yearly growth rate, %



Panel B. GDP per capita in emerging market economies, % of advanced economies' GDP per capita



Note: Real GDP at PPP, population-weighted average. In Panel A advanced economies include Australia, Canada, Germany, France, UK, Italy, Japan, Korea and the US, and emerging-market economies include Brazil, Indonesia, Türkiye and South Africa. In panel B, emerging-market economies include Argentina, Brazil, Bulgaria, Chile, Colombia, Costa Rica, India, Indonesia, Mexico Romania, Russia, Saudi Arabia, South Africa and Türkiye, while all other OECD economies are covered in the AE average. The pre-pandemic trend in Panel B is computed as best linear approximation for the 2000-2019 period.

Source: OECD Economic Outlook 114 database; OECD calculations.

Empirical evidence based on firm-level analysis across OECD economies shows that the slowdown in aggregate productivity is associated with increasing gaps between firms at the global productivity frontier – defined as the top 5% firms in terms of labour or multifactor (MFP) productivity – and laggard firms (Figure 2, Panel A), both across and within countries, even for firms operating within the same industry (Criscuolo et al., 2021^[31]). Firms at the productivity frontier are not only more productive, but also more profitable and capital intensive than laggards, and have larger sales and more patents (Andrews, Criscuolo and Gal, 2016^[32]). Productivity divergences are more pronounced in services and in sectors characterised by stark barriers to business entry and dynamism, suggesting that policy settings in this area may be stifling diffusion (Andrews, Criscuolo and Gal, 2016^[32]).

In this context, evidence suggests that the catch-up of laggard firms across the OECD is hindered by the slow diffusion of frontier technologies and management practices. The access to and adoption of digital technologies related to AI and even more basic assets such as broadband connection is uneven across and within countries, with earlier adoption by larger and initially more productive firms in urban areas and knowledge-intensive sectors (Acemoglu et al., 2022^[33]; Calvino and Fontanelli, 2023^[34]). In general, productivity catch-up is slower in digital and ICT-intensive sectors, due to the need to complement such technology with investments in specific digital and managerial skills (Berlingieri et al., 2020^[35]; Pisu et al., 2021^[36]; Sorbe et al., 2019^[37]).

At the same time, pre-COVID data show that business dynamism – i.e., the process of firm entry, growth and exit – and job reallocation have also sharply declined since the turn of the century (Criscuolo, Gal and Menon, 2014^[38]; Decker et al., 2014^[39]; Calvino, Criscuolo and Verlhac, 2020^[40]), even factoring out the role of business cycles. While the decrease is pervasive in all sectors, it is especially strong in countries and sectors characterised by higher intangible and digital intensity (Calvino and Criscuolo, 2019^[41]) and by higher market concentration and larger gaps between industry leaders and laggards (Calvino, Criscuolo and Verlhac, 2020^[40]; Calvino, Criscuolo and Verlhac, 2020^[40]). These trends may potentially induce a further polarisation of the economy and reduce the incentives for new firms to enter the market, and for all firms to innovate and experiment, with negative repercussions on both productivity and inequality (Calvino, Criscuolo and Verlhac, 2020^[40]).

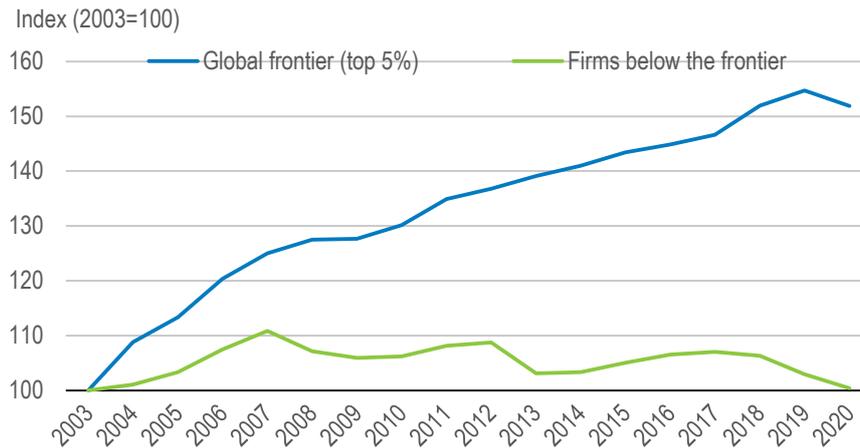
Beyond its effects on the aggregate economy, slower productivity growth also undermines broader progress in living standards. Such progress is further jeopardised by a widespread decoupling between the growth of labour productivity and wages, resulting in limited growth in average and median labour compensation over the past decades (Figure 2, Panel B).² Wage growth has been stronger at the top of the distribution, with median wages falling behind mean wages and wage dispersion increasing (Schwellnus, Kappeler and Pionnier, 2017^[42]). This phenomenon has been linked to various factors such as the general decline in workers' bargaining power and the technology- and globalisation- driven changes in returns to skills, as well as to the productivity dispersion across firms (Criscuolo et al., 2020^[43]; OECD, 2023^[44]; Berlingieri, Blanchenay and Criscuolo, 2017^[45]). Yet, empirical evidence about the relative role of these various factors is mixed and heterogenous across countries (Kahn, 2000^[46]; Card and DiNardo, 2002^[47]; Autor, Levy and Murnane, 2003^[48]; Stansbury and Summers, 2020^[49]; Darvas, Gotti and Sekut, 2023^[50]). Recent data suggest a partial reversal in wage inequality: through 2022, the percentage reduction in terms of real wages induced by inflation spikes was stronger for industries characterised by higher average pay, possibly because collective bargaining and indexed minimum wages, which through

² The decoupling between labour productivity and real labour income growth has been linked to both structural as well as institutional factors (Schwellnus, Kappeler and Pionnier, 2017^[42]; Cho, Hwang and Schreyer, 2017^[200]; Paternesi Meloni and Stirati, 2022^[279]; Mishel and Bivens, 2021^[280]; Guschanski and Onaran, 2021^[281]; Cho, Manaresi and Reinhard, forthcoming^[292]). In particular: the downward wage pressure associated to high unemployment, the erosion of collective bargaining, and globalisation (Mishel and Bivens, 2021^[280]); offshoring and changes in labour market institutions (Guschanski and Onaran, 2021^[281]); pro-competition product market regulations and labour market policies (Pak and Schwellnus, 2019^[283]); and changes in the industry composition of the economy (OECD, 2024^[284]).

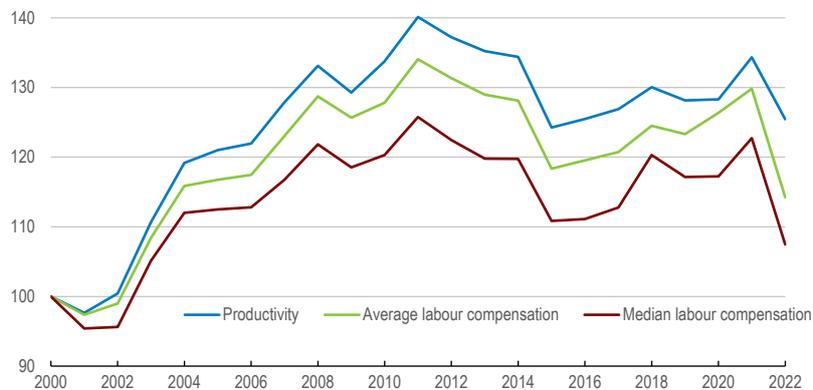
indexation partially shield workers from inflation spikes, are less frequent in these industries (Figure 3). The compression of wages across workers of different pay levels increased further in 2023, with more favourable changes (i.e., larger increases or smaller decreases in real wages) in low-pay than in mid- and high-pay industries (OECD, 2024, forthcoming^[51]; OECD, 2024^[52]; Autor, Dube and McGrew, 2023^[53]).

Figure 2. The divergence in productivity dynamics across firms and the disconnect between productivity and average worker's pay

Panel A. Labour productivity of the top 5% of firms at the global frontier and all other firms below the frontier



Panel B. The disconnect between productivity and workers' pay

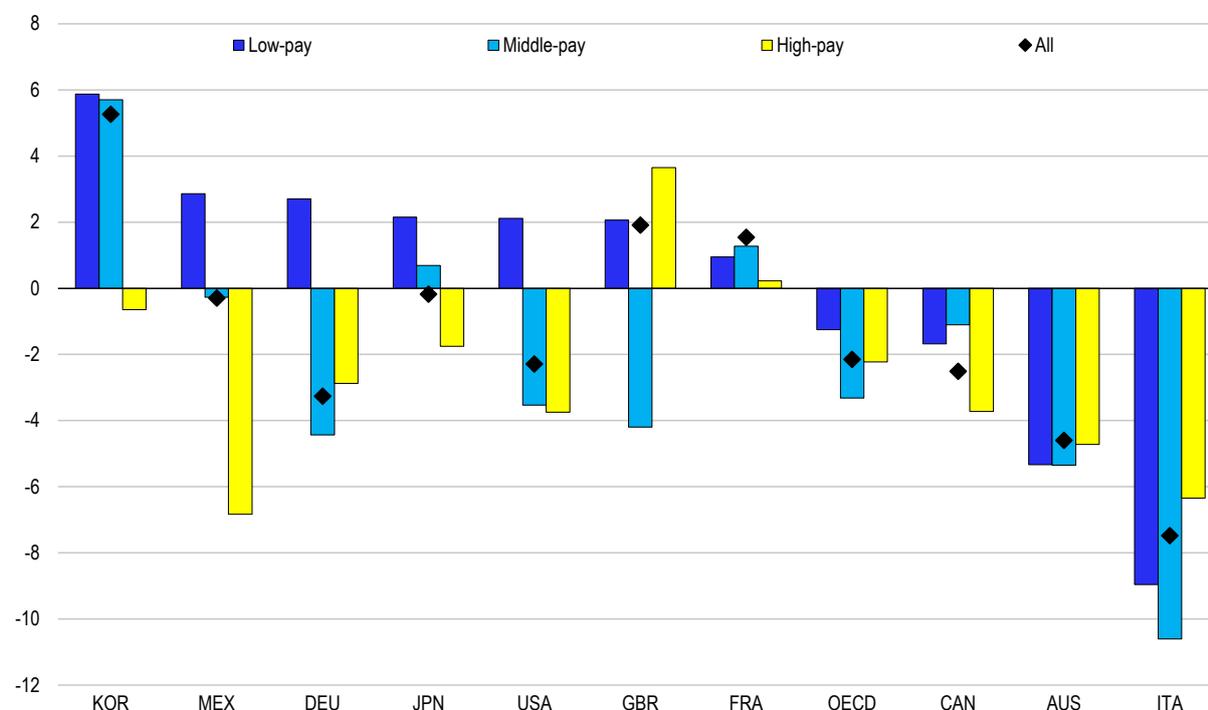


Notes: Panel A: Index (2003 = 100, approximated by changes in logs). The “Global frontier” is defined as the average productivity of the top 5% of firms in the global productivity distribution *within* each detailed industry (2-digit, NACE Rev.2). “Firms below the frontier” is the average productivity of all other firms within the industry. The chart shows the average across industries, 3 year moving averages, covering 24 OECD countries. Labour productivity is defined as value added per employee. See more details in the paper cited in the source. Panel B: The lines show the compounded effects of the weighted average growth rates on the indexed productivity and compensation values over time. Gross value added (GVA) weighted average of 24 OECD countries: Australia, Austria, Belgium, Canada, Czechia, Denmark, Finland, France, Germany, Hungary, Ireland, Israel, Italy, Japan, Korea, Netherlands, New Zealand, Norway, Poland, Slovak Republic, Spain, Sweden, United Kingdom, United States. Graph shows the cumulative growth path for productivity, and average and median labour compensation. The lines show the compounded effects of the weighted average growth rates on the indexed productivity and compensation values over time. For productivity, data is from 2000-2017 for Australia, 2000-2021 for Ireland and Israel, 2014-2022 for Korea, 2014-2020 for New Zealand, and 2000-2022 for all other countries. For average labour compensation, data is from 2000-2017 for Australia, 2000-2021 for Ireland, 2014-2022 for Korea, 2014-2021 for New Zealand, and 2001-2021 for the United States, and 2000-2022 for all other countries. For median labour compensation, data is from 2000-2017 for Australia; 2000-2020 for Belgium; 2000-2021 for Canada, Finland, Germany, Hungary, Italy, Japan, Norway, Spain, and the United Kingdom; 2001-2021 for Austria and the United States; 2002-2020 for Poland; 2002-2021 for Czechia and Israel, 2003-2019 for Ireland, 2003-2021 for Denmark, France, the Netherlands, Slovak Republic, and Spain; 2014-2021 for Korea and New Zealand. Growth rates are assumed to be the average of available data where data is missing. The ratio of median to mean ratios is assumed to be constant where data is missing.

Sources: Panel A: Andre and Gal (2024, forthcoming^[54]) based on the updated calculations described in Andrews, Criscuolo and Gal (2016^[32]) using the Orbis firm-level financial account database (2022 vintage). Panel B: OECD National Accounts Database, OECD Earnings Database data based on Schwellnus, Kappeler and Pionnier (2017^[42]).

Figure 3. Real wages decreased due to inflation spikes but are regaining lost ground, especially in low-pay industries

Cumulative change in real hourly wages between Q4 2019 and Q4 2022 per industries

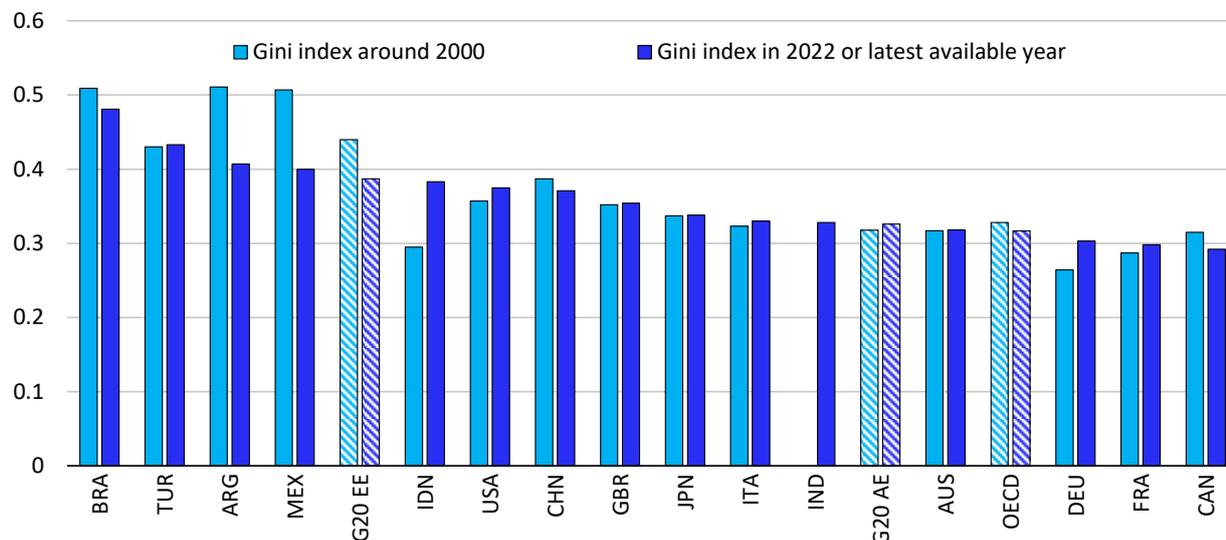


Notes: Real wages are obtained by deflating nominal wages by consumer price inflation (all items). Average employment shares by industry over the four quarters of 2019 are used for aggregation and thus small inconsistencies between changes in wages by industry and changes in average wages are possible. Low-pay industries include Accommodation and food service, Administrative and support service, Arts, entertainment and recreation and Wholesale and retail trade. Middle pay industries include Transportation and storage, Manufacturing, Other service, Real estate activities and Construction. High-pay industries include Human health and social work, Education, Professional activities, Information and communication and Finance and insurance.
Sources: OECD Employment Outlook 2023 (OECD, 2023^[44]).

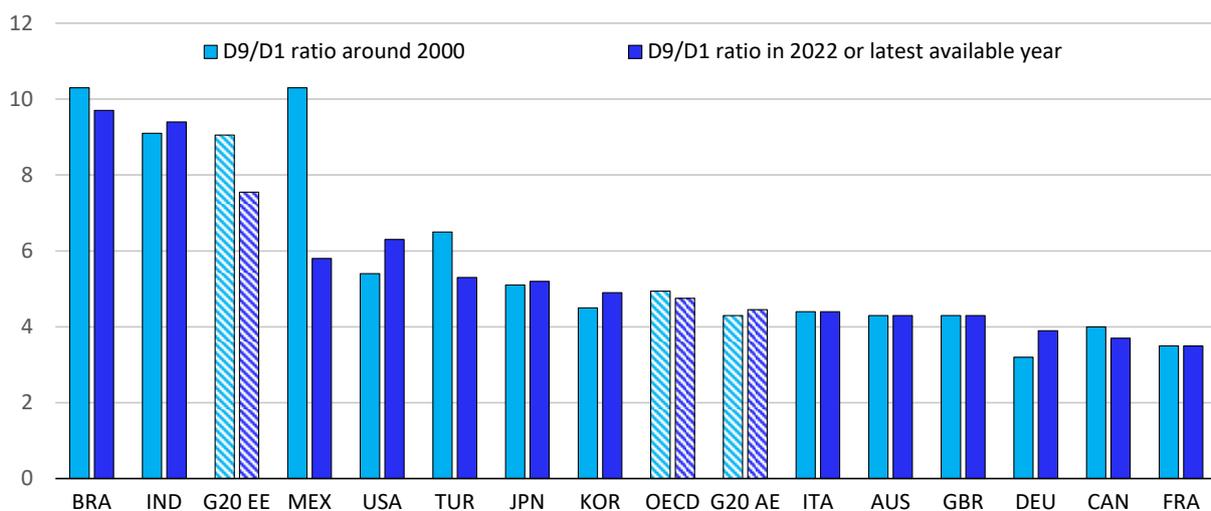
From a global perspective, income inequalities between countries decreased over the last three decades (Lakner and Milanovic, 2015^[55]), but income inequalities within countries remain high in a number of countries (Figure 4). According to the most recent data, on average across OECD countries, the income share of the richest 10% was around 9 times higher than that of the poorest 10% (OECD Income Distribution Database, IDD). Across G20 economies with available data, this ratio is about four times larger for emerging economies than advanced ones; yet some emerging economies, e.g., Brazil and Mexico, have experienced a significant decline in inequalities. The COVID-19 pandemic is estimated to have had a particularly detrimental impact on vulnerable populations in lower income countries, possibly due to the high share of informality: after decades of steady decrease, the global share of population living in extreme poverty (i.e., below the international poverty line of USD 2.15 per day in 2017 PPP) increased sharply in 2020 and was circa 10% in 2023, corresponding to about 70 million individuals more than predicted by pre-pandemic trends (Mahler, Yonzan and Lakner, 2022^[56]; Mahler, Yonzan and Lakner, 2022^[56]; OECD, 2024^[57]).

Figure 4. Progress in income inequality reduction is slow and non-homogenous across countries

Panel A. Gini Index of income inequality, household equivalised disposable income, total population



Panel B. Income gap between the top and bottom deciles (D9/D1 ratio), total population



Note: The Gini index and D1/D9 ratio are defined on household equivalised disposable income and refer to the total population. Note that due to methodological concerns, the comparison of data over time should not be interpreted uncritically (OECD, n.d.^[58]). In Panel A, data around 2000 refers to 2006 for Brazil, 2004 for Türkiye, 1999 for China, and 2000 for the other countries. Latest available data refers to 2016 for Brazil; 2020 for Australia, Germany, Mexico, Türkiye; 2021 for the UK, Italy, India, France, Canada, China and Japan; 2022 for Argentina, the USA, Korea, and Mexico; 2023 for Indonesia. In Panel B, data around 2000 refers to 2006 for Brazil and Korea; 2004 for India and Türkiye; and 2000 for the other countries. Latest data available refers to 2011 for India; 2016 for Brazil; 2018 for Japan; 2020 for Australia and Germany; 2021 for Italy, the UK, Canada, France, Japan, and Türkiye; 2022 for the USA, Mexico and Korea.

Source: OECD Income Distribution Database, data extracted in June 2024.

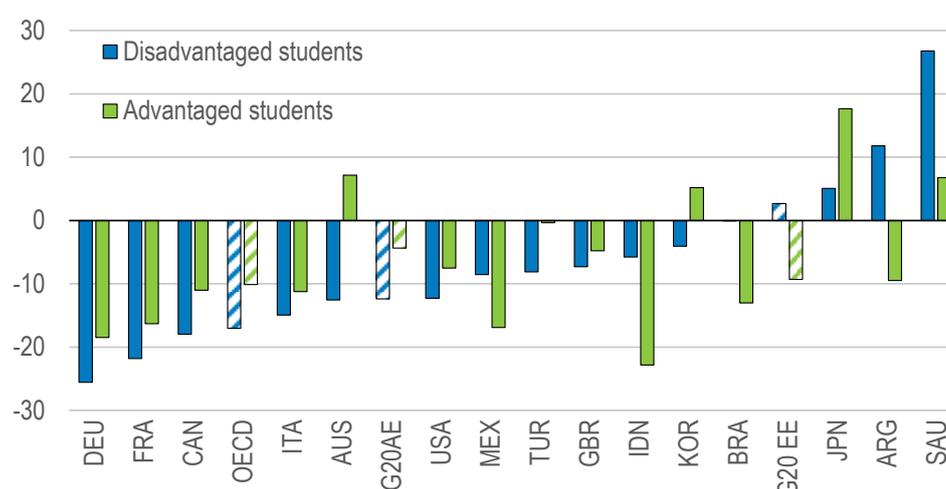
Large inequalities exist in many additional dimensions beyond income, and most notably in opportunities, for instance in access to quality education. This depresses productivity growth, in particular through talents' misallocation and lack of social mobility (Bandiera et al., 2022^[59]; van der Weide et al., 2024^[60]). Income inequalities accumulate over time and across generations, resulting in high levels of wealth inequalities (Chancel et al., 2022^[61]; Piketty and Saez, 2014^[62]) (OECD, 2021^[63]); partly driving an inefficient allocation of capital, especially human capital, which may further compromise economic growth (Persson and

Tabellini, 1991^[26]; Aghion, Caroli and García-Peñalosa, 1999^[64]).³ The COVID-19 pandemic highlighted additional dimensions of inequality, such as access to health care, sick leave, savings and, more broadly, social protection, for vulnerable populations and non-standard workers (Deaton, 2021^[65]; Chancel et al., 2022^[61]; Piketty and Saez, 2014^[62]; Causa and Cavalleri, 2020^[66]; OECD, 2021^[67]; UNDP, 2023^[68]; OECD, 2021^[63]).

Productivity prospects are highly dependent on the accumulation of human capital and skills, which are key drivers of economic growth (OECD, 2022^[69]; Barro, 2001^[70]) and individual well-being (Vila, 2000^[71]; OECD, 2020^[72]). Recent trends in students' performance, as measured by PISA scores, therefore raise concerns for both growth and inclusiveness for decades to come. Two major facts emerge: i) the stark deterioration in students' performance between 2018 and 2022 in a number of countries, with recent accelerations likely due to school closures during the COVID pandemic (OECD, 2023^[73]), and ii) the increasing gaps in scores along the socioeconomic dimension, with disadvantaged students falling further behind (Figure 5).

Figure 5. Students' performance has declined and the gap between advantaged and disadvantaged students has widened

Change between 2018 and 2022 in PISA mathematics performance, by national quartile of socio-economic status



Notes: G20 emerging-market economies (G20 EE): Argentina, Brazil, Indonesia, Mexico, Türkiye and Saudi Arabia. Socio-economic status is measured by the PISA index of economic, social and cultural status (ESCS). Advantaged students are those in the top quarter of the ESCS distribution within their country; disadvantaged students are those in the bottom ESCS quarter. Countries and economies are ranked in ascending order of the mean change in mathematics score for socio-economically disadvantaged students in 2022.

Source: PISA 2022 database and OECD calculations.

Improving productivity and taming inequality: policy pillars

Slow productivity and high inequalities are not ineluctable: policy actions have the potential to raise productivity growth and make it more inclusive, notwithstanding the challenges associated with structural trends such as population ageing and environmental risks (Andre and Gal, 2024, forthcoming^[54]; Denk, 2016^[74]; Andre and Gal, 2024, forthcoming^[2]). While there is no one-size-fits-all strategy, the main pressing

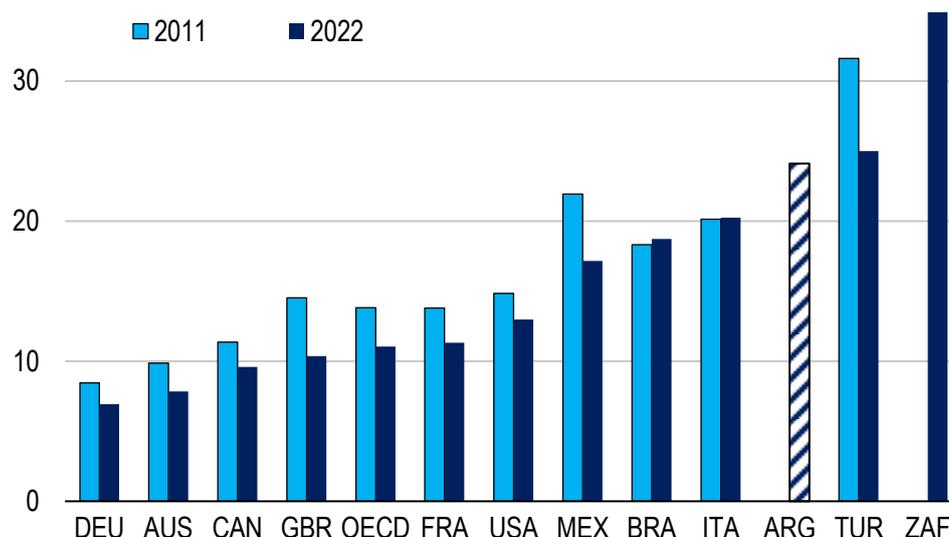
³ See OECD Wealth Distribution Database (<https://stats.oecd.org/Index.aspx?DataSetCode=WEALTH>) and (Balestra and Tonkin, 2018^[221]).

policy challenges can be grouped in five pillars: ⁴ (i) Quality education & upskilling: ensuring that the workforce has the right skill sets, recognising the fact that ongoing transitions can induce fast changes in skill requirements; (ii) Inclusive & efficient labour markets: improving the matching between firms and workers of all ages by enhancing the inclusivity, adaptivity, and resilience of labour markets; (iii) Competition to boost the diffusion of technology, effective management practices and to level the playing field: restoring a competitive environment conducive to firms' investment and productivity-enhancing and environmentally sustainable innovation, facilitating market entry and easing regulatory burdens; (iv) Effective and progressive tax and transfer systems: enhancing the effectiveness of taxes and transfers in reducing inequalities while considering behavioural effects, and (v) International co-operation: fostering international cooperation in an era of rapid change and increased fragmentation.

Unlocking skills development for all

Improving outcomes and equity in education and life-long learning is essential to boost innovation-driven growth and make it more inclusive. In this context, the persistently high incidence of NEET, i.e., young individuals who do not participate in formal education and training nor in employment (Figure 6), is a serious source of concern in both advanced and emerging economies. NEET individuals generally face higher risks of becoming socially excluded, falling below the income poverty-line and lacking the skills to improve their economic status or fully exploit their productive potential in the economy (OECD, 2023^[44]).

Figure 6. NEET: young individuals not in employment nor in formal education or training



Note: NEET refers to young people neither in employment nor in formal education or training. Countries are ranked in descending order of the share of 18–24-year-old NEETs. For more information see the Methodologies and Technical Notes (<https://doi.org/10.1787/d7f76adc-en>) in (OECD, 2023^[75]).

Source: (OECD, 2023^[75]) Table A2.1.

Progress in education and skills can make growth more inclusive through a number of channels, in particular by:

- Enhancing equality of opportunities, which promotes intergenerational social mobility and the allocation of talents and human capital, ultimately supporting economic growth and well-being.

⁴ See previous OECD work on Inclusive Growth (OECD, 2018^[12]).

- Enhancing employment prospects in the formal sector, particularly in emerging economies, and securing the adaptability of the work force to changing demand for skills, to support economic growth.
- Broadening the base for productivity growth to ensure it benefits wider parts of society.
- Contributing to greater well-being through non-income dimensions, such as health status, crime, and civic engagement.⁵

Educational inequalities start at early ages and accumulate over the lifecycle (OECD, 2022^[76]; Clarke and Thévenon, 2022^[77]). Children of parents with high education levels and high incomes generally have better educational outcomes than children from disadvantaged families (OECD, 2012^[78]; Björklund and Salvanes, 2011^[79]; Causa and Johansson, 2010^[80]; OECD, 2022^[76]; Balestra and Ciani, 2022^[81]), especially in lower income economies (van der Weide et al., 2024^[60]). Recent PISA results show that students' performance is not only affected by their own social background but also by that of their school peers, and that these effects are sometime exacerbated for children of migrants, who may face socioeconomic and linguistic barriers (OECD, 2023^[73]). More generally, neighbourhood and peer effects, socio-economic segregation across schools and unequal access to quality teaching have a significant impact on educational opportunities and potential social mobility (Chetty et al., 2018^[82]; Chetty and Hendren, 2018^[83]).

Education and training affect individuals' participation in the labour force and their chances to obtain a job. On average across OECD countries, employment rates rise from about 60% for 25-34 year-olds without an upper secondary attainment to 86% for those with a tertiary qualification, while unemployment rates fall from 13% to 5% and inactivity rates from 31% to 9% (OECD, 2022^[84]). Participation in upper secondary education has generally improved, but vocational training could be further enhanced, especially in low- and middle-income countries. Vocational training is generally regarded as successful in endowing younger workers with the specific skills demanded by the labour market and facilitating the transition from school to work (OECD, 2022^[84]; OECD, 2023^[75]; World Bank; Unesco; International Labour Organization, 2023^[85]), especially when it involves work-based learning. However, across the OECD only about 45% of all students enrolled in vocational programs (who are about 44% of all upper secondary students) are in a scheme with work-based learning (OECD, 2023^[75]). Across emerging-market economies, the prevalence of work-based learning varies significantly, but is generally even lower (International Labor Organization (ILO), 2024^[86]). In addition, especially in low and middle-income countries, work-based vocational learning is generally not well integrated in the education systems (World Bank; Unesco; International Labour Organization, 2023^[85]), and many vocational programs do not grant access to tertiary education (OECD, 2023^[75]).

In addition, individuals with higher education generally have higher life-long earnings, better access to training, and better career prospects, and returns to education tend to be higher in lower income countries and for low-educated individuals: investments in education can therefore contribute to aggregate productivity while also improving economic inclusion (Psacharopoulos, 1985^[87]; OECD, 2023^[88]; OECD, 2022^[84]; Duflo, 2001^[89]; Patrinos and Psacharopoulos, 2020^[90]).

Enhancing equity in education and skills requires reforms in a broad range of policy areas, from pre-school to university, as well as school-to-work transition, training, and life-long learning. In this respect, investing in early childhood education and care has been shown to yield some of the largest returns because individuals can build on the acquired learning as input in later education stages, resulting in a process of dynamic synergies (García et al., 2020^[91]). Returns from early interventions are particularly high for children from disadvantaged backgrounds, including children of migrants and refugees with language difficulties (Bailey, Sun and Timpe, 2020^[92]; Stevens, Siraj and Kong, 2023^[93]; OECD, 2010^[94]; OECD,

⁵ See e.g. Lochner (2011^[288]) and the OECD Framework on current and future well-being (OECD, 2020^[72]; OECD, 2013^[291]) for an overview.

2019^[95]). Access to affordable childcare and pre-schools are thus strong instruments to improve equity in compulsory education (Dougherty and Morabito, 2023^[96]).

Supporting inclusive, adaptive, and resilient labour markets

Supporting the productive and efficient use of human capital requires promoting labour market participation and inclusion. This can be achieved through a mix of demand- and supply-oriented policies aimed at improving work incentives and ensuring job quality, especially among vulnerable and under-represented groups. Policy reforms should foster inclusive, resilient, and flexible labour markets, while limiting labour market dualism and segmentation. This requires actions in several areas including labour market institutions as well as product market regulations and the competitive environment. Active labour market policies and adequate income support for jobseekers are essential, along with efforts to address the under-representation of certain socioeconomic groups in the labour market, especially women, younger and older workers, and migrants.

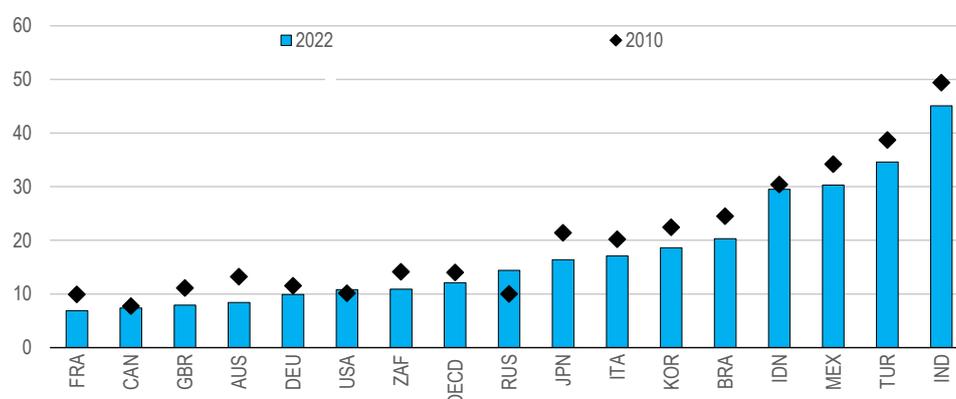
Progress in this area is likely to mitigate supply shortages and strengthen the potential gains from the digital and green transition, in a context where labour markets are tight, especially in advanced economies: a number of countries feature historically low unemployment and high vacancy rates, resulting in labour shortages across a wide spectrum of sectors, both high and low-pay, including healthcare, hospitality, ICT and construction (OECD, 2022^[97]; Causa et al., 2022^[98]).

G20 countries have been increasingly responsive to the challenge of tackling gender gaps. Despite the progress achieved, the challenge remains and is widely spread, as more needs to be done to enhance the inclusion of women in the labour market (Figure 7) and reduce child-penalties (Kleven, Landais and Leite-Mariante, 2023^[99]). This requires policy reforms in several areas; the provision of well-balanced parental leave, quality childcare, and early childhood policies are key in this respect. Progress along these lines is fundamental not only to allow parents to better combine family and work responsibilities, but also to promote equality of educational opportunities for children from disadvantaged backgrounds. Affordable childcare may help improve inclusiveness, as the generally high costs of private childcare determine significant differences in take up across income groups (OECD, 2020^[100]), and equity, as its returns in terms of child wellbeing and learning outcomes are generally highest in the lowest socio-economic groups (OECD, 2018^[101]; OECD, 2023^[102]; OECD, 2019^[95]). In addition, tax and transfer reforms may be needed to remove fiscal disincentives for women to participate in the labour market at their full potential.

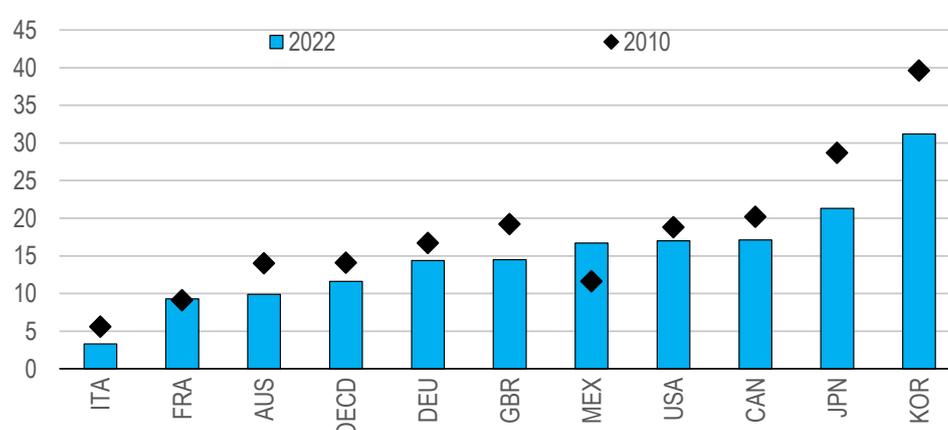
Empowering women is a challenge among all emerging economies, where gender gaps are generally higher than among advanced economies (Figure 7). Reducing those gaps would not only reduce income inequality and enhance inclusiveness, but may also curb child poverty and malnutrition, because women often are the primary-care givers. Closing gender gaps in emerging economies requires concerted action across a broad spectrum of policy domains, with an emphasis on tackling the remaining gaps in education and access to capital; but also, as in advanced countries, freeing women's time by e.g. expanding subsidised childcare and promoting flexible employment and a more equal sharing of care responsibilities; as well as addressing fiscal disincentives and other regulations that limit female participation in the formal labour market.

Figure 7. Gender gaps in labour market outcomes remain large

Panel A. Gender gap in employment, percentage points



Panel B. Gender gap in wages (median hourly wages), percent



Note: Note: The employment gap is defined as the percentage point difference between men and women employment rates for 15–64-year-olds. 2010 data for Brazil is 2011, 2022 data for Indonesia is 2019.

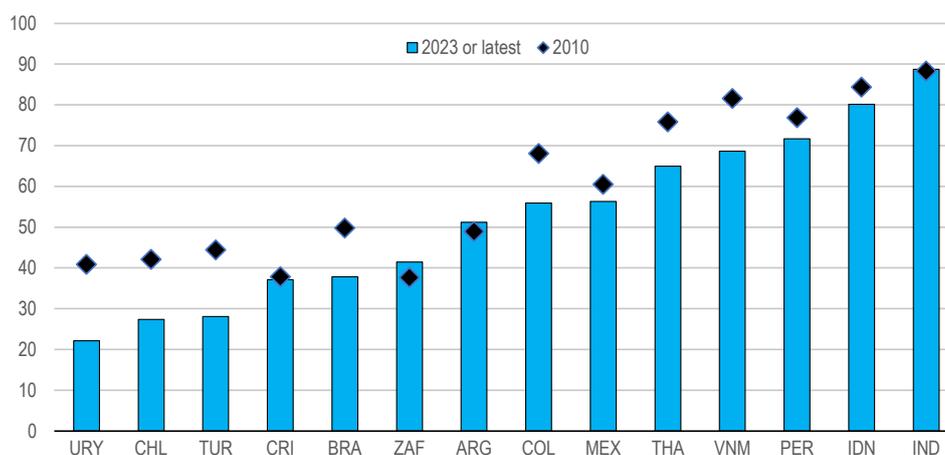
Source: OECD employment database, <https://stats.oecd.org/index.aspx?queryid=54742#>

Informal work creates a vicious circle of low productivity, high inequality, and the intergenerational perpetuation of economic disadvantage (OECD, 2024_[103]). Informal work is generally associated with poor job quality, limited social protection and therefore high economic insecurity; as well as with lower investments and innovation than the formal sector (Arnold et al., 2024_[104]) (OECD, 2019_[105]; OECD, 2022_[106]; OECD, 2019_[107]; Ulyssea, 2018_[108]). Furthermore, informality reduces the tax base for corporate and personal income taxes and erodes the public sector's capacity to boost productivity and reduce inequality. Despite significant improvements, the incidence of informality remains high in emerging economies (Figure 8), dragging on growth and inclusiveness.

Informality has been linked to high costs of formal job creation (i.e., high minimum wages and non-wages costs of labour) and job dismissal (i.e., strict employment protection legislation), low productivity, and weak law enforcement. This suggests a difficult trade-off between supporting formal workers and avoiding the creation of excessive barriers for firms and workers to enter the formal sector (Arnold et al., 2024_[104]). Such a trade-off is further complicated by the fact that the incidence of informality tends to concentrate among low-income and low-educated workers. Tackling informality therefore requires a comprehensive approach, which goes beyond law enforcement and formalisation agendas and includes policies aimed at improving the ease of doing business and supporting workers' access to education and training (Arnold et al., 2024_[104]; Garda, Sorsa and Arnold, 2020_[109]). Progress in this area is needed to break the "low productivity-informality cycle" (OECD, 2024_[103]; Dougherty and Escobar, 2019_[110]).

Figure 8. Informal work remains predominant in several emerging economies

Incidence of informal employment, %, 2022 or latest



Note: Note: The 2010 data corresponds to 2009 for Brazil and Vietnam, 2014 for Thailand and 2016 for Indonesia. The 2023 data corresponds to 2022 for Argentina, Indonesia, Türkiye, Uruguay, and Vietnam; 2018 for Thailand.

Source: Ilostat, Statistics on the informal economy <https://ilostat.ilo.org/topics/informality/#>

Inclusive and dynamic labour markets support productivity growth through the efficient allocation and retention of talents, particularly in the context of high labour shortages. Talent can be retained by ensuring that workers have access to adequate pay and working conditions, as well as social protection and on-the-job training. While priorities depend on country-specific contexts, attracting and retaining talents often requires promoting workers' bargaining rights over pay and working conditions in highly-concentrated labour markets where firms have monopsony power by, for example: i) integrating labour market considerations in competition policy and, as already mentioned, ii) reducing barriers to job-to-job mobility (OECD, 2021^[111]; OECD, 2020^[112]).

The efficient allocation of talents across firms is also important to improve aggregate productivity, mitigate labour and skill shortages and accelerate the catch-up to best global practices. Re-allocation can be supported by removing barriers to business dynamism, including excessive use of non-compete clauses (OECD, 2020^[112]), occupational entry regulations and qualification requirements (Bambalaitė, Nicoletti and von Rueden, 2020^[113]); as well as limiting human capital misallocation in so-called “zombie” firms (Andre and Gal, 2024, forthcoming^[2]), enforcing competition regulations to limit employers' monopsony power (OECD, 2020^[112]), and reducing housing barriers to facilitate geographical mobility (Causa and Pichelmann, 2020^[114]). Improvements in job mobility may also foster equality of opportunities through “job ladders” effects, that is upward mobility, especially among women, the low-skilled and young people (Causa et al., 2022^[115]).

As a result of increased longevity and low fertility, ageing adds pressure to labour markets across G20 economies, with ambiguous implications for productivity (Auclert et al., 2021^[116]; André, Gal and Schief, 2024^[117]; Eggertsson, Lancastre and Summers, 2019^[118]; Crawford, Sturrock and Karjalainen, 2022^[119]; Andre and Gal, 2024, forthcoming^[2]). In order to unlock the skill complementarity between younger and older workers and fully reap the benefits of a multigenerational workforce, policy interventions should focus on improving the quality and security of the working environment to increase the retention and satisfaction of workers of all ages (OECD, 2023^[120]), and on ensuring access to upskilling and training. Among non-pecuniary benefits, evidence suggests that older workers (as well as other sociodemographic groups, such as women and young parents) particularly value work-schedule flexibility but tend to experience little access to associated working arrangements (OECD, 2023^[120]).

Boosting business dynamism and technology diffusion, curbing market power

The weak productivity growth of the latest decades has been associated with slower capital accumulation and has triggered an intense debate on the role of various drivers, notably innovation at the frontier and technology diffusion. The literature, including by the OECD, has developed a deeper knowledge of productivity drivers over the past decade thanks to the use of granular firm-level analysis. Results suggest that sluggish competition has reduced firms' incentives to innovate and invest in physical and human capital and increased their wage setting power, leading to increased wage inequality. This empirical evidence is based on several signs of weakening competition: a rise in industry concentration and mark-ups (De Loecker, Eeckhout and Unger, 2020^[121]; Calligaris, forthcoming^[122]; Calligaris, Criscuolo and Marcolin, 2018^[123]; Bajgar, Criscuolo and Timmis, 2021^[124]), slow reallocation of resources (Toivanen, Jaravel and Blundell, 2022^[125]), downward trends in firms entry and exit rates (Calvino, Criscuolo and Verlhac, 2020^[40]; Akcigit and Ates, 2021^[126]), and wide gaps between the most and least productive firms (Andrews, Criscuolo and Gal, 2016^[32]).⁶

Well-designed policy packages have the potential to tackle both wage inequality and the slow growth in productivity through a combination of firm-oriented and worker-oriented policies. Fast-moving technology and changes in the economic environment require an even stronger focus going forward in the following policy areas (Andre and Gal, 2024, forthcoming^[2]; Calligaris et al., 2023^[127]):

- i) boosting investment and innovation, potentially in a directed way that generates societal gains related to pressing issues, such as the green transition and rapidly developing novel digital tools, including AI;
- ii) improving human capital to ensure more widespread productivity gains across firms and workers, through various means, in particular by appropriate reskilling to work better with more advanced digital tools;
- iii) preserving the benefits of open international markets for innovation and knowledge flows.

Competition can be strengthened by reforms to the regulatory environment aimed at supporting a healthy level of business dynamism (Asturias et al., 2023^[128]; OECD, 2023^[5]; OECD, 2023^[129]), knowledge diffusion (Anderton, Di Lupidio and Jarmulska, 2020^[130]), and firms' potential to benefit from technological change (Calvino, Criscuolo and Verlhac, 2020^[40]). In particular, creative destruction plays an important role in freeing up resources for productive incumbents or entrants. The costs of low business dynamism in terms of foregone productivity, due to the persistence in the market of less innovative and less productive incumbent firms, may be especially high in emerging and developing markets, where market concentration is high and competition is low (Hasanov and Cherif, 2021^[131]). To facilitate the downscaling, restructuring and exit of unsuccessful firms from the market, insolvency regimes should not over-penalise business failure, especially in intangible-intensive sectors that typically imply higher risks of failure (Demmou and Franco, 2021^[132]; André and Demmou, 2022^[133]), and they should be complemented by policies to improve pre-insolvency detection and support measures (Andrews and Petroulakis, 2017^[134]).

A number of G20 countries show room for progress in the area of business dynamism and competition, as can be seen in OECD Product Market Regulation indicators (Figure 9, see Vitale et al. (Vitale et al., 2020^[135])).⁷ Among specific policy priorities, reducing barriers to entry for new business is important to boost productivity in the light of two major mechanisms. First, it can increase competition and reinforce the incentives for all firms, incumbent and new, to engage in productivity-enhancing investments. Second, as young firms are more likely to experiment with new business models and technologies (OECD, 2023^[136]),

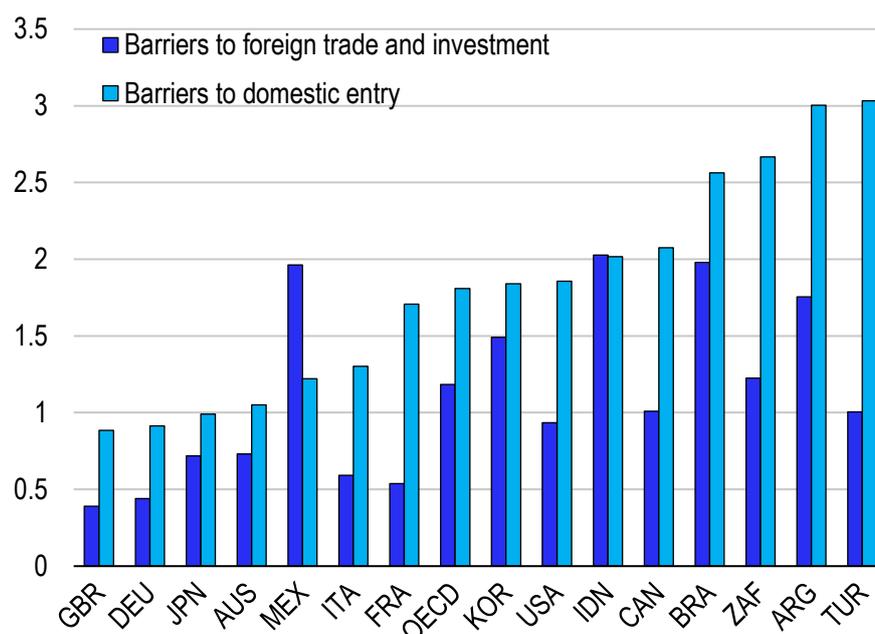
⁶ More recently, early signs of a possible recovery of business dynamism have been noticed, but for now remain limited to the US (Haltiwanger, 2021^[289]).

⁷ Preliminary results from the latest data collection round for the upcoming 2023 PMR indicators (forthcoming) confirm the main qualitative picture presented here which are based on the latest publicly available indicators.

it can foster innovation. As noted above, labour market regulations can reinforce such effects by facilitating the movement of workers and business practices across spaces and economic sectors (Bambalaitė, Nicoletti and von Rueden, 2020^[113]). As stressed before, reforms to enhance competition may not only boost productivity but also help reducing wage inequalities by acting as a levelling field to reduce differences in productivity and wage setting power across firms (OECD, 2021^[111]; OECD, 2020^[112]).

Figure 9. Barriers to business entry remain high in many G20 economies

OECD PMR high level indicator Barriers to domestic and foreign entry (2018)



Source: OECD Product Market Regulation Database (2018).

In many emerging markets, slow productivity growth can be tracked back to a combination of weak competition and widespread informality (Docquier, Müller and Naval, 2017^[137]), which, as noted above has negative impacts on inclusiveness through poor job quality, economic insecurity, and limited fiscal space for redistribution. On the business side, informality tends to be associated to small size and weak productivity and may induce governments to impose higher tax burdens on larger formal companies (though compositional effects may complicate a causal interpretation of the association). A strategy to tackle such complex combinations, boosting productivity and economic growth and reducing inequality, involves simplifying the tax and regulatory systems, easing administrative burdens, encouraging market entry, and reducing trade barriers (Loayza, 2018^[138]; Loayza, Oviedo and Serven, 2005^[139]; Garda, Sorsa and Arnold, 2020^[109]; Arnold et al., 2024^[104]), trying to strike a balance between protecting formal workers and preserving firms' incentives to operate in the formal sector.

Private productivity-enhancing investments can be complemented and further catalysed by public infrastructure. For example, public investments in transport infrastructure can facilitate the matching of firms to both workers and products, while public funding can mitigate the high uncertainty of investments in R&D and innovation, unlocking positive externalities for the society that individual firms are not able to capture. At the same time, infrastructure can foster economic and social inclusion by connecting remote areas and granting access to fundamental services such as education and health. This is particularly important for emerging economies to foster economic development and inclusion (OECD, 2021^[140]; OECD, 2020^[141]). Infrastructure-related priorities feature prominently in both OECD economic surveys (e.g. the

latest Brazil survey (OECD, 2023^[142]) and in the OECD Going for Growth publication, which identifies the top priorities countries need to address to boost inclusive, sustainable and resilient growth (OECD, 2023^[5]).

For technological innovations and digitalisation to deliver productivity gains, businesses need to implement complementary investments in intangible assets (Pisu et al., 2021^[36]): in this context, policies play a crucial role in easing the financing constraints related to intangibles (Demmou and Franco, 2021^[132]) and closing the large gaps in access to, and use of, digital technologies (OECD, 2023^[5]).

Enhancing the effectiveness of taxes and transfers in reducing inequalities

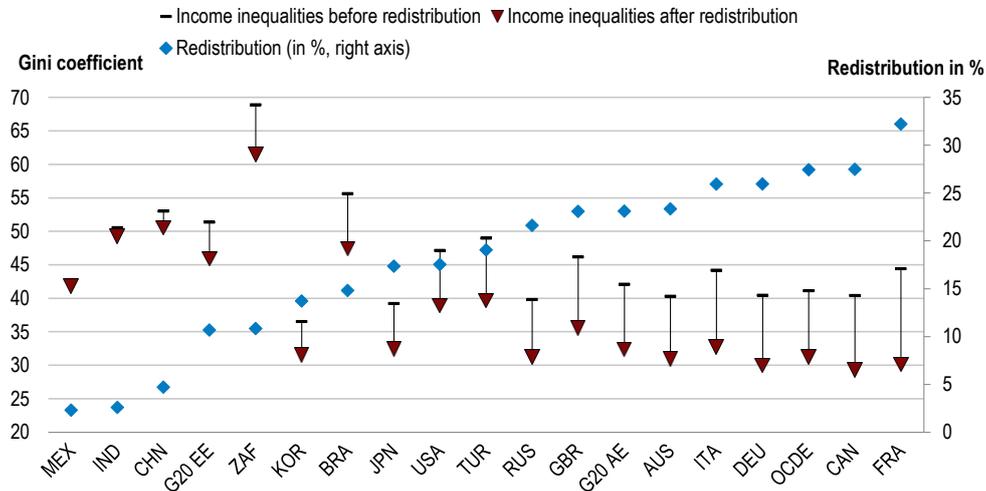
Productivity and inequality challenges are compounded by increasing fiscal pressures, for instance due to ageing populations and climate change. Factor mobility in a globalised world raises the efficiency costs of using taxes on labour and capital to pursue domestic equity goals. While trade-offs between equity and efficiency objectives exist, there is ample room for governments to design tax and transfer policies for inclusive growth while also supporting the revenue-raising capacity of the tax system and ensuring the sustainability of public spending. Achieving this will not be the result of any single policy, but a careful balance of policy choices and trade-offs (OECD, 2023^[5]; Brys et al., 2016^[143]). While a “one-size-fits-all” tax system to facilitate inclusive growth does not exist, this section provides key messages on possible reform avenues to make the tax and transfer system more efficient and redistributive, summarised along the following broad pillars:

- Strengthening the overall progressivity of the tax and transfer system
- Enhancing the capacity of tax and transfers to support employment, skills investments, and labour market formality
- Improving the coverage and targeting of social transfers
- Enhancing tax policy administration and international tax co-operation

The welfare state plays an important role in redistributing market incomes to reduce the gap between richer and poorer households in terms of net disposable incomes, and in improving equality of opportunities, with potential benefits also in terms of productivity and economic growth. Yet redistribution through taxes and transfers has declined in a number of OECD countries, driven primarily by social transfer reforms, for instance less generous unemployment benefits (Causa and Hermansen, 2017^[144]; Causa, Browne and Vindics, 2019^[145]), but also by tax cuts for capital income and top earners, resulting in less progressive personal income taxation. The significant cross-country variation in the equalising effect of taxes and transfers, even for similar levels of economic growth, GDP-per-capita, and pre-tax inequality (Figure 10), suggests that most countries have scope for making their tax and transfer systems more redistributive without undermining economic efficiency and productivity growth.

Figure 10. Redistribution through taxes and transfers varies widely across OECD countries, even for similar levels of pre-tax inequality and GDP per capita

Redistribution through taxes and transfers, working age population



Note: For each country, data from the latest available year is represented, spanning from 2016 to 2021.
Source: OECD IDD Database.

Reforms to increase the reliance on property taxation and the progressivity of the tax system have the potential to enhance efficiency, redistribution, intergenerational mobility and equality of opportunities, while preserving fiscal revenues (Piketty and Saez, 2013^[146]; OECD, 2021^[63]; OECD, 2021^[147]). In the area of property taxation, well-designed housing taxation is good for equity, efficiency, and resilience. Reform avenues in this area include: i) introducing progressive recurrent taxes on immovable property based on regular valuation updates and cash-deferral provisions to address possible liquidity constraints, and ii) avoiding regressive preferential taxation of housing (such as mortgage interest deduction), and exemptions of housing-related capital gains tax (OECD, 2021^[148]; OECD, 2022^[149]).

Taxes and transfers also act as an important tool to provide incentives to individuals and businesses and can therefore affect their pre-tax behaviour. For example, behavioural effects should be considered in the design of unemployment-related and broader social support programs, for instance to avoid introducing labour supply distortions. In order to provide income support while also preserving incentives, well-resourced and designed active labour market and training programs are key complements to unemployment benefits. While the former reduces the risk of productivity losses associated with long-lasting scarring effects for displaced individuals, the latter offer income support and help reduce income inequality.

Enhancing the coverage and targeting of social transfers is fundamental to boost growth and inclusiveness, especially in emerging-market economies where widespread informality and weak administrative capacity can be major obstacles to universal social protection (Arnold et al., 2024^[104]), (OECD, 2024^[103]). Social spending remains low in developing and emerging-market economies and significant additional revenues need to be mobilised in order to finance universal social protection. Fulfilling the potential to increase tax revenues requires careful tax reforms. This includes the need to identify the most suitable tax revenue sources and improve tax administration capacity, both in terms of compliance and enforcement.

In addition to limited coverage, social protection programmes are also often poorly targeted, including in many advanced economies. Support programmes often fail to reach the intended beneficiaries, even when they are eligible for assistance, and end up benefiting social groups that may not be in immediate need of

assistance. On average across countries, the same share of cash transfers reaches the poorest and the richest 20% of the working-age population (OECD, 2023_[5]).⁸ Support to shield households and businesses from the impact of high energy prices has also been mainly untargeted (Hemmerlé et al., 2023_[150]).

Shifts towards environmental taxation can contribute to improving the sustainability of economic growth and wellbeing, provided appropriate measures are taken to avoid that lower-income and most-exposed households are disproportionately affected. Recent cross-country evidence also suggests that the public support for climate-related policies and taxation is higher when tax revenues are used to fund green infrastructure and clean-technology adoption (Dechezleprêtre et al., 2022_[151]).

International cooperation for an inclusive and sustainable globalisation

Globalisation has brought benefits in terms of income convergence of developing and emerging-market economies, including through a significant decline in poverty and the emergence of a global middle class (Milanovic, 2013_[152]). This process has improved consumer welfare through lower prices and a greater variety of goods, but it has also induced significant adjustment costs, with job losses in advanced economies concentrated in geographical areas and markets which were most exposed to imports competition (Autor, Dorn and Hanson, 2016_[153]; OECD, 2011_[154]). As national security, environmental, and place-based/inclusiveness objectives and strategic considerations take traction, globalisation faces political headwinds (Walter, 2021_[155]).

Policy action should aim at addressing the downsides while preserving the benefits of economic openness. In order to pursue resilient and inclusive economic growth, protectionist policies should be avoided, and attention should be paid to the risks endowed in global value chains. To avoid negative international spillovers and ensure fairness, international coordination is necessary. For instance, protectionist measures can be counter-productive, by e.g. spurring increases in import prices and alienating key trade partners (OECD, 2023_[156]).

Enhancing tax policy and administration is key to achieving more growth and inclusiveness, by tackling tax avoidance and evasion and supporting progressivity. Progress in this area requires international tax co-operation, in particular actions to end tax avoidance and to enhance transparency and exchange of information for tax purposes, including under the OECD umbrella (OECD, 2023_[157]).⁹

Systematic assessments of the progress made in productivity growth and in the reductions of inequalities are significantly hindered by data lacunes that are especially marked, but not limited to, emerging economies. In particular, efforts could be focused on sharing timely and harmonised data on inequality in income (including market income and disposable income) and wealth, granular data on expenditures, wages, and labour market indicators. Even across advanced economies, systematic comparisons and analysis are complicated by the use of non-harmonised systems of classification, which often vary on a country-by-country level, and by the scarce timeliness of data releases.

⁸ One important policy dimension in this area relates to the frequency of payments and the length of waiting times: those should be carefully chosen to balance the need to preserve incentives for workers to maintain job stability and that of limiting their financial distress (OECD, 2023_[290])

⁹ For more information see <https://www.oecd.org/tax/beps/>, <https://www.oecd.org/tax/exchange-of-tax-information/>,

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