1. Discussions on inclusive growth: State of play

The concept of inclusive growth, and particularly income inequality, is seizing public attention as economies continue to bear the social consequences of the 2008-09 global economic crisis. The OECD has been increasingly vocal on the issue through landmark reports such as Growing Unequal? (2008), Divided We Stand (2011), and All on Board: Making Inclusive Growth Happen (2014), as well as the ongoing New Approaches to Economic Challenges (NAEC) process.

The OECD describes inclusive growth as:

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   economic growth that creates opportunity for all segments of the
population and distributes the dividends of increased prosperity, both in
monetary and non-monetary terms, fairly across society.¹
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This is an all-embracing definition. On the one hand it reflects the OECD’s approach in economic policy whereby people’s general well-being, as opposed to solely their economic welfare, is placed foremost in policymakers’ considerations. On the other hand, however, it signals a move towards increasingly complex, and possibly less manageable, “multi-disciplinary” policy responses. It also prompts us to question what is “fair” distribution, how should prosperity be measured, is it absolute or relative, what is the time perspective, which specific well-being objectives should policymakers emphasize over others, how do different policy responses interact, how much state intervention is appropriate, and so on. Moreover, the definition does not reflect how growth is generated in the first place.

Complicating the debate further, different interpretations of inclusive growth exist. For instance, the World Bank’s notion of inclusiveness refers more narrowly to equality of opportunity in access to markets, resources, and unbiased regulatory conditions for

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businesses and individuals. Meanwhile, the definition of inclusive growth in the Europe 2020 Strategy focuses more specifically on skills and jobs.²

In the absence of a clear debate grounded in internationally-agreed definitions and evidence, public opinion can become misinformed. A recent study shows that public perceptions of inequality are already disconnected from the facts in some countries: many people in Europe perceive income distribution in their countries as being far more unequal than is actually the case, while in the United States the middle class is truly smaller and the lower income group considerably more numerous than its citizens suppose.³ Such misconceptions matter: they influence the politics and policies that impact upon our economies and societies.

To put it simply, there tends to be far too little common agreement on what inclusive growth really means, how it matters, how it should be measured, and which policies should be adopted. If the concept of inclusive growth should lead to sound policy advice, there is an urgent need for greater clarity and understanding.

This BIAC discussion paper raises key considerations and recommendations for the OECD and its member governments. In this context, BIAC makes the following recommendations, described in more detail in the following pages:

- The OECD work on inclusive growth should seek to bring greater clarity and precision to debates on the scope and consequences of the subject, in order to determine appropriate and coordinated policy responses.

- Policymakers should explicitly recognize that productive societies and strong economic growth are fundamental for inclusive growth.

- The effective implementation of structural reforms in product and labor markets is vital, and should promote equal opportunities in our economies.

2. Bring clarity to the “inclusive growth” debate

Research findings on the subject of inclusive growth are often incomparable. The OECD report Divided We Stand (2011) notes that “the empirical evidence as to the key drivers of inequality remains largely inconclusive and is made more so by a lack of precise

² Ibid.
³ See Niehues, J. (2014) “Subjective Perceptions of Inequality and Redistributive Preferences: An International Comparison”, Cologne Institute for Economic Research (IW). According to this study, Europeans – notably in Germany and France – were found to significantly underestimate the proportion of middle-income earners and overestimate the proportion of the poor.
definitions and concepts used in different studies”.

Conclusions depend highly on the definitions used, reference populations, and time periods.

Crucially, the inclusive growth debate must not ignore the fact that cross-country variation is often significant, meaning that sweeping generalizations and a “one-size-fits-all” policy response should be avoided. For example, a recent IMF Staff Discussion Note concludes that “redistribution appears generally benign in terms of its impact on growth” and “only in extreme cases is there some evidence that [redistribution] may have direct negative effects on growth”.

However, data shows that around a third of OECD countries may fall into the “extreme case” category – i.e. they redistribute to such an extent that they seem to cause a dampening effect on their growth. A much more nuanced country-by-country analysis is therefore critically important in the inclusive growth debate.

Through improving the international comparability of data and deepening policy analysis on a country-by-country basis, we believe that the OECD can greatly illuminate discussions on inclusive growth.

We encourage the OECD to consider the following questions:

- How can the OECD, together with governments and other institutions, increase the quality, and international comparability of data needed to better understand inclusive growth?
- Are there lessons to be learned from countries’ efforts to promote growth and inclusiveness that could apply to others?
- How might constraints to economic growth, such as barriers to trade and investment, excessive regulation, and excessive taxation, impact upon opportunities for inclusive growth?

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6 The IMF Staff Discussion Note states that further redistribution seems to start having a negative direct effect on growth when it is greater than 13 Gini points. According to version 4.0 of the Standardized World Income Inequality Database (2013), Austria, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, and Sweden all redistribute to the extent that their Gini coefficients are reduced by more than 13 points, thus suggesting a negative impact on growth.
3. Growth is key

The world economy still hasn't broken free from the legacy of the 2008-09 financial and economic crisis. Both trade and investment are still performing sluggishly and haven't yet regained their pre-crisis levels. Youth unemployment remains exceptionally high in many euro area countries, standing at over 50% in Greece and Spain. The G20 is now on a lower potential growth path than pre-crisis: the 2013 real GDP level in the G20 is still 2% below the downside growth path projected in 2010.

OECD and IMF analysis of G20 countries' growth strategies finds that “product market reforms aimed at increasing productivity are the largest contributor to raising GDP”. This has to be a priority in light of the news that total factor productivity growth in major markets of both labor and capital inputs -- essential for raising prosperity -- dropped below zero in 2013. In order to bolster growth and productivity, a comprehensive set of reforms is needed that will increase investment, boost trade, promote competition, foster innovation, strengthen skills, and make it easier for companies to hire.

Given the prominent role of productivity for the success of our economies, it is important to ensure that the underlying sources of economic growth should not be sidelined and should be well understood in the public debate on inclusive growth. The following two aspects of the debate illustrate this concern:

Firstly, it is often noted that rising incomes have disproportionately benefited the rich, whereby the average income of the richest 10% is now 9.5 times that of the poorest 10% in OECD countries. The bestselling book that has dominated headlines this year, Capital in the Twenty-First Century by Thomas Piketty, has launched a debate whether there is evidence that a market-based economy will inherently lead to an unequal distribution of income and wealth. As a result, key aspects of market-driven economic growth are facing greater scrutiny.

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8 IMF (2014) “Macroeconomic and Reform Priorities”.
11 For example, the “four cylinders” of the global economy – trade, investment, credit, and emerging markets – as described by OECD Secretary-General Angel Gurría in OECD (2014) “Strategic Orientations of the Secretary-General”, available online here: http://www.oecd.org/about/secretary-general/MCM-2014-Strategic-Orientations-5G.pdf
Secondly, there is a growing view that policy frameworks for achieving inclusive growth cannot focus solely on economic outcomes; they must also capture other dimensions that matter for people’s well-being, such as jobs, skills, health, and civic participation. However, it is important to ensure that such policy frameworks do not unduly penalize or neglect economic growth. The “cold numbers of GDP and economic statistics”, as labelled by the OECD Better Life Index, are essential for growth that is inclusive, and should not be cast aside.

Without reforms in place that enhance productivity and enable the private sector to propel our economies through investment, trade, job creation, innovation and entrepreneurship, the goal of sustainable and inclusive growth will be much harder to achieve. Evidence shows that economic growth lifts people out of poverty and leads to shared prosperity. In turn, it should be recognized that excessive equality and excessive redistribution cannot be conducive to growth.

Where growth is weakened, income inequality may be exacerbated, as weak growth cannot sufficiently improve incomes of the poor and governments will possess fewer resources for redistribution. Piketty (2014) finds that when the rate of growth is low, then wealth tends to accumulate more quickly from returns on capital than from labor, and tends to flow more to the rich, leading to increased inequality. Strong and sustainable growth is therefore needed to help foster inclusive growth.

Worryingly, however, the pace of policy actions for growth across both product and labor markets in OECD countries has slowed over the past two years and has been largely piecemeal. The business community similarly perceives a deficit in implementing reforms: the BIAC Economic Policy Survey 2014 finds that only 4% of the OECD’s 2013 country-specific recommendations were fully implemented a year later, and 35% not implemented at all.

Section 4 of this paper explains which policy measures are urgently needed to revive growth and productivity.

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15 World Bank (2014) “Prosperity for all - Ending extreme poverty”.
4. **Reforms for sustainable and inclusive growth**

On the basis that inclusiveness and policies for growth go hand-in-hand, BIAC recommends the following priorities for action:

- **Build a growth-friendly business environment through the implementation of structural reforms.** There are clearly synergies between the impacts of structural reforms on growth and equality. New OECD analysis finds that many structural reforms such as lowering labor taxation, promoting active labor market policies, and reducing regulatory barriers to domestic competition, trade and FDI, are found to lift incomes of the lower middle class in the long-term and thus help to narrow inequality in disposable incomes.\(^20\) Moreover, structural reforms may not lead to additional financial burdens for state budgets. Earlier OECD work also emphasizes that regulatory reforms can be designed in such a way that they make markets more efficient and encourage employment, while reducing inequalities at the same time.\(^21\) The BIAC Economic Policy Survey 2014 draws particular attention to reducing regulatory burden, improving public sector efficiency, making tax structures more efficient, strengthening human capital, and stepping up labor utilization. BIAC also asserts that it is critical for OECD countries to ensure the sustainability of their social security programs.

- **Ensure equal opportunities for all groups to participate in economies and societies.** We emphasize that it is critical for policymakers to develop policies that provide people with equality of opportunities, rather than focusing only on equality of outcomes. Policies towards this objective should, for example, facilitate access for all individuals to quality education and labor markets, and encourage access to quality health care services. In particular, action is needed to urgently step-up women’s employment and entrepreneurship, as shown in recent BIAC reports.\(^22\) Providing opportunities for immigrants is also most important.

- **Strengthen the employability of individuals.** Addressing the challenge of inequality depends to a large extent on increasing the employability and social mobility of individuals, including youth in particular. Access to quality education

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is critical, from early childhood throughout adult life. As highlighted in the BIAC Education Survey 2013, BIAC emphasizes the need for improvements in school curricula to increase their relevance to labor market needs, better teacher training and career professionalization, strengthening of secondary and post-secondary vocational education including broadening the scope and quality of apprenticeships, and adequate assessment of learning outcomes.23

- **Encourage participation in the formal economy.** To a varying degree, informal sectors pose a serious impediment to the growth of many economies, undermine their countries’ tax bases, and often bar or constrain individuals’ access to education and health care. Policies that encourage individuals and firms to transition into the formal sector can help reduce inequality.

- **Improve the stability and efficiency of tax systems.** Ensuring stable, transparent, non-distortive frameworks for taxation at sustainable levels, both domestically and internationally, is essential for attracting investment and efficiently redistributing resources.

- **Support flexibility in labor markets, accompanied by effective active labor market policies (ALMPs).** Flexibility, including contractual arrangements which enhance the ability for companies and individuals to adapt to changes in today’s workplace, is a critical factor for competitiveness and social mobility. Regulatory frameworks, including employment protection and tax and benefit systems, must provide incentives to employment and entrepreneurship.

- **Promote healthy lifestyles.** Health is fundamental to support employment, mobility and gender equality. Healthcare is also vital for a productive labor force, and business advocates policies for behavioral changes that enhance prevention and health promotion over the long-term, rather than relying on short-term quick-fixes. The rise of non-communicable diseases and issues related to ageing – including accelerating the fight against Alzheimer’s disease – require OECD governments to address health horizontally across education, infrastructure, and long-term prevention policies.

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5. Conclusions

The OECD is in a unique position to advise policymakers on matters of growth that is inclusive. Its world renowned economic data, advice on structural reforms, and sharing of good policy practices should be leveraged in global discussions on inclusive growth. Crucially, the OECD should contribute to a balanced policy discussion that does not neglect the fundamental need for economic growth.

Recognizing that close dialogue with the private sector is vital for the design and implementation of reforms, BIAC remains committed to our close cooperation with the OECD on issues of inclusive growth.