CIVIL 20 PROPOSALS FOR STRONG, SUSTAINABLE, BALANCED AND INCLUSIVE GROWTH

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Economic inequality is increasing both within and across countries. Growing inequality has negative economic, social and political consequences, it constrains economic growth, undermines social cohesion and political stability. Eradicating causes of inequality and turning structural barriers to equality into opportunities is fundamental for generating strong, sustainable, balanced and inclusive growth. Transition to this growth model will depend on G20 coherent policy actions globally and nationally.

In the run up to the St. Petersburg G20 summit the Civil 20 initiated preparing a report and recommendations to G20 focused on surmounting the risks originating from growing income inequality. A special Task Force, bringing together experts from G20 member countries has been established to draft the report. Presented and discussed within the Russian G20 Presidency Civil Society Track (www.g20civil.com), the report provides an independent analysis and proposals for a dialogue between a wide range of stakeholders and the G20 governors on the G20 concerted policies and actions to improve economic equality within their countries and beyond.

This set of policy recommendations on how G20 can address inequality takes full account of the existing authoritative, best available, consensus, analysis and evidence of the IMF, OECD, UNDP, other international organizations and relevant scholarly, civil society and policy communities, as summarized above. It builds directly upon the extensive evidence and analysis of the causes and practical policy cures for income inequality in the G20 member countries, as identified in the country reports prepared by and for members of the Civil 20 Task Force on Equity (currently including Australia, Canada, China, France, India, Indonesia, Mexico, Korea, Russia, Turkey and the US).

The Civil 20 propose that G20 leaders at their St. Petersburg summit can act together to improve income and economic equality within their countries and beyond by agreeing the Saint Petersburg Initiative for Strong, Sustainable, Balanced and Inclusive Growth affirming the value of equality and inclusion along with economic growth and efficiency.

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Foreword

Economic inequality is increasing both within and across countries. Growing inequality has negative economic, social and political consequences, it constrains economic growth, undermines social cohesion and political stability. The G20 decisions address the issues of overcoming income inequality in the context of structural reforms, promotion of employment, social protection, and financial inclusion. However it has not yet directly dealt with economic inequality on a sufficiently focused, direct and comprehensive scale, to clearly reduce increasing inequality in the world and thus reap the economic, social and political rewards that greater equality brings. The G20 can and should do more to combat economic inequality, given its core mission to make globalization work for the benefit of all and given the economic, social and political benefits that economic equality brings. It can do so by acting now, through priority principles, policies and actions to be agreed at the St. Petersburg summit in September 2013.

In the run up to the St. Petersburg G20 summit the Civil 20 initiated preparing a report and recommendations to G20 focused on surmounting the risks originating from growing income inequality. A special Task Force bringing together experts from G20 member countries has been established to draft the report. The Civil 20 drafting process was carried out in partnership with the United Nations Development Programme (UNDP) and was coordinated by the International Organizations Research Institute of the National Research University Higher School of Economics (IORI HSE) and the G20 Research Group of the University of Toronto. The G20 members' perspectives have been highlighted by country reports. The recommendations are based on the analysis presented in the synthetic report and the country reports. Early publication of the draft aimed to elicit comments and generate consultations.

Presented and discussed within the Russian G20 Presidency Civil Society Track (www.g20civil.com), the report provides an independent analysis and proposals for a dialogue between a wide range of stakeholders and the G20 governors on the G20 concerted policies and actions to improve economic equality within their countries and beyond.

We believe that eradicating causes of inequality and turning structural barriers to equality into opportunities is fundamental for generating strong, sustainable and balanced growth. Transition to inclusive growth will depend on G20 coherent policy actions globally and nationally.

We propose that, building on the G20's foundational mission of making globalization work for the benefit of all, the G20 should agree **the Saint Petersburg Initiative for Strong, Sustainable, Balanced and Inclusive Growth** affirming the value of equality and inclusion along with economic growth and efficiency. The Initiative should be reinforced by the G20 new development action plan centered on addressing inequalities.

The dialogue and work among task force members will continue as the G20 work related to inequality does. Civil 20 stand ready to contribute to implementation of G20 commitments on equalizing opportunities and outcomes within and across countries.

Dr. Marina Larionova, Director IORI HSE

Professor John Kirton, Co-director, G20 Research Group, University of Toronto

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Executive Summary

Trends in Inequality: Globally and Nationally

Global inequalities remain unacceptably high at Gini coefficient of 0.70 as a measure of dispersion of income across the whole population. Though there is some evidence of a minor decrease in the last decade due to a limited growth of middle classes in emerging countries, the global crisis is squeezing middle and lower classes in many countries. Inequality is holding back economic recovery, growth and investment. Having prioritized growth through free market mechanisms with only residual attention to equity issues, in the last couple of years most economists agree that a more equal distribution of income promotes economic stability, sustained economic growth, healthier and more cohesive societies.

The global dynamics is driven by national changes. The increase in within-country income inequality is one of the persistent trends of the past three decades across most of the G20 countries. The G20 is a varied group of countries, and that is also reflected in the levels of income inequality. Inequality ranges from rather low in France to very high in South Africa. The G20 countries cluster around two groups – emerging economies (South Africa, Brazil, Mexico, Russia, Argentina, China, and Turkey) with higher inequality relative to developed countries with lower Ginis (for instance France, Germany, Canada, Italy, and Australia.) Since 1980, income concentration and overall levels of inequality have increased dramatically in several high income countries. The rich are getting richer. The top 1% of Americans have doubled their share of national income (from 8 to 17%) since Ronald Reagan was inaugurated. Top earners in other rich economies such as Australia, the UK and Japan have also increased their share of income. The estimates of the Gini coefficient in India and China suggest a wider dispersion of income.

How inequality constraints growth

Empirical research shows that reducing inequality is consistent with stronger growth over a sustained period of time. Inequality limits the potential of disadvantaged groups to invest in education and health, and subsequently reduces their capacity to engage productively in the market and contribute to growth. Insufficient physical, and/or financial capital, or skewed allocation of assets, create barriers for the poor/disadvantaged to engage fully with markets, limiting entrepreneurial activity, with a negative impact on jobs and income generation, constraining demand and affecting growth. High levels of inequality can cause social unrest, conflict and discourage investment. Inequality may encourage poor economic policy which could have adverse impacts on both medium and long term growth and development. Fiscal and monetary policies may favor the rich, encourage unproductive activity, and possibly increase exposure to economic shocks. Alternatively, where the poorer sections of society have political influence, policy might aggressively redistribute income, reducing aggregate savings.

Key Drivers of Income Inequality

Many factors combined over the past thirty years to cause rising income inequality across the world: technical change; trade and financial liberalization; changes in labor market regulations; and changes in fiscal policies. Financial and trade liberalization, supported by a fast-paced skill-biased technological progress, led to an increase in the income share of capital at the expense of labor and an increase in wage disparities between skilled and unskilled labor. These trends were compounded by changes in labor market regulation that weakened the bargaining power of labor and changes in fiscal policies that reduced the redistributive impact of taxes and public transfers.

In the case of emerging economies, these factors were coupled with other structural factors such as spatial and horizontal inequalities, unequal access to basic services, and widespread informal employment which contributed to perpetuating and increasing income inequality.

Key Policy Options to Tackle Inequality

In addressing inequality, utmost consideration must be given to the specific challenges and opportunities of different country contexts. However, four areas of focus can be identified:

Reducing primary inequality through truly inclusive patterns of economic growth

Those at the bottom of the income distribution mostly share the benefits of growth when their incomes are increased through quality employment opportunities. Therefore, an inclusive pattern of growth first and foremost promotes the centrality of labor. Key policies related to this objective include: the adoption of a macroeconomic policy framework that promotes employment creation; the enactment of fiscal and monetary policies encouraging productive investment over financial speculation, and sustainable growth over macroeconomic stabilization as an autonomous goal; as well as the adoption of industrial policy measures encouraging the creation of more productive jobs with incomes above the poverty line. In addition, given the growing share of returns to capital in the distribution of income, an inclusive model of growth will increasingly require actions aimed at ensuring a more equitable access to capital and the benefits of entrepreneurship.

Reducing secondary inequality through a fair and effective redistribution measures

Fiscal policies are instrumental in achieving social equity and a redistribution of wealth. Depending on the instrument used, fiscal policy can influence income distribution both directly, through its effect on current disposable incomes, and indirectly through the provision of public services, which in turn affect future earning capacity. This is achieved by adopting progressive taxation systems, expanding the tax base, and improving the effectiveness of public expenditure. International tax cooperation is also necessary in order to reduce top-heavy wealth concentration. It can include a range of instruments such as the automatic exchange of information, multilateral simultaneous tax examinations and international assistance in the collection of tax due.

Social protection is important for social equity and the distribution of wealth because it supports poor households to better cope with shocks without having to deplete their assets. Conditional cash transfers have shown enormous potential in this context. Temporary public employment programmes and employment guarantee schemes are other forms of social protection which can be an effective policy tool for creating jobs and spreading the benefits of growth.

The governance dimension of inequality reduction: transparency and accountability

Fostering transparency of public institutions through measures aimed at stemming corruption and illicit capital flight is critical for achieving more equitable and pro-poor development outcomes, as corruption hinders economic development by distorting markets, damaging private sector integrity, reducing the availability of funds in developing economies.

Fostering accountability through participation of civil society organizations in monitoring the delivery and quality of social services should be promoted by improving access to information, using ICT and e-governance for strengthening the participation of disadvantaged groups.

Addressing inequality of opportunities and horizontal inequality

Policies required to address inequality of opportunities and horizontal inequalities include removal of barriers preventing equal access to critical public services and employment and livelihood opportunities, such as inequality in access to credit, employment facilitation services, agricultural extension services, small and medium enterprise development services.

While actions to tackle inequality must be taken at country level, it is clear that the causes underpinning the increasing economic inequality are inadequately addressed through exclusively domestic interventions. For instance: industrial policy aimed at promoting investment in sectors with larger proportions of high-skills jobs are dependent on the structure of international intellectual property regimes; the taxation of financial transactions cannot be effectively enforced in a context of high mobility of financial capital without adequate coordination across countries; similarly in a context of high trade integration, coordinated efforts are indispensable to ensure the full realization of international labor standards. It is therefore necessary to harness the political will not only within countries, but also within international economic coordination mechanisms.

Recommendations for G20 Actions to Improve Equality

Building on the G20's foundational mission of making globalization work for the benefit of all the G20 should agree ***the Saint Petersburg Initiative for Strong, Sustainable, Balanced and Inclusive Growth*** affirming the value of equality and inclusion along with economic growth and efficiency. The Initiative could begin with general principles and extend to specific supporting actions relevant to all G20 members.

As a matter of priority G20 should:

1. Strengthen those polices that the G20 has already agreed to and that are of a proven value in promoting income equality across the members' societies and beyond.

2. Assess the social impacts of proposed economic policies in order to openly discuss which policy options may most effectively address equality and growth. The first step is to formally include distributional impacts and equality measures, and subsequently aspirational targets, within the Framework for Strong, Sustainable and Balanced Growth. The second step is to encourage members to add equity indicators, starting with the Gini coefficient, and subsequently aspirational targets into their national development plans and annual budgets.

3. Emphasize the G20 actions that simultaneously enhance economic and equity growth. This should start with those equity enhancing actions that most directly and inexpensively contribute to new sources of economic growth and jobs, and fiscal sustainability where possible, in the short and the medium term.

4. Affirm the need to strengthen public policy and the role of the state to tackle inequality,through a) macroeconomic policies promoting employment and boosting aggregate demand; fiscal and monetary policies encouraging productive investment; stemming corruption; progressive taxation systems; reducing tax evasion and improving the effectiveness of public expenditure; b) protecting basic human rights, specifically, universal and equal access to food, water, health care, education, social protection, affordable housing, and others such as the right of free movement for citizens within the country.

5. Strengthen the social security systems in ways that move toward wider and ultimately universal coverage, in an effective and fiscally responsible way.

6. Create a G20 Working Group on Equality to collaborate with appropriate international organizations and civil society groups to help refine and implement

these recommendations, and devise new ones for actions by G20 leaders at their Brisbane summit in November 2014.

7. Encourage the United Nations to include the goal of reducing inequality as one of the post-2015 Millennium Development Goals.

Concrete actions of relevance to most G20 members should be spelt out:

1. Job generating macroeconomic and industrial policy measures, as well as actions ensuring equitable access to capital and benefits of entrepreneurship.

2. Opportunity equalizing measures such as investment in human capital through promoting high quality education and training for acquisition of knowledge, relevant competencies and skills enabling citizens to fulfill their potential in the labor market; universal health services and inclusive formal financial systems, providing access to approapriate financial services to a larger proportion of the population, including the most vulnerable groups.

3. Revenue generation and taxation policies to broaden the tax base, make taxation fairer and more progressive, improve effectiveness of public expenditure, reduce tax evasion and avoidance, including illicit financial flows. As purely domestic measures prove insufficient in dealing with the issue of tax evasion the G20 countries should actively engage in international tax cooperation mechanisms, such as: automatic exchange of information; multilateral simultaneous tax examinations; and international assistance in the collection of tax due.

4. The composition of subsides, taxation and transfer systems should be changed in order to close the “loopholes” that benefit the rich, and instead support populations that are hard hit by recession.

5. Actions to ensure access to critical public services through more effective redistribution and social programs: making the social transfer systems more progressive, notably for housing, family, and social assistance; extending coverage of social security, including expansion of social protection floors; improving public pension plans for aging populations in ways that maximize the economic contribution of experienced, aged workers while controlling the fiscal demands on the government; supporting women’s contribution to the labor

force and economic growth through promoting region-specific pro-poor policies, including physical infrastructure, human capital, and inter-regional equality and integration policies, while ensuring that they do not privilege wealthy urban areas at the expense of poorer, rural ones.

Country Specific Policies

G20 members could agree on the recommendations adopting measures most suitable to the national socio-economic circumstances. Additional steps could be considered by the G20 members with particular needs.

PART I.

SUSTAINED AND BALANCED GROWTH REQUIRES EQUITABLE POLICIES

Chapter 1. Trends in Income Inequality in the World and in the G20

Introduction

The world is changing rapidly and, with it, the role and influence of citizens in their respective countries and as global inhabitants. One of the aspects that most clearly reflects this dynamic is the changes in income inequality within countries and globally.

Income inequality is now being discussed widely as we approach the deadline for the Millennium Development Goals in 2015. Different commentators have suggested the need for monitoring inequality in the follow up to the MDGs. The opening of the public space to discussion on inequality is something that should be commended. Not long ago, the Managing Director of the IMF publicly dismissed such debates as a distraction from more "important" issues related to economic growth (Krueger, 2003). In her 2002 speech Anne Krueger, then First Deputy Managing Director of the IMF, said "*Poor people are desperate to improve their material conditions in absolute terms rather than to march up the income distribution. Hence it seems far better to focus on impoverishment than on inequality.*" That has changed. Equality is regarded as fundamental to the realisation of human development goals and economic stability

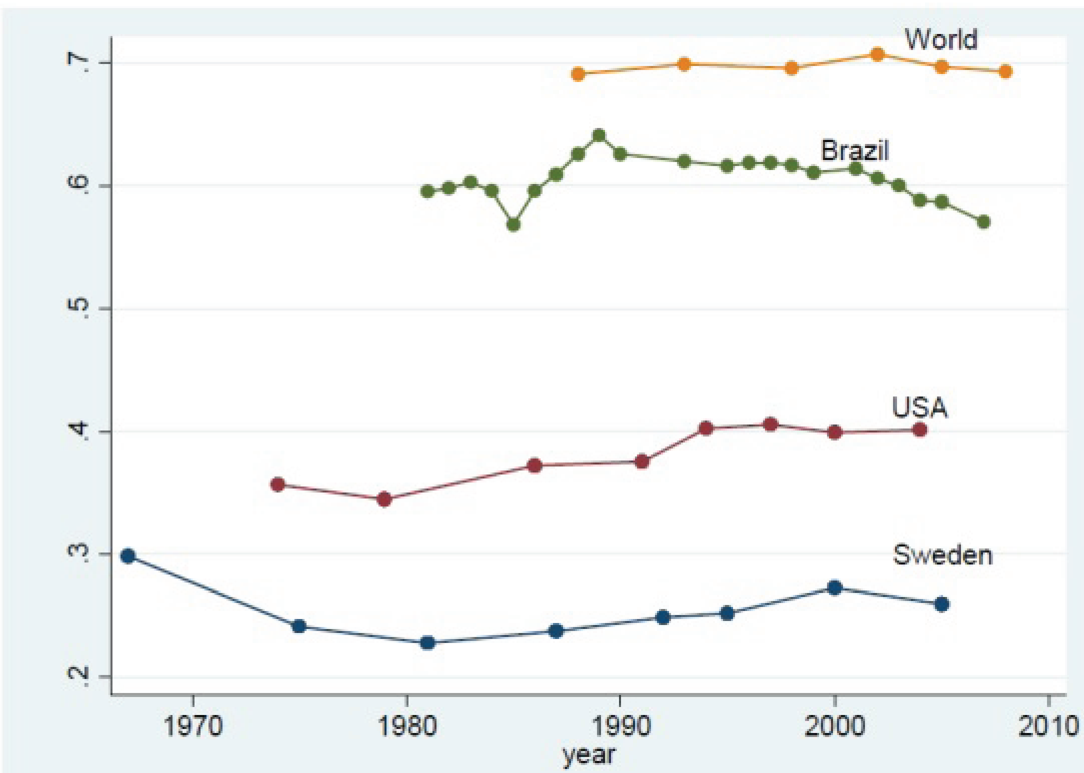
Inequality globally and nationally

What do we know about inequality? The present section will focus on global inequality first, then on inequality within countries and finally on inequality in the G20 countries.

Let's start with global inequality. If the world were one single country, if we all were global citizens in the most basic definition, how unequal it would be? As it turns out very unequal. According to the research by Branko Milanovic from the World Bank, the Gini coefficient, a measure of the dispersion of income across the whole population, is 0.70. For comparison, the Gini coefficient for South Africa, one of the most unequal countries in the world is 0,631.[1]

But as Milanovic also points out, we are often concerned not only with the level of global income inequality but with its trend. What do we know about this? There is enough reliable data to calculate global inequality for every five years during the 20 years spanning from 1988 to 2008. Milanovic found that "*perhaps for the first time since the Industrial Revolution, there may be a decline in global inequality. Between 2002 and 2008, global Gini decreased by 1.4 points*" (Milanovic, 2012).

Figure 1.1. Global Gini coefficient compared to the Ginis of selected countries



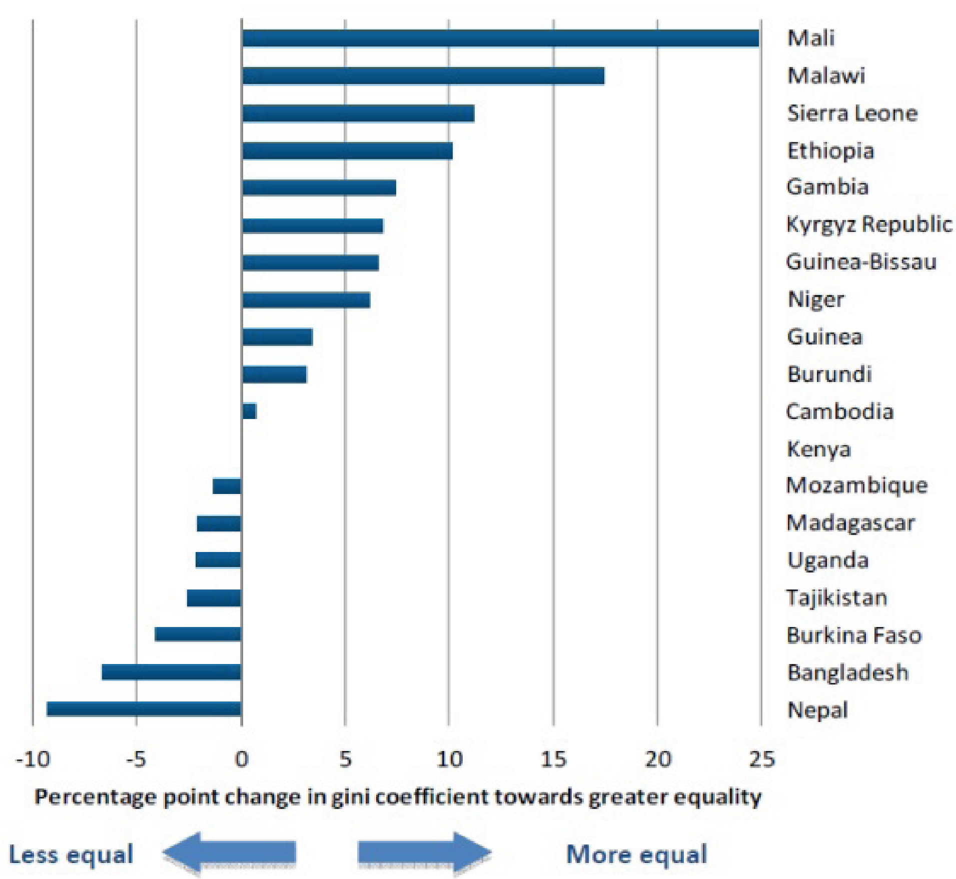
Source: (Milanovic, 2012)

Given the diversity of experiences around the world, it is not surprising that income inequality follows different patterns across the countries. There are

[1] The World Bank Database. GINI index. Available: http://data.worldbank.org/indicator/SI.POV.GINI [24 May 2013].

some groups that stand out though. Recent research (Oxfam, 2012) shows that income inequality is falling in most low-income countries – in fact, income inequality is converging towards the G20 countries' level. Recent research highlights the experience of several low-income countries (Mali, Malawi, Sierra Leone, and Ethiopia) that have achieved substantial reductions in inequality. Latin America, led by Brazil, has also experienced a recent and consistent decline in income inequality.

Figure 1.2. Changes in inequality in low-income countries, 1990-mid 2000s (2004, 2005 or 2006, depending on availability)

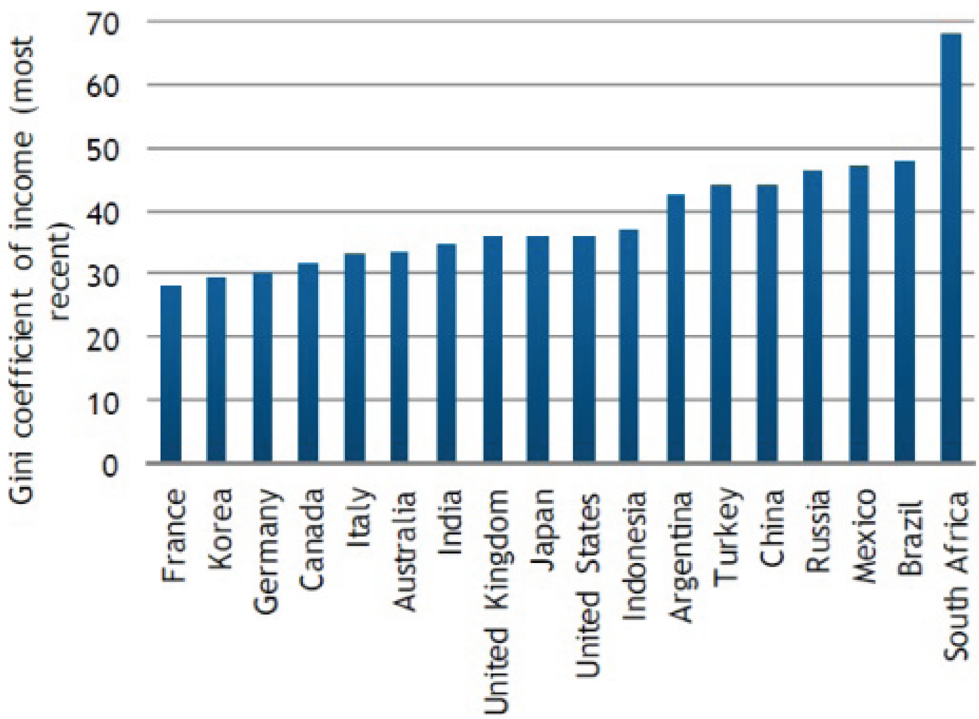


Source: Chart compiled by Oxfam using data sourced from (Solt, 2010)

This leads to the overall trend in the economies belonging to the G20. The G20 is a varied group of countries, which is reflected in the levels of income inequality as well. Inequality ranges from rather low in France to very high in

South Africa. The G20 countries cluster around two groups- emerging economies (South Africa, Brazil, Mexico, Russia, Argentina, China, and Turkey) with higher inequality relative to developed countries with lower Ginis (for instance France, Germany, Canada, Italy, and Australia).

Figure 1.3. Gini coefficient of income in G20 countries, 2005-2009



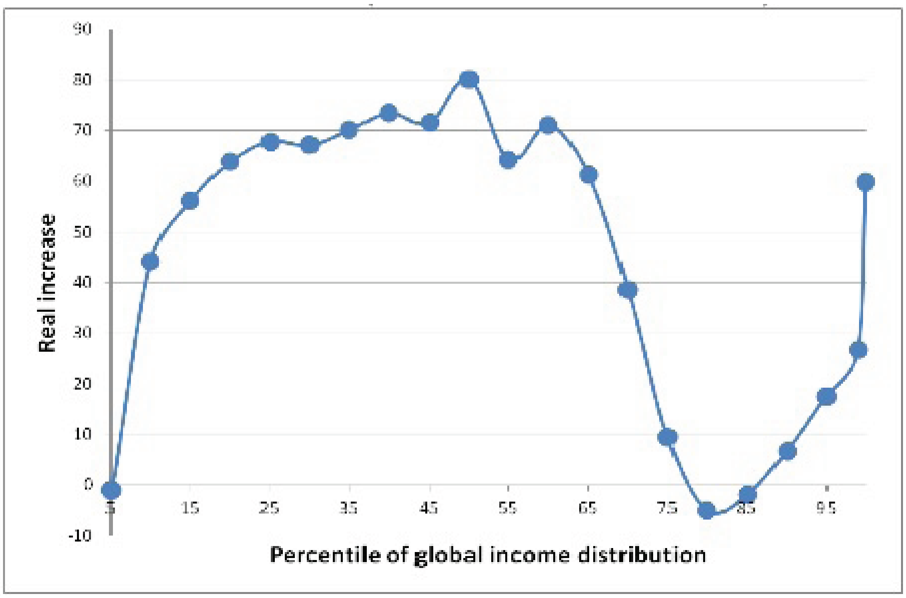
Source: Figure compiled by Oxfam using data sourced from (Solt, 2010)

Yet the trends are changing these clusters. As mentioned above, richer countries have been experiencing a worrying trend. The only four countries in the G20 where income inequality has fallen since 1990 are the emerging market economies: Brazil, Korea, Mexico, and Argentina. Moreover, only Brazil and Korea reduced inequality consistently in both the 1990s and 2000s (Oxfam, 2012).

These four countries bucked the trend for the G20. Across the G20 countries as a whole, and in every high-income country except Korea, inequality was higher in the late 2000s (latest data available) than in 1990. And some countries have experienced a surge in inequality in the last decade. Among them are: Turkey, Germany, Indonesia, Australia, India, and South Africa.

The changes in income inequality around the world can be lumped in four categories: a stagnation in the incomes of the extremely poor; a rapid rise of the middle class, mostly coming from large emerging economies; a stagnation of the middle class in the developing and some developed countries; and the concentration of income in the global top 1 percent. The changes in income for these four groups can be seen in this Milanovic's graph.

Figure 1.4. Change in real income between 1988 and 2008 at various percentiles of global income distribution (calculated in 2005 international dollars)



Note: The vertical axis shows the percentage change in real income, measured in constant international dollars. The horizontal axis shows the percentile position in the global income distribution. The percentile positions run from 5 to 95, in increments of five, while the top 5% are divided into two groups: the top 1%, and those between 95th and 99th percentiles.

Source: (Milanovic, 2012)

It will be useful to identify the dynamics behind this graph. Milanovic explains that two groups benefitted particularly over the past two decades: "the very rich, those at the top of national and global income distributions, and second, the middle classes of emerging market economies, in particular China, India, Indonesia and Brazil [...] which includes more than a third of world population". (Milanovic, 2012)

There is another group that improves their lot: those at the bottom third of the global income distribution but outside extreme poverty.

The two groups who have not improved their standing in recent decades are the poorest 5% of the world's population but more dramatically, the people between 75th and 90th percentiles of the global income distribution. For this last group – dubbed the "global upper- middle class" by Milanovic and which includes a large share of people from former Communist countries, Latin America and rich developed countries – income has remained stagnant since the mid-1980s.

Conclusion

As mentioned above, the global dynamics is driven by national changes. The trend is very different for the rich world and some large developing countries, most notably India and China. Since 1980, income concentration and overall levels of inequality have increased dramatically in several high income countries. In other words, the rich are getting richer. The top 1% of Americans have doubled their share of national income (from 8 to 17%) since Ronald Reagan was inaugurated. The top earners in other rich economies such as Australia, the UK, Japan and Sweden, have also increased their share of income. Similarly, the estimates of the Gini coefficient in India and China (with all the measurement challenges they may have) suggest a wider dispersion of income. In summary, as The Economist noted in a recent survey "*the majority of the people on the planet live in countries where income disparities are bigger than they were a generation ago*" (The Economist, 2012).

Chapter 2. How Inequality Affects Growth

Introduction

Determining the main drivers of economic growth remains one of the more contested areas of economics, and this lack of consensus is also evident in the debate over how inequality interacts with growth. Earlier approaches to this question argued that inequality was actually necessary for growth because the wealthy saved more of each unit of income received, thus providing a larger pool of funds available for investment than would be possible if income was more evenly distributed. More recent approaches though have challenged this view, emphasizing the negative impact of inequality on human capital formation, particularly as development continues (Bhatti et al., 2011).

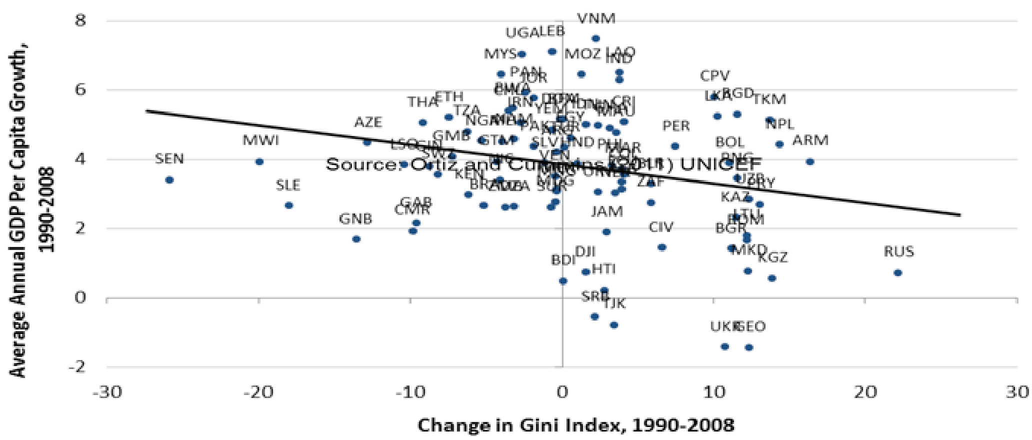
How Inequality Can Constrain Economic Growth

This section considers some of the ways that inequality may operate to constrain economic development, either by limiting the pace or sustainability of economic growth, or by increasing social unrest, thus increasing uncertainty and dampening investment needed for growth and broader economic development. But before considering how inequality and development may interact, it is important to see what has actually happened. Empirical research over the past two decades shows that reducing inequality is consistent with strong growth in income over a sustained period of time.

As the chart shows, although some countries that achieved strong sustained per capita income growth also experienced greater income inequality, many others were able to avoid this. So at the very least, declining inequality can accompany sustained economic growth – equity is not inconsistent with efficiency. Equally important, constant or increased inequality is neither essential for, nor an inevitable consequence of, growth.

What is less clear is the mechanism through which inequality can affect growth. In the absence of an agreed growth model, a diverse range of explanations have been suggested, but several main themes emerge (Marrero & Rodriguez, 2010). One theme relates inequality, particularly income inequality, to lower labor and capital productivity; a second emphasises the impact of inequality on the ability of some countries to maintain periods of strong growth; while a third stream highlights connections between inequality and the enabling environment needed to encourage growth and development (Aghion et al., 1999).

Figure 2.1. Growth in Per Capita Income and Change in Income Inequality. 94 Developing Countries, 1990-2008*



*Or latest available data. Source: (Ortiz & Cummins, 2011)

Human capital formation[2]

Building up human capital is one of the main ways of increasing labor productivity, and is likely to be of particular importance as development progresses and the technological sophistication of production increases. The inability of the poor to invest sufficiently in education, including basic education and training, is often seen as a major reason for inadequate human capital formation (Berg & Ostry, 2011). This lack of investment has often been put down to credit constraints. Poor people are very limited in their ability to finance education from their current income, and are typically constrained in the amount they can borrow because they cannot use future earnings as collateral against a loan (Mejia & St-Perre, 2004). These credit market imperfections not only limit the ability of the poor to develop their human capital, but also reinforce existing patterns of inequality, perpetuating the problem. The provision of low cost public education is important to offset these barriers to the creation of human capital and the reduction of inequality over time.

[2] For a theoretical and historical discussion see (Galor, 2011).

Financial limitations are not the only barriers to increasing human capital. Discrimination on the grounds of gender and ethnicity due to cultural, traditional, legal, religious, socio-economic or political norms can also be important obstacles (The Guardian, 2012). For example, the persistent inequitable treatment of girls and women in some countries reduces their capacity to contribute economically. The amount and type of education and training available to girls and young women, vertical and horizontal occupational segregation, and a bias in recruitment and promotion all work to limit women's productivity. Gender and other social inequality can further affect productivity by reducing the incentive to work. Whether (particularly gender) inequality causes poor economic outcomes, is the result of a low level of development, or reflects other variables such as health status or maternal mortality, has not been conclusively determined, and may vary over time and across countries. More micro level studies are needed to improve our understanding of how greater gender and social equity improves economic efficiency. But there is a strong case to keep refining policies to eliminate inequality to ensure that the potential of all groups to contribute to growth and development is realised (Badiera & Natraj, 2013).

Labor productivity is also influenced by health through its impact on aggregate hours worked and the type of work performed. Not surprisingly, there is a large body of evidence that supports the idea that health and income *levels* are positively related. However, there is also evidence that health is related to income *inequality*, in some studies even after controlling for factors such as race, smoking, and poverty (Thorbecke & Charumilind, 2002).

Physical capital accumulation

The amount of physical capital in an economy affects both total productivity and the productivity of labor (through the capital/labor ratio, or the amount of physical capital each person has to work with). The poor are likely to have inadequate physical capital for a variety of reasons including the inability to accumulate sufficient savings (not only because of low incomes but sometimes because of a lack of secure savings facilities), or the exposure of many poor people to asset loss due to human induced shocks or natural disasters.

At a more macro level, the specific pattern of capital formation in a country can both exacerbate inequality and create pressure for its reduction. For example, the magnitude of China's exports of certain manufactured goods has depressed world prices for those products, kept domestic wages in those industries low, and exacerbated existing inequality. Recognition of the need for domestic demand to play a larger role in future growth means that household incomes will need to rise (via higher wages and social protection programs), developments that should reduce inequality (Vandermoortele et al., 2013: 14). And India's growth has generated relatively little employment due to the existence of a growing, capital intensive, formal manufacturing sector, alongside a large, low productivity informal sector whose share of GDP has been essentially constant for more than 60 years (Vandermoortele et al., 2013: 5-8).

In short, insufficient human, physical, and/or financial capital, or the skewed allocation of assets, create barriers to the poor engaging fully with markets. The results are that inequality continues or worsens and growth is slower than would otherwise be possible.

Inequality and the duration of growth

Sustained economic growth is generally considered to be essential for a country to permanently move out of poverty. If a country is unable to sustain strong growth once it has started, or is prone to economic shocks that significantly reduce growth, it will face major obstacles to poverty reduction. Recent studies have suggested that income inequality may exacerbate both these problems. For example, Berg and Ostry, looking at the link between the extent of income inequality and the duration of spells of strong growth, found that a 10 percentile reduction in inequality increases the expected length of a spell of strong growth by 50 per cent (Berg & Ostry, 2011).

Inequality may also encourage poor economic policy that leads to growth disrupting shocks. In his influential book *Fault Lines*, Raghuram Rajan has argued that easy monetary policy coupled with increasing income inequality in the US encouraged the wealthy to increase their savings, the poor to borrow to sustain their consumption, and financial institutions to facilitate both developments, all of which contributed to the global financial crisis that began in 2008 (Rajan, 2011).

Broader social linkages

Inequality has also been linked to social instability (UNRISD, 2013). The existence of horizontal inequalities – economic, political, social, and/or cultural status inequalities between groups that share a common identity – can increase the risk of social unrest and conflict. A range of studies have found that inequalities may become a cause of civil war between groups with wealth levels well above or below country averages. The probability of separatist conflict increases if a region is richer or poorer compared to the national average. The intensity of conflict is also related to the extent of some types of horizontal equity (Stewart, 2010). From the perspective of economic development, civil unrest resulting from horizontal inequality is likely to increase uncertainty and discourage investment, and may even cause civil war and the destruction of assets (Thorbecke & Charumilind, 2002). Ironically, policies to reduce horizontal inequalities may also create social tensions. Actions to reduce preferential treatment of privileged sectors of society may encourage political action to protect those privileges (in turn possibly triggering further social unrest).

Finally, considerable attention has been given to the interaction of redistribution policies, tax rates on income from labor and capital, and inequality (Milanovic, 1999; Ghosh & Pal, 2004). Depending on the extent of existing inequality, there can be tension between the tax rate that maximises growth, and the rate that is preferred by the ‘median voter’ who would benefit from a reduction in income inequality. In countries with democratic institutions and marked inequality, governments may implement a tax regime that favours income redistribution but actually impedes the reduction of inequality over time. This could be for a variety of reasons. For example, if income tax rates were changed to significantly redistribute income, the (higher) incomes of those who were saving more would be reduced and incentives to work and save would be distorted. Such changes would reduce the pool of aggregate savings available for investment. Or if redistribution was done through expensive subsidies that benefit the poor (such as fuel subsidies), this could reduce public funds available for investment in areas such as education and infrastructure. Empirical support for the median voter hypothesis is mixed, but it does highlight the potential importance of the political dimension of growth and inequality.

Conclusion

In short, economists are still working to fully understand why, as found by empirical studies, inequality can act as a significant barrier to sustained economic growth and longer term economic development. Research over more than two decades has identified a number of channels through which inequality can impede some of the basic drivers of economic development:

- Imperfect capital markets lend insufficient amounts to the poor for investment in education and income generating assets.
- High levels of inequality may distort economic policy settings, which could have adverse impacts on both medium and long term growth and development. Fiscal and monetary policies may favor the rich, encourage unproductive activity, and possibly increase exposure to economic shocks. Alternatively, where the poorer sections of society have political influence, policy might aggressively redistribute income, reducing aggregate savings.
- High levels of inequality can cause social unrest and conflict, discouraging investment.

The interaction of these forces, however, is complex, and it seems unlikely that a predominant cause will be identified. But it is becoming increasingly clear that there are good economic, as well as social and ethical, grounds for actively reducing inequality, particularly in the poorest countries.

Chapter 3. Key Drivers of Income Inequality

Introduction

The increase in within-country income inequality is one of the most robust trends of the past three decades across most countries of the G20[3].

Four factors have been primarily responsible for this trend: technical change; trade and financial liberalization; changes in labor market regulations; and changes in fiscal policies. These four factors have been driving income inequality mainly through two channels: 1) by increasing the wage premium of high-skilled workers relative to low-skilled workers and 2) by increasing the share of capital in total income relative to labor (or, in other words, by making the functional distribution of income increasingly biased in favor of capital).

Technical Change

Technical change has had many positive effects on productivity and the quality of people's wellbeing around the world, but has also been a driver of income inequality over the past decades, especially with the development of Information and Communication Technologies (ICT). ICT has replaced the routine tasks typically performed by low-skilled workers while enhancing the productivity of high-skilled workers, thus biasing production technologies (and thereby income distribution) in favor of the latter (OECD, 2011; UNCTAD, 2012).

More precisely, there are two distinct channels through which skills-biased technical change has impacted income inequality. First, it has widened the earnings disparity between skilled and unskilled workers. Second, by enhancing labor productivity, it has kept the rate of growth in employment well below the rate of economic growth, weakening – in this way – the position of labor vis-à-vis capital and constraining real wages.

Trade and Financial Liberalization

While trade and financial liberalization supported greater international economic integration and all the opportunities that this generated for both advanced

[3] The G20 included 11 advanced economies and 9 emerging economies. Income inequality increased in all G20 countries except for Argentina, Brazil, Mexico and Turkey (measured by Gini index, World Development Indicators, 2012).

and emerging economies, there is also evidence that these trends contributed to rising income inequality.

Trade liberalization stepped up the pace of skills-biased technical change because, in open markets, heightened competition reinforced the incentives for investment in cost-saving and productivity-enhancing technologies, which in turn – as mentioned in the previous section – increased the wage premium for high-skilled workers and contained wage growth. Indeed, evidence shows that the skills bias in technology has been more pronounced in sectors which experienced greater trade liberalization (Wood, 1994; Theonig & Verdier, 2003).

Research on the effects of financial liberalization shows that relaxation of financial regulations (such as open capital accounts and flexible exchange rates) has been associated with a fall in the wage share in several countries, both advanced and emerging (ILO, 2011; Lee and Jayadev, 2005). Increasing financial integration also exacerbated countries' vulnerability to the volatility of international financial flows. During the times of boom, the growth of financial flows helped increase the profitability of capital and depress the growth in wages (by granting capital the mobility to freely go to wherever labor costs were the lowest). And during the times of crises, low-income groups and other vulnerable groups were much more likely to suffer job losses (UNDP, 2011; van der Hoeven & Saget 2004; UNCTAD, 2012). In short, low-income groups benefitted the least during periods of boom and recovery, and suffered a disproportionate share of the costs of financial crises.

Emerging economies appear to be more vulnerable to these impacts of financial liberalization because private capital flows to these economies are significantly more volatile than flows to advanced economies (Broner & Rigobon, 2006), and because the size of these capital flows can overwhelm those countries' regulatory and policy frameworks (UNCTAD, 2012).

Financial and trade liberalization increased cross-border mobility of both goods and capital and spurred a growth in production relocation or offshoring. The relocation of production and investment, usually in the form of Foreign Direct Investment (FDI) had a number of beneficial impacts on employment and growth in receiving countries, but also in many instances an adverse impact on income inequality (UNCTAD, 2012; IMF, 2007).

In a context of increasing trade and financial liberalization and thanks to technical change, firms were able to increase profitability by combining state-of-the-art technology with lower labor costs (UNCTAD, 2012). As a result, on balance, offshoring changed the functional distribution of income in favor of capital at the expense of labor in the countries experiencing significant production relocation trends.

In emerging economies, firms in the growing export-oriented manufacturing sector offered higher wages to attract workers relative to traditional agricultural sectors. For instance, in China the growth in private sector manufacturing in coastal areas contributed to increasing both spatial and urban/rural wage differentials (ADB, 2012; Galbraith, 2012). Moreover, new manufacturing firms adopted more advanced technologies which further increased the wage premium of skilled workers (ADB, 2007).

Changes in labor market regulations

In many countries, regulatory changes were introduced in the 1980s and the 1990s in order to increase competition in the goods and services market and to make labor markets more flexible (OECD, 2011). Labor market regulatory changes included: a relaxation of employment protection legislation for workers with temporary contracts, a reduction in minimum wages relative to the median, a lowering of the unemployment benefits relative to pre-unemployment wages (i.e. the benefits replacement rate) (OECD, 2011).

Increased flexibility in labor markets had, by and large, a significant positive impact on employment levels and growth (Blanchard & Giavazzi, 2003), but many of the above-mentioned reforms also had adverse distributional effects compressing wages and increasing wage dispersion (OECD, 2011).

In addition, declines in union density, which disproportionately affected manufacturing and low-skilled jobs, further weakened the bargaining power of workers that were already disadvantaged by skills-biased technological change. A number of studies pointed out a strong relation between the weakened position of trade unions, and a higher wage inequality (e.g. Visser & Cecchi, 2009; Wallerstein, 1999).

Fiscal policy

Traditionally, taxes and public transfers played a major role in improving the primary distribution of income[4]. However, since the mid-1990's the equalizing effect of fiscal policy declined in a majority of G20 economies (OECD, 2011).

As countries competed to attract private capital flows in a context of high capital mobility, they reduced taxes on capital returns. In addition, the lowering of personal income tax rates, which occurred in several advanced economies, weakened the overall redistribution impact of taxation (UNCTAD, 2012). In particular, it should be noted that despite the fact that incomes became highly concentrated at the top 10 or even 1 per cent of households (Atkinson et al., 2011)[5], top tax rates were often significantly reduced (e.g. they went from an average of 60-70% to around 40% between the 1990s and 2000s in major OECD countries) (OECD, 2011).

Trends related to transfers and benefits had mixed effects across G20 economies. In advanced economies, there is evidence that changes in the rules and regulations of government benefits schemes in the 1990s and 2000's weakened the redistributive impact of fiscal policy (OECD, 2011). On the other hand, in a number of emerging countries, improved fiscal accounts have been successfully used to support the provision of public goods, including education, and the expansion of social transfers with inequality reducing results (UNCTAD, 2012).

Focus on Emerging economies

The four drivers mentioned above had a significant impact on increased economic inequality in all of the G20 economies, but there is a second set of factors that have contributed to high levels of income inequality, especially in the context of emerging economies.

[4] The primary distribution of income is the distribution of income that results from economic activity before any kind of government taxes or transfers. The secondary distribution of income is the distribution after government taxes and transfers.

[5] In the United States, for instance, the share of the top 0.1% in total pre-tax income quadrupled in the 30 years to 2008. Just prior to the global recession, the top 0.1% accounted for some 8% of total pre-tax incomes in the United States, some 4-5% in Canada, the United Kingdom, and Switzerland, and close to 3% in Australia, New Zealand, and France (OECD, 2011).

Spatial inequality

Economic inequality patterns in emerging economies highlight the significance of spatial inequality that is driven by “the interaction between new opportunities through trade, technology, and market-oriented reform, interacting with the structure of geography and infrastructure” (ADB, 2012:70). In a large majority of emerging economies, communities in rural regions or in remote provinces often receive a significantly lower share of economic growth relative to other regions. For instance, it has been demonstrated in the early 1990s to late 2000s China, India and South Africa saw larger increases in urban per capita incomes than rural incomes (ADB, 2012; OECD, 2011).

Unequal access to social services

Access to social services varies greatly by gender, region, cultural background, and socio-economic standing with the highest rates of access in already rich provinces. For instance, in India, children belonging to households from bottom quintile of income earners are three times more likely to be out of school than children in the richest quintile (ADB, 2012). The absence of opportunities to build human capital limits the potential for upward mobility and traps people in low paying, vulnerable employment.

Informality

Informal employment is widespread in India, Indonesia, Brazil, China, South Africa and Russia with much employment concentrated in low-skill manufacturing, agriculture, construction, hotels and restaurants, domestic services, and wholesale and retail trade (OECD, 2011). Although informal employment can help raise household incomes especially for those at the bottom end of the income distribution, there is supportive evidence for the view that persistent informal economic relations lead to greater income inequality (Jutting & Laigesia, 2009). This is mainly because many informal jobs provide wages that do not exceed the poverty line, are highly unstable, lack adequate social protection networks, and limit opportunities for growth and for human capital accumulation.

Horizontal inequality

One of the factors that contribute to income inequality is the exclusion of specific groups based on gender, race, ethnicity, or other cultural differences (horizontal inequality). Since these disadvantaged groups have less access to basic social services and suffer from discrimination in the labor market, their opportunities to secure employment and decent wages is lower compared to the groups who do not face similar kinds of discrimination.

Conclusion

In conclusion, many factors combined over the past thirty years to cause rising income inequality across the world. Trade and financial liberalization, supported by a fast-paced skill-biased technological progress, led to an increase in the income share of capital at the expense of labor and an increase in wage disparities between skilled and unskilled labor. These trends were compounded by changes in labor market regulation that weakened the bargaining power of labor and changes in fiscal policies that reduced the redistributive impact of taxes and public transfers.

In the case of emerging economies, these factors were coupled with other structural factors such as spatial and horizontal inequalities, unequal access to basic services, and informality which contributed to perpetuating and increasing income inequality.

Chapter 4. Key Policy Options to Tackle Inequality

Introduction

Growing levels of inequality worldwide can be largely explained as the result of a number of main drivers – technological progress favoring high-skilled workers and increasing wage disparities; financial and trade liberalization with the corresponding expansion in highly-volatile capital flows and production relocation; labor market regulations impacting on particular worker's bargaining power; and changes in the redistributive impact of fiscal policies. The combined effect of these drivers has increased primary inequality (i.e. inequality of incomes before taxes and transfers) through two channels – a decline in the share of labor in the functional distribution of income and an increase in the inequality of earnings between skilled and unskilled workers. Tackling inequality will therefore require the promotion of inclusive growth patterns capable of reversing or mitigating these effects.

In addition to reducing primary inequality by promoting inclusive patterns of growth, policies can also promote fair and effective redistribution measures that reduce secondary inequality (i.e. inequality of incomes after taxes and transfers). Fiscal policy and social protection measures have an especially important role to play in this respect. At the same time, the reduction of economic inequality cannot be achieved only through measures of economic policy. The quality of governance and the strength of democratic institutions are fundamental for a fair distribution of income. In this context, transparency and accountability are especially critical challenges.

Wide gaps in the chances available to individuals of different socio-economic backgrounds to fulfill their aspirations – what is referred to as inequality of opportunities – represent, from a normative and ethical perspective, one of the most problematic aspects of economic inequality. Horizontal inequalities (inequalities in economic and political resources as well as social and cultural status between specific groups defined along demographic, cultural, spatial or other dimensions) are a specific aspect of inequality of opportunities which have been shown to hold the potential to significantly undermine social cohesion.

In addressing inequality, utmost consideration must be given to the specific challenges and opportunities of different country contexts. However, on the basis of the above considerations, four areas of focus can be identified:

- Reduction of primary inequality through inclusive growth;
- Reduction of secondary inequality through redistributive policies;
- Promotion of governance institutions that are conducive to inequality-reduction;
- Reduction of inequality of opportunities and horizontal inequalities.

Reducing primary inequality through truly inclusive patterns of economic growth

Those at the bottom of the income distribution mostly share the benefits of growth when their incomes are increased through quality employment opportunities. Therefore, an inclusive pattern of growth is first and foremost a pattern that promotes the centrality of labor. Key policies related to this objective are:

- Adoption of a macroeconomic policy framework that promotes employment creation, and also through the enactment of fiscal and monetary policies encouraging productive investment over financial speculation and sustainable growth over macroeconomic stabilization as an autonomous goal;
- Adoption of industrial policy measures encouraging the creation of more productive jobs with living wage incomes that are above the poverty line;
- Regulatory measures supporting the full implementation of international labor standards, addressing exploitative work and enabling workers' collective action for full realization of labor rights, though necessarily these measures would need to be introduced over time given institutional weaknesses and financial constraints in various developing countries;
- Investment in human capital and in skill development for those who have been disadvantaged by technological progress.

In addition, given the growing share of returns to capital in the distribution of income, the realization of an inclusive model of growth will increasingly require actions aimed at ensuring a more equitable access to capital and the benefits of entrepreneurship. Among the policy options to be considered in this context are:

- Policies supporting Small and Medium Enterprises (SMEs), entrepreneurs and start-ups in gaining access to finance, human capital and markets and more generally improving the business environment in which they operate.
- Policies that improve the access of the rural poor to key factors of production – such as irrigation, electricity, transportation, new technologies, enhanced seeds, financial services and insurance.
- Asset redistribution in the rural sector, also through innovative approaches to land reform such as the distribution of micro-plots, civil society-based reform, resettlement schemes, restitution, land leasing and sharecropping. In this context, it is also important to take into account the issue of land tenure and security of property rights, which is a critical issue for marginalized rural populations. The issue of equal access to land and resource rights between men and women should also be addressed, if asset redistribution is to generate sustainable structural changes.

Reducing secondary inequality through fair and effective redistribution measures

Fiscal policy

Fiscal policies are instrumental in achieving social equity and a redistribution of wealth. Depending on the instrument used, fiscal policy can influence income distribution both directly, through its effect on current disposable incomes, and indirectly through the provision of public services, which in turn affect future earning capacity. This is achieved by adopting progressive taxation systems, expanding the tax base, and improving the effectiveness of public expenditure. Improvements in the effectiveness of public expenditure call, in turn, for stronger capacities in policy formulation and public expenditure management. In addition, fiscal policy can reduce inequality by influencing the price of consumer items on which the poor spend a disproportionate amount of their incomes. An effective fiscal policy means that public investments in expanding access to opportunities to the poorest and most disadvantaged segments are maximized.

Moreover, if countries are to stop competing for investments by reducing their top income tax rates, then international tax cooperation will be necessary. International cooperation on tax policy will help reduce top-heavy wealth concentration.

Social protection

Social protection is important for social equity and the distribution of wealth because it supports poor households to better cope with shocks without having to deplete their assets. Furthermore, social protection programmes have shown that they can actually have inequality reducing impacts as measured by the Gini coefficient. Conditional cash transfers have shown enormous potential in this context. For instance, it has been established that the conditional cash transfer programme Bolsa Familia in Brazil is responsible for between 21 and 16 percent of the reduction in inequality in Brazil since 2001. Temporary public employment programmes and employment guarantee schemes are other forms of social protection which can be, under appropriate circumstances, an effective policy tool for creating jobs and spreading the benefits of growth.

The governance dimension of inequality reduction: transparency and accountability

Fostering transparency of public institutions

Corruption undermines human development by diverting public resources to private gain and reducing access to public services. Corruption also hinders economic development by distorting markets and damaging private sector integrity. Similarly, illicit financial flows reduce the availability of funds in developing economies and deprive those countries of highly needed investments in social equity without which the promotion of social mobility and the redistribution of wealth become impossible. Promoting transparency in public institutions – also through measures aimed at stemming corruption and illicit capital flight – is therefore critical for achieving more equitable and pro-poor development outcomes.

Fostering accountability through participation

Having effective mechanisms for holding governments accountable allows civil society organizations and citizens' groups to monitor the delivery and quality of social services as well as the effectiveness of public expenditures through a variety of different instruments such as public hearings, social audits, community score cards, citizens' report cards, participatory public expenditure and budget reviews. Empowering poor and vulnerable communities with information and tools to engage in civic activity is particularly important. It is often these very groups who are left at the margins of decision making, in part due to lack of information. Improving access to information, using ICT and e-governance, are hence important for strengthening the participation of disadvantaged groups.

Addressing inequality of opportunities and horizontal inequality

Another key driver of economic inequalities is unequal access to opportunities, including unequal access to critical public services – such as education and health – as well as services related to economic activity – such as for instance credit services – and more generally employment opportunities. This inequality is more pronounced along specific demographic dimensions – with women and young people consistently experiencing disadvantage in income as well as access, but also other dimensions of cultural or spatial nature (for instance in the case of ethnicity-based discrimination or in the case of the significant divide still separating rural and urban areas).

Policies required to address inequality of opportunities and horizontal inequalities include:

- Removal of barriers preventing equal access to critical public services such as, for instance, excessive direct and indirect costs, insufficient geographic coverage, favouritism in the delivery of services;
- Removal of barriers preventing equal access to employment and livelihood opportunities, such as inequality in access to credit, employment facilitation services, agricultural extension services, small and medium enterprise development services;
- Adoption and implementation of anti-discriminatory policies and affirmative action measures.

Conclusion: the complementarity of domestic and international policy frameworks

While actions to tackle inequality must be taken at country level, it should be emphasized that decisive progress will only be possible in the presence of conducive international policy frameworks. It is clear that the causes underpinning the increasing economic inequality are ill-addressed through exclusively domestic interventions. For instance: industrial policy aimed at promoting investment in sectors with larger proportions of high-skills jobs are dependent on the structure of international intellectual property regimes; the taxation of financial transactions cannot be effectively enforced in a context of high mobility of financial capital without adequate coordination across countries; similarly in a context of high trade integration, coordinated efforts are indispensable to ensure the full realization of international labor standards. It is therefore necessary to harness the political will not only within countries, but also – in a prospective of global governance – within international economic coordination mechanisms.

Chapter 5. Recommendations for G20 Actions to Improve Equality

Introduction

The G20 leaders at their St. Petersburg summit can act together to improve income and economic equality within their countries and beyond by adopting a set of recommendations of varying specificity, ambition, and time horizon, in each of these three categories: those common to all G20 members; those of comprehensive relevance to most; and those specific to the countries with particular needs.

This set of policy recommendations on how G20 can address inequality takes full account of the existing authoritative, best available, consensus, analysis and evidence of the IMF, OECD, UNDP, other international organizations and relevant scholarly, civil society and policy communities, as summarized above. It builds directly upon the extensive evidence and analysis of the causes and practical policy cures for income inequality in the G20 member countries, as identified in the country reports prepared by and for members of the Task Force on Equity (currently including Australia, Canada, China, France, India, Indonesia, Mexico, Korea, Russia, Turkey and the US).

The set of recommendations recognizes that increasing income inequality requires immediate and sustained actions across a wide front, within both the financial-economic and social realms, as there is no "silver bullet" able to achieve the goal on its own. It is consistent with those policies that have been introduced to increase income equality in several G20 members and in the G20 summit connectively and that, according to the best evidence available, have proven to be effective in this regard (Kirton & Larionova, 2012; Kirton et al., 2013).

Saint Petersburg Initiative for Strong, Sustainable, Balanced and Inclusive Growth

Building on the G20's foundational mission of making globalization work for the benefit of all the G20 should agree the Saint Petersburg Initiative for Strong, Sustainable, Balanced and Inclusive Growth affirming the value of equality and inclusion along with economic growth and efficiency.

A. Common Principles and Policies for All

The Initiative could begin with general principles and extend to specific supporting actions relevant to all G20 members.

1. Reinforce Success: strengthen those particular polices that the G20 has already agreed to and that are of a proven value in promoting income equality across the members' societies and beyond while reducing those that work against this goal. This involves producing an inventory of the relevant principles, policy commitments and the members' compliance with them, and introducing measures that improve compliance with the commitments already agreed. The compliance of members with all commitments should be assessed for their employment and inequality effects (Kirton et al., 2012). The IMF, World Bank and OECD, working with relevant multilateral organizations such as the ILO, UNDP, could be invited to contribute analytically to this work, especially as new G20 principles, commitments and implementing actions are introduced.

2. Assess the social impacts of proposed economic policies in order to openly discuss which policy options may most effectively address equality and growth. The first step is to formally include distributional impacts and equality measures, and subsequently aspirational targets, within the Framework for Strong, Sustainable and Balanced Growth. The second step is to encourage members to add equity indicators, starting with the Gini coefficient, and subsequently aspirational targets into their national development plans and annual budgets.

3. Emphasize the G20 actions that simultaneously enhance economic and equity growth. This should start with those equity enhancing actions that most directly and inexpensively contribute to new sources of economic growth and jobs, in fiscally responsible ways, in the short and the medium term.

4. Affirm the need to strengthen public policy and the role of the state to tackle inequality, through a) macroeconomic policies promoting employment and boosting aggregate demand; fiscal and monetary policies encouraging

productive investment; stemming corruption; progressive taxation systems; reducing tax evasion and improving the effectiveness of public expenditure; b) protecting basic human rights, specifically, universal and equal access to food, water, health care, education, social protection, affordable housing, and others such as the right of free movement for citizens within the country. The G20 should support organizations – official and civil society – which are attempting to achieve these goals.

5. Strengthen the social security systems in ways that move toward wider and ultimately universal coverage, in an effective and fiscally responsible way.

6. Create a G20 Working Group on Equality to collaborate with appropriate international organizations and civil society groups to help refine and implement these recommendations, and devise new ones for actions by G20 leaders at their Brisbane summit in November 2014.

7. Encourage the United Nations to include the goal of reducing inequality as one of the post-2015 Millennium Development Goals.

B. Comprehensive Policies for Most

Those recommendations of comprehensive relevance to most members focus on more specific policy actions in several domains: 1. Job creation policies (including support to SMEs, start ups, and retraining, especially for the poor); 2. Opportunity equalizing measures such as policies to ensure access to education,health and food; 3. Revenue generation and taxation policies that promote equality; and 4. Redistribution, social and development programs; and 5. Social dialogue.

a. Job Generation

1. *Employment.* Create more and better jobs that offer decent salaries, good working conditions, good career prospects and opportunities to escape poverty. This includes an appropriate blend of measures to:

- Develop and implement support strategies for start ups, new small businesses and young entrepreneurs at the national and G20 levels, including accessible and timely information, easy registration of companies and preferential taxation.

- Enable access to funding for SMEs and young entrepreneurs, such as start-up loans with favorable interest rates and/or repayment-free year schemes, and guarantees in order to minimize the default risk for lenders.
- Reduce employers' social security contributions when they they hire women, youth, the long term unemployed and for workers in training and R&D.
- Create public sector jobs in health, education and environment spheres, including by providing public loans to private firms to this end.
- Implement national/international labor standards.
- Cut down on temporary unemployment and end discrimination against women and temporary workers.
- Reduce informal employment without social benefits.
- Increase the wages of workers in agriculture and other primary sectors.
- Increase minimum wages in the public and private sector.

b. Opportunity Enhancing Measures

The G20 should encourage national and sub-national governments, international institutions and relevant civil society groups to do the following in regard to education, health and financial inclusion:

1. *Education*. Invest in human capital through promoting high quality education and training for acquisition of knowledge, relevant competencies and skills enabling citizens to realize their potential in the labor market:

   - Promote universal access to education from early childhood to compulsory education with a focus on vulnerable groups (children and young adults in disadvantaged areas, the poor, women and girls) and cutting the dropout rate.
   - Promote lifelong learning to help individuals enhance their employability and businesses to improve their innovative capacity and competitiveness.
   - Build up education and training systems responsive to structural changes in the economy and society.

2. *Health.* Promote health by providing: universal access to health care public health systems and health insurance and more effective funding for health care, including programs programs to prevent and control the major non-

communicable diseases of cancer, health disease and stroke, diabetes and chronic respiratory disease through measures against obesity and overweight, unhealthy food, tobacco, alcohol abuse and physical inactivity.

3. Further Financial Inclusion, Education and Consumer Protection. Build more inclusive formal financial systems providing access to appropriate financial services to a larger proportion of the population, including the most vulnerable and unserved groups following up on the actions the G20 has initiated, with a priority on the Financial Action Task Force's revised Guidance on Financial Inclusion approved by G20 Finance Ministers and central Bank Governors at their meeting in Washington in April 2013.

c. Revenue Generation and Taxation for Equality

1. *Reduce Tax Evasion and Avoidance.* At the national level, broaden the tax base, and make taxation fairer and more progressive by reducing tax evasion and avoidance, including illicit financial flows, starting by elaborating on the relevant measures approved by the G20 Finance Ministers and Central Bank Governors at their meeting in Washington in April 2013. As purely domestic measures may prove insufficient to deal with the issue of tax evasion the G20 countries should consider engaging in international tax cooperation mechanisms, such as: automatic exchange of information; multilateral simultaneous tax examinations; and international assistance in the collection of tax due.

2. Shift Subsidies. Shift subsides from those that in practice privilege the rich to those that directly target the poor, accomplish their particular policy purpose, are not distorted by corruption, and assist with G20 governments' goal of fiscal sustainability in the medium and longer term. This starts with the need to implement the G20 leaders commitment made at their summit in Pittsburgh in September 2009 to phase out inefficient fossil fuel subsides in the medium term. It could continue with action on subsidies to agriculture and other natural resource sectors.

3. Reform Tax and Transfers. Reform taxation and transfer systems to expand the base and progressivity of the tax system, close "loopholes' that benefit the rich and support populations that are hard hit by recession:

• Increase taxes on capital, inherited income, real estate and land wealth, beyond an individual's primary residence or productive plot for self-sufficiency.

• Increase taxes on the very rich, whose incomes have soared in recent years.

• Decrease regressive taxes.

d. Redistribution, Social and Development Programs.

1. *Social Services.* Strengthen social services by:

• Providing free, accessible, quality, public social services for education, health and family care.

• Paying for social benefits from general taxes rather than labor income alone.

• Expanding public housing.

• Extending coverage of social security, including expansion of social protection floors with due regard of the social security systems role as automatic social and economic stabilizers, helping stimulate aggregate demand in times of crisis and beyond, and supporting a transition to a more sustainable economy.

• Ensuring that the poor can meet their basic human needs for food, housing, clothing, electricity, water, education and health as a social right.

2. *Pensions.* Improve public pension plans for aging populations, in ways that maximize the economic contribution of experienced, aged workers while controlling the fiscal demands on the government.

3. *Women.* Support women's contribution to the labor force and economic growth through:

• encouraging their participation in the work force, including by reducing high tax barriers to women entering work force as second income earners for families;

• providing education for all women and girls;

• ensuring equal pay for work of equal value;

• improving child care and parental leave policies.

4. *Pro-Poor Regional Policies.* Promote region-specific pro-poor policies, including those relating to physical infrastructure, human capital, and inter-regional equality and integration policies, while ensuring that they do not privilege wealthy urban areas at the expense of poorer, rural ones. Such policies could include investment incentives for underdeveloped regions, remote rural areas and slums.

C. Country Specific Policies

G20 members could agree on the recommendations adopting measures most suitable to the national socio-economic circumstances. Additional steps could be considered by the G20 members with particular needs.

Recommendations for Further Consideration

Inequality is a multifaceted challenge which can not be overcome through simple and fast track solutions. The Civil 20 members are deeply convinced that the policies which diminish inequality should be an integral and explicit component of the G20 Framework for Strong, Sustainable and Balanced Growth. For growth to be sustained, strong and balanced, it must be inclusive. The report generated heated discussions and many valuable recommendations which demand further consideration. The the Civil 20 members hope that the dialogue with G20 on Equality launched within the Russian Presidency will continue as a long term and structured process. With this perspective in mind the following recommendations generated in the course of consultations are suggested for further consideration.

A major reason why inequality has increased worldwide is because economic policies are taken detached from social objectives such as generating employment and supporting people's development. That is, decision-making is often based on a narrow focus (e.g., containing inflation, cutting budget deficits, servicing debt, and so on), which is necessary, but insufficient without also taking into account the social consequences, particularly related to employment and the welfare of the population. This type of decision-making risks, benefitting the wealthiest and exacerbating the patterns of inequality. To redress this trend representatives from civil society, recommend the following:

1. Avoid regressive macroeconomic and fiscal policies. Additional fiscal space can be found in macroeconomic policies focused on employment-generating growth and development (e. g., avoiding a narrow focus solely on reducing inflation/budget deficits or servicing debt). Instead, focus on:

- Restructuring sovereign debts to allow for economic and human development.
- Stopping fiscal consolidation and austerity measures.
- Accommodating monetary policies such as tolerance for some inflation to fund necessary economic and social investments.

2. Recognize that decent jobs are a result of adequate macroeconomic, sector and labour policies that should include:

- Monetary and fiscal policies that boost aggregate demand; e. g., excessive fiscal austerity or an excessively tight monetary policy focused solely on containing inflation does not generate jobs.
- Financial services for growth of the "real economy," branching out to the local or rural areas, supporting SMEs, start ups, new small businesses and young entrepreneurs at the national and G20 levels.
- Technology policies supportive of national industry.
- Either avoid free trade agreements that hinder the promotion of national industry and services or tailor such agreements to these goals.
- In all of the above areas, ensure monitoring and tracking of gender-disaggregated outcomes.

3. Ensure labour market policies include labour standards and fair income: Decent employment is not only about generating jobs, most poor people work long hours but they cannot bring their families out of poverty; it is also about adequate salary and working conditions. Therefore:

- Stop the imposition of labour flexibilization policies and enforce national/ international labour standards.
- Cut down on temporary unemployment and end discrimination against women and temporary workers.
- Reduce informal employment without social benefits.
- Support collective bargaining and other means to increase minimum wages in the public and private sectors.

4. To ensure equity and real economy growth in the financial sector, the following actions should be taken:

- Reform the financial sector to serve the needs of the real economy and mitigate risks, making it smaller, simpler, more transparent and accountable.

- Regulate the financial sector, discouraging speculative activity and adequately taxing it.
- Reform bankers' remuneration systems to link them to long-term performance rather than short-term results.
- Regulate the unhealthy power and influence that the financial sector has over regulators and politicians.

5. In terms of fiscal space and taxation for equality, the following actions should be taken:

- Increase taxes on corporations, including financial institutions.
- Ensure that taxes on extraction provide fair compensation for citizens in countries with natural resources.
- Increase taxes on the very rich, whose incomes have soared in recent years.

6. Continue with revisions to military expenditures, financial sector bailouts, and other areas.

7. To reduce inequality, redistributive policies as follows must appear on national development agendas.

- Provide free, universal, accessible, quality, public social services. Targeting to the poor is insufficient, policy-makers should look at universal provision to also support the middle classes (which are often shrinking).
- Extend coverage of social security, strengthening public pension systems including expansion of social protection floors. The trend to privatize pensions and reform benefits should be reversed; social protection should be scaled up during times of crisis. Social security systems act as automatic social and economic stabilizers, help stimulate aggregate demand in times of crisis and beyond, and support a transition to a more sustainable economy.
- Expand public housing.
- Donor countries should deliver on their development aid commitments.

8. Encourage national and international institutions as well as civil society groups related to food security and rural development to:

- Ensure food security for all
- Implement measures for equitable agricultural production, including a) access to land (through land redistribution when necessary); b) public support to farm inputs, such as fertilizers and seeds; c) rural infrastructure; and d) agriculture extension services.

9. Some countries still face significant inequalities in terms of caste, ethnic or religious origin, among others. New effective programs should be enacted to ensure inclusion of marginalized groups.

10. Social dialogue is critical to reach optimal solutions in macroeconomic policy, public and private investment, the need for productivity, job and income security. In the current context of austerity, when public budgets for people's development are contracting, it is essential that decision-making is done with the participation of civil society, and different policy options discussed in an open and transparent manner. The G20 should support trade unions and national civil society groups is essential to reducing inequality.

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PART II.

TRENDS IN INEQUALITY AND NATIONAL POLICIES FOR INCLUSIVE GROWTH IN G20 MEMBERS: COUNTRY PAPERS

Australia

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Introduction

This note surveys the trends in inequality in Australia over the past several decades and discusses the complex interaction of factors behind these trends. As in many countries, there is a marked skewing of income and wealth in Australia. Further, the top 20 per cent of the population has increased its share of both over the past four decades, although this upward trend has included periods of falling inequality. A range of factors has contributed to this. Government policies and domestic social trends appear to have had the greatest impact, but external factors – for example the global financial crisis and the stimulus to the Australian economy from increasing global integration – have had some influence. Despite a trend of generally increasing inequality, however, by international standards, Australia has been considerably more successful than many countries in directing assistance to the most needy.

1. What are the inequality trends in Australia?

Australia has a quite well developed data base for research into inequality. Most studies of poverty and inequality use data collected by two Australian Bureau of Statistics (ABS) surveys – the Household Expenditure Survey (HES), and the Survey of Income and Housing (SIH). The HES was run seven times between 1974-75 and 2003-04, and is now run every six years. The SIH has been run annually for most years between 1994-95 and 2003-04, and biennially since then. Between them, the two surveys provide a reasonably comprehensive picture of the income and expenditure of Australian individuals and households, plus some information on wealth, although changes to survey design, sampling procedures and questionnaires have meant that more recent data is not always comparable with earlier findings (Doiron, 2011). Researchers in Australia studying trends in inequality have consequently tended to focus on relatively short time periods.

A snapshot of income (Australian Bureau of Statistics, 2010) and wealth (Australian Bureau of Statistics, 2012) distribution in Australia as at 2009-10, adjusted for household size and composition shows:

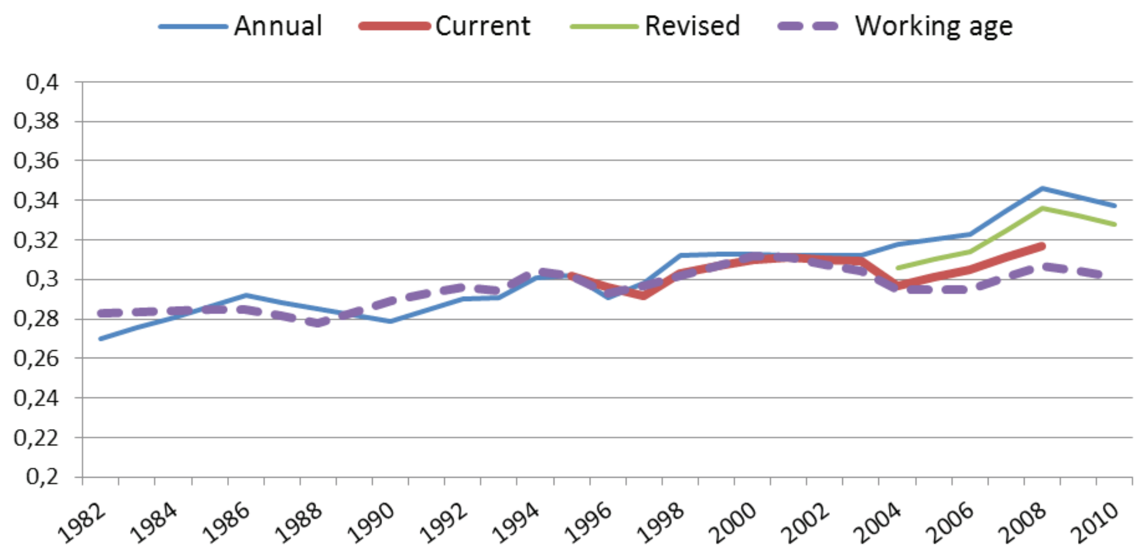
- The Gini coefficient for Australia was 0.328 (The Gini coefficient (or index) averages the shares of income across the entire population).
- People in households in the top quintile of household incomes received 40.2 per cent of disposable income, while the second and third lowest quintiles combined received 10.1 per cent.
- For most (over 80 per cent) of middle and high income households, wages and salaries were the main source of income, while for more than 60 per cent of households in the second and third lowest income quintiles, government pensions and allowances were the main source of income.
- Wealth ownership was highly concentrated in the top 20 per cent of households. The average net worth (assets less liabilities) of the top quintile was AUD2.2 million per household, compared to AUD32,000 for the bottom quintile.
- The highest net worth quintile of households held 62 per cent of total net worth, while the lowest three quintiles combined held 18 per cent.
- In Australia, high net worth households were much more likely to own their homes outright (62 per cent); in the lowest net worth quintile, 91 per cent of households were renters.

The chart below takes a longer view of income inequality in Australia. When looking at trends in the Gini index, it is important to keep in mind that even small changes in the measure imply large transfers of incomes.[6] More gener-

[6] For example, consider an increase in the Gini of 0.035. This is equivalent to a transfer of 7 per cent of the overall average income from persons below the median to persons above the median. Since

ally, indices of inequality such as the Gini look only at inequality (or the shape of the distribution) and do not take into account levels of income. So if all incomes in the population in question were doubled, the Gini would not change (even if individuals perceived they were better off) (Doiron, 2011).

Figure 1. Trends in income inequality in Australia, 1981-82 – 2009-10 (Gini coefficient)



Source: (Whiteford, 2012)

Looking at the changes in income inequality over the past three decades in Australia, several trends are apparent. As one researcher has noted, 'trends in inequality differ by time period, income components and income measures. Thus, there is no single trend but the complex interaction of multiple influences' (Whiteford, 2012). Adding to this complexity, individual and household disposable income is influenced by a range of factors. Income consists of labour income (from wages and salaries and self-employment), capital and other income (from investment and property), and transfer payments from government (pensions and other social security benefits). Disposable income is estimated after deducting direct taxes. Changes in any of these can influence measures of inequality. And some important policy changes are not captured in dispos-

those below the median typically have incomes substantially below the average, this means a reduction of more than 7 per cent in their incomes while for those above the median, it typically translates into an increase of less than 7 per cent.

able income measures (for example, Medicare, the extension of superannuation, and the Goods and Services Tax) (Whiteford, 2012).

However, there is support for the view that broadly, inequality in Australia has been rising over the longer term. Mohammed O'Haque, using HES data from 1974-1999, found that 'various indicators used to measure income inequality elasticity illustrate that income inequality increased in Australia during the period.' For example, in 1975-76, the bottom 10 per cent of the population shared 3.80 per cent of the income, but by 1998/99, this had fallen to 2.74 per cent. The corresponding figures for the top decile were 21.01 per cent and 22.53 per cent respectively. The gap between the top and bottom deciles therefore increased from 17.21 percentage points in 1975-76 to 19.79 percentage points in 1998-99, indicating that the poorest people had become poorer and the richest people richer despite periods of strong economic growth in Australia (Haque, 2000).

Denise Doiron of the Academy of the Social Sciences in Australia (ASSA) has agreed with this general picture, noting also that earnings inequality started to rise in the early 1980s in many countries. This trend accelerated in the 1990s in some countries (USA and UK), while in others (Australia and Canada), acceleration did not occur until the 2000s. Further, Doiron found the increasing earnings inequality in Australia was pervasive, no matter how the data was disaggregated – by occupation, sex, age group, industry or education (Doiron, 2011). Doiron concluded that the years 1993-2003 corresponded to a period of offsetting trends, with rapidly increasing individual earnings at the top of the distribution being mitigated partly by increases in employment rates of women. Once the rate of female employment growth stabilized in 2003-2007, the increase in inequality became even more rapid, compounded by less redistribution occurring through the tax system (Doiron, 2011).

Contributing to this longer run trend of rising inequality has been changes to income shares at the top of the income distribution. To study top income earners, representative household surveys such as the SIHC are not appropriate due to under-reporting. However, a 2006 paper by Atkinson and Leigh examined trends in the share of overall income accumulating to the top 10 per cent, 1 per cent and 0.1 per cent of income earners in Australia.

Table 1. Income shares based on tax data (Doiron, 2011)

	1983-87	1988-92	1993-97	1998-2002
Top 10%	26.4%	28.5%	29.5%	31.0%
Top 1%	5.3%	6.8%	7.3%	8.6%
Top 0.1%	1.3%	2.1%	2.2%	2.7%

The table indicates that the share of income accumulating to the top end of the income distribution was growing steadily throughout the last two decades of the past century. This is consistent with OECD research showing that the richest 1 per cent of Australians saw their share of total national income almost double, from 4.8 per cent in 1980 to 8.8 per cent in 2008. Over the same period, top marginal income tax rates declined markedly (see below) (Yeates, 2012).

O'Haque and the OECD have also found evidence of rising inequality in Australia in more recent years. In a country note in 2011, the OECD found that income inequality among working-age people in Australia had been rising since 2000 and is currently above the OECD average. Widening disparities of market incomes and weakening redistribution were cited as causal factors (OECD, 2011).

Inequality in Australia may have become even greater were it not for the global financial crisis. While the impact of the crisis merits further research, ABS data for 2008-09 suggests that the crisis dampened the trend of rising inequality somewhat, mainly due to large declines in property and other investment income going to households at the top of the income distribution, and the impact of progressive household stimulus packages implemented by the Labor Government at the time (Doiron, 2011).

Finally, looking at income alone does not provide a comprehensive picture of inequality in Australia, and focusing on disposable income understates the extent that inequality has increased. The Reserve Bank of Australia (RBA) has noted that there are important differences between the distribution of *income* and the distribution of *wealth* (assets minus liabilities). Wealth in Australia is distributed less equally (is more skewed) than income overall, although this trend also weakened over the 2006-2010 period, again due at least in part to the global financial crisis (Finlay, 2012).

2. What are the causes of inequality in Australia?

Researchers studying the drivers of inequality in Australia have emphasised demographic change, labour market trends, and the impact of government policies. More recently, another issue has become increasingly important: understanding what is happening at the top end of the income or earnings distribution (Doiron, 2011).

Demographic change

The main long run demographic trends influencing income inequality in Australia are the changing age structure of the population, and changes in household structure. These in turn are caused mainly by increases in life expectancy, reductions in fertility, increases in divorce rates, and the increasing age at first marriage.

Australia's population is ageing. Over the two decades to 30 June 2012, the proportion of Australia's population aged 65 years and over increased from 11.5 per cent to 14.2 per cent, while the proportion of population aged 85 years and over more than doubled from 0.9 per cent of the population to 1.9 per cent. As the proportion of the population aged 15-64 was relatively stable, the proportion aged under 15 years conversely decreased (from 21.8 per cent to 18.8 per cent) (Australian Bureau of Statistics, 2012). The effect of these demographic changes on inequality is the net outcome of two opposite influences. A falling proportion of young people in an ageing population would be expected to reduce inequality (because younger people typically have lower incomes and less wealth). An increasing share of older individuals, however, would be expected to increase inequality, since they also typically have lower incomes, and supplement their incomes by drawing down savings and selling assets.

Societal changes have also likely contributed to rising household earnings inequality over the longer term through the interaction of a number of trends favouring smaller household sizes. A reduction in the share of two-parent households and the increasing share of lone parents and people living alone would tend to push inequality up, due to less sharing of resources within households.

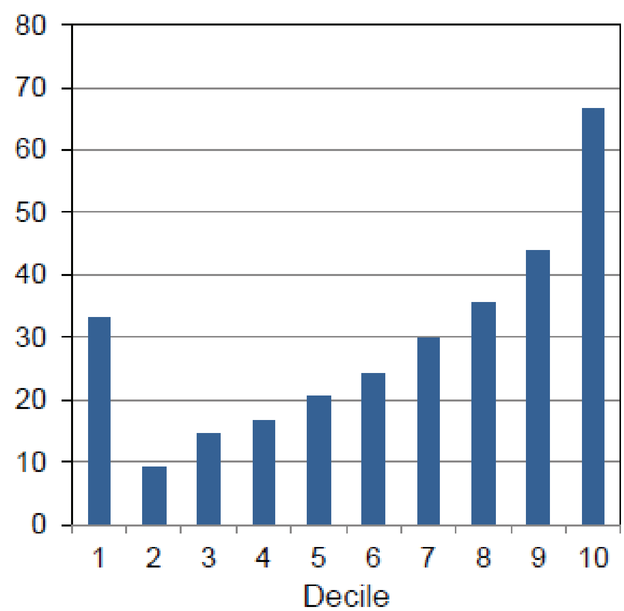
At the bottom end of the distribution, analysts have linked the declining share of total income to the increase in part-time and casual work, the expansion of which may reflect the need for more flexible working arrangements for women with children. In the beginning, higher employment rates for women are believed to have mitigated the effects of the growing gap in male incomes. By the mid-2000s, however, this had become a liability because of the increased incidence of single parenthood, a slowdown in women's entry into paid work, and the proliferation of 'working poor' families (Valenzuela, 2012).

The net effect of all these changes is an empirical matter, and is difficult to quantify; theorising does not enable us to untangle the relative importance of any one trend in isolation of others (Doiron, 2011).

Labour market trends

Labour market changes have been a key driver of inequality trends in Australia. Wage inequality in Australia has increased steadily from the early 1980s onwards; the earnings gap between the highest and lowest 10 per cent of paid full-time workers increased by a fifth between 1980 and in 2008 (OECD, 2011). From the mid-1990s to the global financial crisis, income growth in Australia was very high by historic and international standards; all income groups had large real income increases – but the rich did best (Whiteford, 2012).

Figure 2. Average weekly labour earnings by labour income decile, Percentage change, 1988-89 to 2009-10

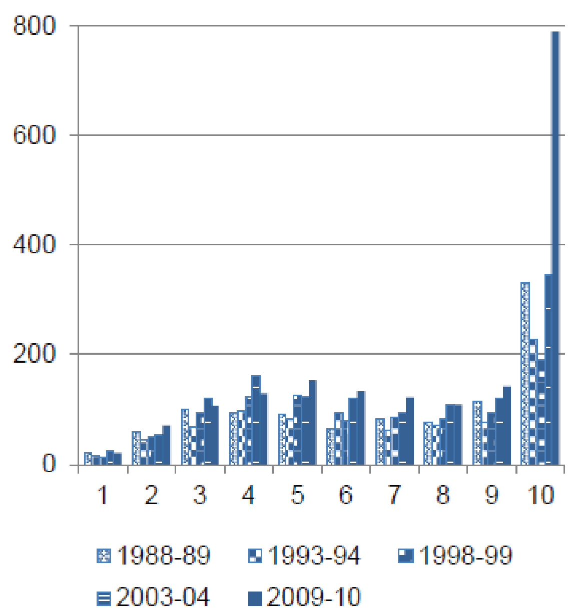


Source: (Australian Government, Productivity Commission, 2013)

The dominant explanation for this trend is the increasing demand for high-skilled, high ability workers. Behind this is the continuing expansion of skill-biased technological change (SBTC) such as computerisation of the workplace. Although most economists believe this to be the prime driver of the increased earnings inequality, it has proved difficult to quantify the effect of SBTC (Doiron, 2011). Increasing trade and globalisation has also influenced earnings inequality through increased demand for high skilled labour, and reduced demand in developed countries for low skilled labour in the tradeables industries (Doiron, 2011).

The participation of women in the workforce is also often cited as a factor contributing to trends in inequality in Australia. While male labour supply – in terms of both participation rates and hours worked – in Australia is similar to that in other OECD countries, female labour supply is lower. The difference is mainly for women with young children, and persists even after the youngest child reaches school age. This situation may in part be due to inadequate child care options – Alison Preston and colleagues have argued that the poorly developed childcare services and parental leave provisions are important in explaining differences in female labour supply between Australia and Canada (Doiron, 2011).

Figure 3. Distribution of household capital and other income. Proportion of households, mean income by gross income decile, 1988-89 to 2009-10



Source: (Australian Government, Productivity Commission, 2013)

Capital income

Capital and other income – predominantly income from interest, rent, dividends, and royalties (including income from superannuation) over the past decade has both grown rapidly, and been extremely unevenly distributed. Most households earn little or no capital and other income – 65 per cent of all households in 2009-10 earned AUD50 or less per week. But for households in the top gross income decile in 2009-10, capital and other income, at nearly AUD800 per week was more than double the inflation adjusted level of 2003-04. In 2009-10, the Gini coefficient for capital and other income was 0.980.

Government policies

A detailed assessment of the impacts of the range of specific government policies on income inequality is beyond the scope of this section. Here we focus mainly on the Australian income tax system. We do this because

- Together with direct and indirect transfers, income tax is a major mechanism of income redistribution and changes in income distribution. Income tax raised around 43 per cent of total Australian government revenue in 2012; spending on social security and welfare benefits (direct cash payments and some indirect transfers such as education) accounted for approximately 35 per cent of revenue over the same period.
- There have been major changes to the Australian income tax rates over the past ten years. For example, the top marginal tax rate in 1999-2000 was 47 per cent for each dollar over AUD 50,000 per annum. By 2008-09, this had been reduced to 45 per cent on each dollar over AUD 180,000 per annum. Over the same period, the tax-free threshold – the level of income below which no tax is paid – increased from AUD 5,400 in 1999-2000 to AUD 18,200 in 2012-13.
- While family payments have been an increasingly important source of redistribution for more than half a century, the biggest increases (as a share of GDP) were during the 1990s (Whiteford et al., 2011).

We also briefly consider the superannuation system, as the introduction of compulsory retirement savings in the early 1990s and subsequent increases in compulsory contributions was an important structural reform geared at increasing the retirement incomes of low income earners (Gruen, 2011). By 2009-10, total superannuation, of which compulsory superannuation was a growing share, accounted for 16 per cent of average household net wealth.

Peter Whiteford has found that the effectiveness of the tax system in reducing inequality was stable in the 1980s and early 1990s, but declined after 1996. Trends also differed significantly by time period. In the early 1980s and again in the early 1990s, median income growth was very slow and there was a hollowing out of the middle class, with gains being highest at the top and bottom of the income distribution. Much of the increase in inequality was offset by taxes and transfers – and to an even greater extent if non-cash benefits[7] and indirect taxes[8] are taken into account. Between the mid-1990s and the global financial crisis, however, taxes and transfers reduced inequality less effectively than in the early 1990s benefit (Whiteford, 2012).

Denise Doiron examined the changing redistributive power of the tax system by using the ratio of the Gini coefficient for pre-tax incomes to the Gini coefficient for post-tax incomes as a proxy measure of progressivity in the tax system. She found that between 1993-94 and 2006-07, the amount of redistribution achieved by taxation fell by around 19 percent (Doiron, 2011). Doiron noted a reduction in the top marginal tax rates following tax reform in 2000,[9] and increases in earnings where no further increases in marginal tax rates occur (i.e. at the top of the income distribution).

So the evidence suggests that, over the long run, redistribution through the tax system has declined. Both progressivity and average tax rates have declined,

[7] Non-cash benefits include access to healthcare, education and community services

[8] Indirect taxes include taxes not levied directly on income. Examples of Indirect taxes in Australia include a Goods and Services Tax (10% levied on most goods and services but excluding fresh unprocessed foods, excises on tobacco and alcohol, customs duties and property taxes.

[9] The major elements of this reform included: the introduction of the Goods and Services Tax (GST); an associated one-off payment of a savings bonus for older Australians to compensate for the impact of GST on savings; establishing Australian Business Numbers (ABNs) which allow for single entry point arrangements for dealing with Federal, State and local government bodies; the replacement of five payment and reporting systems for withholding tax arrangements with one ‘Pay As You Go’ system, streamlining administrative costs for small businesses; and registering charities and non-profit organisations such that charitable donations are now tax deductable.

with average tax rates falling the most for the highest decile in income distribution. According to the latest data, taxes and benefits currently reduce inequality by 23 per cent, which is about OECD average (Karvelas, 2012).

As well as the tax and transfer system, Australia governments have also influenced the pattern of inequality through compulsory superannuation (Keegan et al., 2010). Under the Superannuation Guarantee (SG) scheme, which came into effect in 1993, employers placed an amount equal to 3 per cent into a superannuation account for use in retirement. The employer contribution was gradually increased to 9 per cent in 2002. Compulsory superannuation was designed to increase retirement incomes and reduce the fiscal impact of an ageing population, but studies have shown that the retirement income from the SG scheme is very dependent on the characteristics and experience of employees through their working life. While a long term (40 years plus) of uninterrupted full time employment with an employer contribution of 9 per cent is capable of generating a substantially higher retirement income than would have been available under the aged pension, many people will not achieve this for a variety of reasons.

- Women often have less superannuation than men because of lower average wages and breaks in employment to raise children.
- Couples typically have more superannuation than singles, and couples and singles without children have more superannuation than couples with children and single parents.
- Education levels or a disability, and particularly a combination of any of these factors that affects lifetime earning ability can significantly reduce superannuation income available at retirement. So, for example, modeling has suggested that a mother with less than Year 12 education is likely to accumulate only 20 per cent of the superannuation of a baseline assuming 40 plus years in the labour force.

3. What are the consequences of inequality in Australia?

Determining specific consequences of inequality in Australia is difficult due to the complex interaction of many economic and non-economic factors. However, some key points are regularly mentioned in the literature.

At a general level, Australia is not immune from the problems of inequality identified by Nobel Laureate Joseph Stiglitz: that inequality is self-reinforcing over time and space, and that many of the distortions that lead to inequality (such as those associated with monopoly, power and preferential tax treatment for special interests) undermine the efficiency of the economy. This new inequality then goes on to create new distortions, further undermining efficiency, and so on. Stiglitz cites the example of young people who, seeing the astronomical earnings generated in the financial sector, have pursued careers in finance rather than entering fields which, he argues, would lead to a more productive and healthy economy in the long term. He also refers to the ability of mining interests in Australia to successfully overturn proposed legislation to tax superprofits in that industry, which would have had a redistributive effect (Valenzuela, 2012).

More specifically in Australia, a consequence of inequality is its impact on particular groups. The Australian Council of Social Services (ACOSS) Poverty Report 2012 (ACOSS, 2012) highlighted the segments of Australian society that are most at risk of living in poverty, including:

- Unemployed people.
- Single people over 65 years of age.
- People in households mainly reliant on social security.
- Single parent families.
- Single people working age without children.

Unemployment For Australian households, earnings from work represent around three quarters of total pre-tax income (Whiteford, 2012). But in the bottom quintile, employment income makes up only one third of household income (compared to an OECD average of two thirds), meaning joblessness greatly increases the risk of households falling to the bottom of the income distribution (OECD, 2011).

Gender Women face a significantly higher risk of poverty than men, reflecting women's more restricted employment opportunities, often lower wages, the greater likelihood that they are engaged in unpaid caring roles, and their lower investment incomes in retirement.

Singles Single people with and without children generally face a higher risk of poverty than couples, reflecting in part the economies of scale available to people living with partners.

Language Adults born in countries where English is not the main language spoken also face a much higher risk of poverty, reflecting the difficulties that migrants from non-English speaking countries face in securing well-paid employment (including language barriers, limited skills that are recognised in Australia, and discrimination).

ACOSS' comparison of data from SIH surveys undertaken by the ABS indicate that the risk of poverty in Australia rose between 2003 and 2010, broadly indicating that as inequality rises, so too does the risk that the people at the bottom of the income distribution will fall below nationally-specific poverty lines (ACOSS, 2012).

4. Is inequality a government priority? How is it addressed? Are the approaches effective?

In this section we provide a brief discussion of developments in the Australian taxation system – one of the principle mechanisms for governments to reduce inequality.

In recognition of the need to reform the Australian taxation system over the medium term, the Labor Government in 2008 commissioned the 'Australia's Future Tax System Review' (the Henry Tax Review). Its findings were published in 2010. Around that time, academics and commentators provided views on features of the current Australian taxation and welfare system which exacerbated inequality, including:

- Income tax liabilities for most high-income individuals have fallen substantially since 1990. People on low incomes and those with children have benefited from increases in the Low Income Tax Offset (Australian Government. Australian Taxation Office, 2012) and Family Tax Benefits (Australian Government Department of Human Services, 2013b) respectively. But for full-time workers on low or modest wages without dependent children, tax cuts have been much less (Tax Watch, 2010). Specific concessions such as these exacerbate ‘horizontal’ inequity – inequity between individuals with similar income levels but in different social circumstances.

• Effective marginal tax rates under the Australian system take on an inverted U shape: low at very low levels of income, rising to their highest point towards the middle of the distribution, and then falling towards the top. The structure of the system is such that second earners in a family, typically women, can be faced with high tax barriers when seeking to enter paid employment.

• The level of support for unemployed people (the Newstart payment) was (and is) low compared to support for pensioners (Australian Government Department of Human Services, 2013c). This problem is particularly acute for unemployed people who have no children, and who are thus exempt from other family tax benefits (Social Security Note, 2013). Newstart is also means-tested, with benefits being reduced starting from a very low level of wage income. This system is not well-suited to labour markets where work opportunities fluctuate and work is intermittent.

• Aged pension rates are also low, and single people in rental accommodation are disadvantaged. By contrast, the Australian Government allocates significant expenditure to better-off retirees through extending eligibility for concessions cards to non-pensioners and providing tax cuts through the Senior Australians Tax Offset (Australian Government. Australian Taxation Office, 2011).

• As discussed ABOVE, Compulsory superannuation in Australia is designed to promote savings for retirement, but the current system is skewed towards the rich, and the tax system overall provides inadequate support for saving towards mid-life needs as opposed to later life (Stebbing, 2010). As well as:

  ◦ Tax concessions for superannuation provide substantially greater benefits for men, because women earn less and tend to have broken work histories (Ingles, 2010).

  ◦ Current concessions are highly regressive in that they provide little or no benefit to low income-earners and very high benefits to high income earners. While income is taxed at progressive rates, superannuation income is taxed at a flat rate of 15 per cent, providing an incentive for high income earners to salary sacrifice large proportions of their income. The top 5 per cent of individuals consequently account for 37 per cent of concessional contributions.

◦ Superannuation tax concessions are sustained at a considerable and growing cost to the Australian Government, and they are predicted to become the largest category of tax expenditure, above (the more redistributive) Medicare and Family Tax Benefits.

Overall, though, while the Henry Tax Review found that the Australian tax and transfer system is too complex and requires substantial reform in order to reduce the number of income tax rates, it did not propose to alter the basic architecture of the system. Moreover, the recommendations of the Henry Review were underpinned by the view that different taxes have different behavior effects on tax payers, and that tax measures that have a damaging effect on investment and economic growth in the short term should be avoided. Generally, therefore, the Henry Review suggested that higher taxes should be imposed on activities that are less susceptible to change or relocation, rather than focusing on reforms that would reduce inequity in Australian society (Boccabello, 2012).

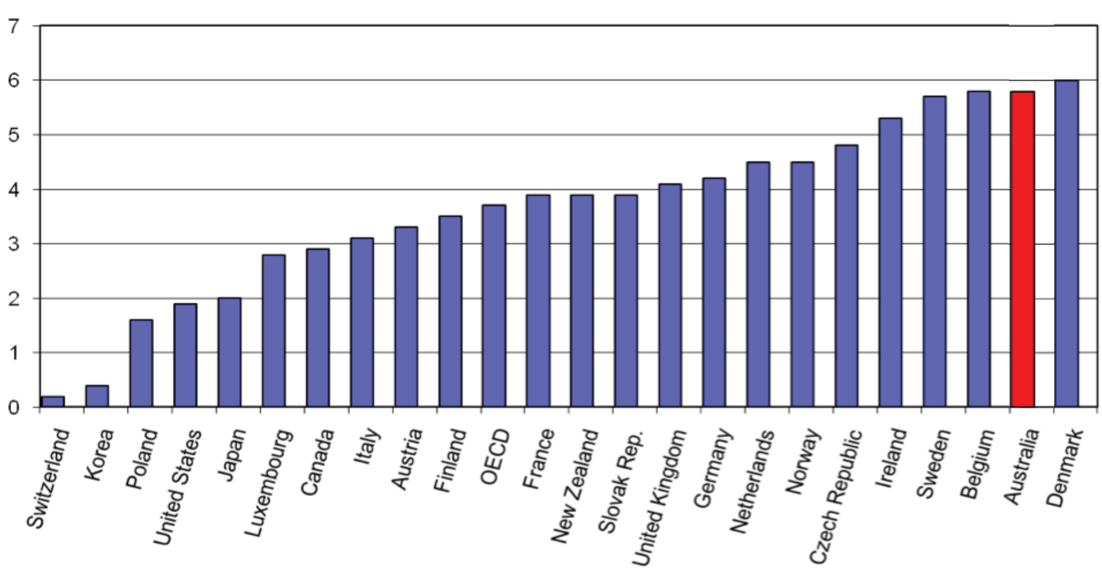
The findings of the Review have not been fully implemented. Commentators note that comprehensive tax reform requires considerable investment of time and political capital, especially when benefits are likely to be reaped over the longer term. The current fiscal situation in Australia provides limited options to introduce tax reform that involves a net revenue cost (exacerbated by a political climate that emphasises the importance of returning the national budget to surplus), and revenue neutral reforms will involve some losers – at least in the short run. In the context of an election year in 2013, this makes the pursuit of comprehensive reform unlikely.

Finally, consideration of the effectiveness of responses to inequality in Australia should also consider how Australia compares with other developed countries. And in this area, Peter Whiteford and others have argued that Australia's approaches to inequality, poverty, and income distribution have been both relatively effective and efficient (Whiteford, 2011c). Australia's redistribution occurs within a relatively low tax framework. OECD data for 2008 estimated

Australian taxes to be about 27 per cent of GDP compared to an OECD average of 35 per cent, placing Australia sixth lowest among OECD countries. Australia also spends less on cash benefits – 16 per cent of GDP compared to an OECD average of 19 per cent. Australia has reconciled a (relatively) low tax/low spending approach to poverty reduction and income redistribution by emphasising means testing of payments to ensure they are targeted at the most needy. Using OECD data for 2005, the latest data available for these comparisons, the poorest 20 per cent of the Australian population received almost 42 per cent of total social security spending, while the richest 20 per cent received only around 3 per cent. As Whiteford has noted 'As a result, the poorest fifth receives twelve times as much in social benefits as the richest fifth, while in the United States the poorest get about one and a half times as much as the richest'.

Looking at the interaction of the tax and welfare systems shows that the Australia welfare system is also relatively progressive in net terms i.e. taking into account both the level of benefits going to the poorest 20 per cent, and the amount of tax paid by people in that group.

Figure 4. Net redistribution to the poor, 2005
(percentage of household disposable income)



Source: (Whiteford, 2011b)

Since 2005 there has been a significant further change to the Australian income tax system resulting from the introduction of a carbon tax (Whiteford, 2011c). The major change has been to increase the tax free threshold – the level of income below which no tax is paid – from AUD6,000 to eventually AUD19,400. Coupled with the other changes to rates in the income tax schedule, the net effect of this change has been to provide an income tax cut to single people with incomes below AUD80,000 a year, and no real change in taxation for people above this amount. Further, pensions and other selected social security payments have been increased to assist people in the social welfare system who frequently do not pay income tax and consequently do not benefit from the tax rate changes. The net effect of all the changes announced means that low income earners will do relatively better. So overall, the net redistribution to the poor has likely increased from the level at 2005.

Conclusion

The past decade has seen a complex set of forces that have worked to influence income inequality in Australia. The direction of these forces has varied. Working against greater inequality.

- At the broad macroeconomic level, strong economic growth driven by overseas demand for Australian commodities has also had the positive effect of underpinning low levels of unemployment and reducing the impact on Australia of the global financial crisis.
- The move to a national superannuation scheme has begun to contribute to higher retirement incomes.
- Australia's system of transfer payment are low cost and very targeted by world standards.
- As well, Australia's labour income inequality is relatively low by OECD standards.

However, there have been some powerful forces working to increase inequality.

- The strong export led growth enjoyed by Australia has favoured particular industries, regions, and skills which has tended to exacerbate income and wealth inequality.

- Changing work patterns, particularly increasing part-time and casual work, and less favourable treatment of women in some circumstances have disadvantaged some groups of employees.
- While compulsory superannuation has added to retirement incomes, the design of the system (particularly the preferential tax treatment of superannuation) has favoured higher income earners.
- Major changes to the mix of taxation types, tax rates, and access to cash and non-cash benefits have influenced income inequality, at times in offsetting directions.

On balance, over the past three decades, and particularly through the first decade of this century, it has been the forces increasing inequality that have dominated, leaving Australia on the broad measure of household disposable income inequality at the higher end of OECD countries.

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Canada

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Trends and Levels of Inequality in Canada

Income inequality in Canada has risen in recent decades to a level where Canada's Gini coefficient is once again just above the average of the members of the Organisation for Economic Co-operation and Development (OECD) (see Annex 1). Even though there is less inequality in Canada than in the neighboring United States, Canada's inequality is increasing at a faster rate (House of Commons Debate 2012). Inequality within Canada is increasing among individuals, within individual regions of the country, within cities, and between aboriginal and non-aboriginal Canadians.

In the 1980s, Canada reduced inequality and in 1989 had achieved its lowest Gini coefficient of 0.281. In the 1990s, however, inequality rose, surpassed the

OECD average in 1995. It has remained around 0.32, above the OECD average for the duration of the 2000s (Conference Board of Canada, 2013a). Canada's ranking on the Human Development Index (HDI) produced by the United Nations Development Programme (UNDP) has also recently decreased. Canada is ranked 11th in the 2012 HDI but drops to 16th place when the index is adjusted for inequality (UNDP, 2012). Canada does better than the United States on social mobility. In Canada, 19% of a family's disadvantage is passed on to its children, while that figure is 47% in the U.S. and 50% in the United Kingdom (Conference Board of Canada, 2013b). The Fraser Institute study reported that “Canadians are not permanently stuck in fixed income groups. Over the course of their lives, the overwhelming majority of Canadians move up and down the income ladder” (Lammam et al., 2012).

Inequality among the Canadian People

These overall increases in income inequality in Canada can be seen by looking at the distribution of income flowing from economic growth. During the fastest growing decade, from 1997 to 2007, Canada's richest 1% of people – those with an average annual income of USD 404,000 – took almost a third (32%) of all the growth in incomes (Yalnizyan, 2010). This is a reversal of long-term trends as inequality had decreased during the post-war years. From the beginning of the Second World War to 1977, the income share of the richest 1% of Canadians was almost halved, from 14% to 7.7%, as the gains from growth led to more people working and to better-paid jobs. By 2007, however, inequality was back at pre–World War Two rates, as the richest 1% held 13.8% of incomes in Canada (Yalnizyan, 2010).

In 2011 Canada's average gross domestic product (GDP) per capita was USD 40,450 (OECD, 2013). However, in December 2012 the United Nations Report of the Special Rapporteur on the Right to Food concluded that a growing number of Canadians remained unable to meet their basic food needs. In 2007–08, 7.7% of Canadian households reported moderate or severe food insecurity (De Schutter, 2012). Moreover, the Conference Board of Canada (2013b) reported that the child poverty rate increased from 12.8% in the mid 1990s to 15.1% and that working-age poverty rose from 9.4% in the late 1990s to 11.1%.

Inequality within Canada's Regions

Within the various regions of the country, the Canadian economy is divided by access to resources (House of Commons Debate, 2012). Yet since the 1980s no province has become more equal and all have become more unequal in varying degrees. Alberta, a resource-rich province, is the most unequal. The richest 1% of Albertans are 18 times wealthier than the bottom 90% of those in the province and have had the largest pay increase since 1982. Over the last 30 years since 1982, the income of the top 1% of Albertans has doubled, on average making USD 320,000 more today. In contrast, the income of the bottom 90% of Albertans has increased by USD 3,900 in the same period. In British Colombia, another affluent province, the bottom 90% make less than they did in 1982. The most equal province is Prince Edward Island, where "the ratio of income between the top 1% to the bottom 90% is 8 times" (Canadian Centre for Policy Alternatives, 2013). As a whole, the Atlantic Provinces growth in incomes is more equal between the top 1% and the rest.

Inequality within Canadian Cities

In Vancouver, Toronto, and Montreal – Canada's three largest cities – inequality is also increasing. Together, the bottom 90% in these three cities make less today than in 1982. Their incomes dropped by USD 4,300, USD 1,900 and USD 224 respectively. However, the top 1% in those cities have had pay increases of USD 189,000, USD 297,000 and USD 162,000 respectively (Centre for Policy Alternatives, 2013). In the most unequal province of Alberta, the major city of Calgary is also the most unequal. Since 1982, the top 1% had an increase of USD 570,000 in income compared to USD 2,000 for the bottom 90%. These data indicate that not only is income inequality extreme in major Canadian cities but also that in some places incomes are decreasing for the lowest earners (Canadian Centre for Policy Alternatives, 2012). A study in Hamilton, Ontario, linked income inequality in Hamilton neighbourhoods and health. It found a 21-year difference in life expectancy between those living in the richest neighbourhoods and those living in the poorest. When compared to the world life expectancy rates, the poorest neighbourhood in Hamilton would rank 165th (House of Commons Debate, 2012).

Inequality between Aboriginal and Non-aboriginal Canadians

Overall, aboriginal people living in Canada both on and off reserves are less likely than other Canadians to be employed. For those who are employed, annual earnings are considerably lower (Reading and Wien 2009). The data in 2006 indicate that for every dollar the rest of Canadians earned, aboriginal Canadians earned only 70 cents (Wilson & Macdonald, 2010; Broadbent Institute, 2012). In 2011, the unemployment rate was 5.6% higher for aboriginal Canadians than for other Canadians (Centre for Study of Living Standards, 2012). Life expectancy is also lower for aboriginal Canadians: in 2000, life expectancy at birth was estimated at 68.9 years for males and 76.6 for females, a difference of 8.1 years and 5.5 years from the rest of Canadians respectively.

Food insecurity is also higher among aboriginal communities. In 2007–08, 17.8% of First Nations adults aged 25–39 and 16.1% of First Nations adults aged 40–54 reported being hungry but did not eat due to lack of money for food (De Schutter, 2012). The UN Special Rapporteur reported that he was disconcerted by the deep and severe food insecurity faced by aboriginal peoples living both on and off reserve in remote and urban areas (Reading & Wien, 2009).

The Consequences of Inequality for Financial Stability and Economic Growth

Growing inequality in Canada has been constrained by a resulting increase in borrowing as Canadians increase personal debt to maintain standards of living because of declining employment income and prospects. On average Canadians owe more than USD 1.50 for every dollar of annual income, creating what has been termed debt-financed consumption (House of Commons Debate, 2012). Increasing household debt has become a concern for financial stability and economic growth. Indeed, the Bank of Canada, Canada's central bank, has identified record levels of household debt as the biggest risk to the economy. It is projected that as the degree and interest rates of borrowing increase, the problems of growing income inequality and the struggles of the middle class will become critical (House of Commons Debate, 2012).

The Causes of Growing Inequality in Canada

As the OECD (2011) reports: "The rise in inequality was largely due to widening disparities in labour earnings between high and low paid workers, but also to less redistribution. Taxes and benefits reduce inequality less in Canada than in most OECD countries".

More specifically, the key cause is the divide in hours worked, with high-income earners working more and low-income earners working less. A second cause, responsible for 25% of the increased income inequality, is the rise in self-employment, as the self-employed earn less than full-time workers. A third cause is changes in redistribution through taxes and benefits, which offset more than 70% of market income inequality before the mid 1990s but only 40% afterward. Here the key changes have been falling benefit rates and more targeted transfers, while changes in income tax rates have had less effect. Social changes have little net impact, as the rise in single-parent families, people living alone and people marrying within similar earning classes has been offset by higher employment rates for women. Technological changes have caused wages to increase for individuals with post-secondary education, but for less skilled labour, wages have not increased and demand has decreased (Sarlo, 2009).

Some Canadians, however, focus on social spending and tax cuts (Broadbent Institute, 2012). They argue that the increase in after-tax inequality started in the early 1990s along with the social spending cuts introduced to deal with an increasing public debt created by two recessions and high unemployment. At that time, the federal government cut the unemployment insurance benefits and provincial transfers, which helped pay for social assistance, childcare and other anti-poverty programs. Tax cuts were later introduced. It has been calculated that the tax rate for the top 1% of income earners decreased by 4%, while the bottom 10% experienced a tax increase. Another benefit for the wealthy is that income from investments, especially capital gains, is taxed at a much lower rate than the wages of ordinary workers (Broadbent Institute, 2012). The total tax revenue in Canada has fallen from 36% to 31% of GDP since the mid 1990s. This has been matched by an equivalent decline in spending on social programs as a share of GDP. The shift in Canada has been one of the largest by far in the OECD (Broadbent Institute, 2012).

A study by the Conference Board of Canada (2012a) estimates that the Canadian tax system and transfers to the poor help to lower income inequality by 27%, as the Gini coefficient falls from 0.441 to 0.324 after tax and transfers are made. Without government benefits and taxes, poverty rates would be 23%, compared to the current 12%.

Policy Recommendations

The Canadian government is now facilitating a multistakeholder dialogue on the state of inequality. The House of Commons Standing Committee on Finance announced that it will begin a study on income inequality in Canada in April 2013. The study will review Canada's federal and provincial/territorial systems of personal income taxation and income supports, examine best practices to reduce income inequality and improve per capita gross domestic product, identify any significant gaps in the federal system of taxation and income support that contribute to income inequality, identify any significant disincentives to paid work in the formal economy that may exist as part of a "welfare trap" and provide recommendations on how best to improve equality of opportunity and prosperity for all Canadians (Parliament of Canada, 2013). The study will be based on four meetings held from April to June and conclude with a final report.

At present, the recommendations about how to reduce income inequality in Canada are best based on a consideration of those offered by the OECD (2011) in its "Country Note on Canada". These are as follows:

1. Employment. Create more and better jobs that offer good career prospects and a change to escape poverty.

2. Education. Invest in human capital from early childhood through to compulsory education in the years beyond.

3. Transfers. Reform tax and benefit policies to directly help low-income groups who are hard hit by recessions.

4. Taxation. Increase taxes on the rich, whose incomes have risen a great deal.

5. Social services. Provide free, accessible, quality, public social services for education, health and family care.

Annex 1. Gini Coefficient: Canada versus OECD Average

Country	mid 1980s	mid 1990s	mid 2000s	Late 2000s
Canada	0.29	0.29	0.32	0.32
OECD Average	0.28	0.30	0.31	0.31

Source: OECD Statistics, http://stats.oecd.org/Index.aspx?DataSetCode=INEQUALITY

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China

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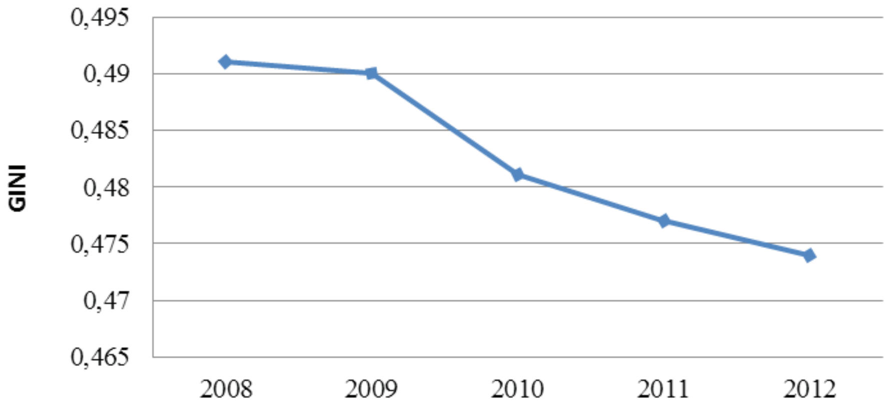
1. Trends and Causes of Income Inequality in China

From 2008 to 2012, the income of urban and rural residents increased continually. According to the Chinese government work report, over the past five years, the per capita disposable income of urban residents has increased by an annual average of 8.8%, the per capita net income of rural residents has increased by an annual average of 9.9%. Although income has increased, the income gap in China is still severe.

Data from National Bureau of Statistics show that in recent years, the Gini coefficient in China has indeed been gradually decreasing, which is a positive phenomenon. However, we should recognise that the Gini coefficient between 0.47 to 0.49 is not a low level, it actually exceeds the level of 0.4, internationally recognized as warning for social stability. As shown in Figure 1, from 2008 to 2012, the Gini coefficient was decreasing, however, the magnitude of the trend is very small. These data actually demonstrate that the work which aims to tighten the inequality of social income still has a long way to go.

Figure 1. Gini Coefficient Trends in China, 2008-2012



Source: (National Bureau of Statistics of China, 2013)

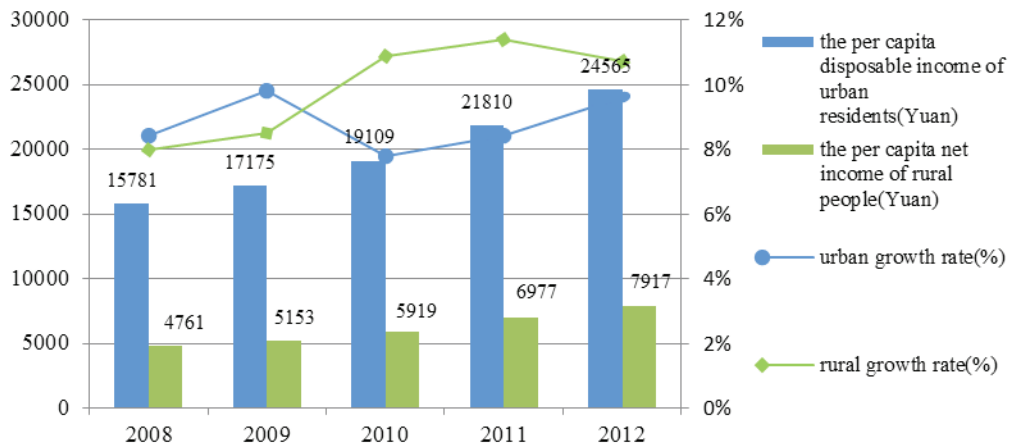
1.1 The urban-rural income gap widening

1.1.1 Current situation and trends of the urban-rural income gap

Since the reform and opening up, accompanied by a rapid economic growth, the disposable income of urban residents of China and the per capita net income of rural residents of China have increased significantly. The per capita disposable income of urban residents increased about 71 times from 343 yuan (92 USD) in 1987 to 24,565 yuan (3892 USD) in 2012; per capita net income of rural residents increased about 59 times from 134 yuan (36 USD) in 1987 to 7,917 yuan (1254 USD) in 2012. Figure 2 shows that from 2008 to 2012, in general, the income growth rates of urban and rural residents increased in various degrees, but the per capita disposable income of urban residents is still significantly higher than that of rural residents. Therefore, we can conclude that the income gap is still wide.

As for the absolute income gap between the urban and rural residents, it was less than 210 yuan in 1978, but in 2012, the gap had widened to 16,648 yuan. The relative income gap shows a significant volatility. In addition, due to the Chinese long-standing tendency of preferential policies for cities, the urban residents have been receiving more subsidies from the government on housing, medical care, social security, education etc. If we take these subsidies into account, the income of urban residents is probably 5-6 times higher than that of rural residents (Suxia & Tongming, 2012).

Figure 2. Rural and Urban Residents per Capita Income and its Actual Growth Rate, 2008-2012



Source: (National Bureau of Statistics of China, 2012)

1.1.2 Causes of the urban-rural income gap

(1) Development factors

First of all, we would like to argue that the income gap between urban and rural areas is related to the difference among industries. Currently, although rural China has developed a variety of industries, agriculture is still the dominant in rural economic structure. This is an essential difference compared with cities. The productivity of labor differs significantly between agricultural sector and industrial sector.

(2) The urban-rural dual system and the policy factors

In the process of urbanization and industrialization, the migration of surplus rural labors to cities and non-agricultural industries has been hampered by the urban-rural dual system. The financial support policy for agriculture is not enough to fully exploit the agricultural potential and it also fails to improve its competitiveness. Although China has increased the agriculture related investment in recent years, the overall pattern of urban bias has not fundamentally changed.

(3) Individual differences of workers

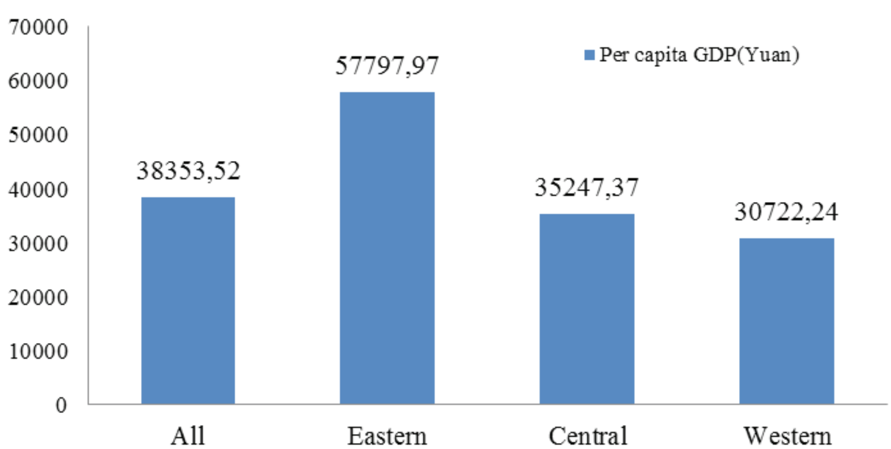
There is a big difference in the investment in human capital between urban and rural residents. The average number of years of education for urban residents is much higher than for rural residents, and comprehensive quality of human capital in rural areas is relatively low.

1.2 Regional income gap widening

1.2.1 Current situation and trends of the regional income gap

The regional income gap in general has been widening with the development of the economy since the reform and opening up. And with the deepening of structural reform, the upward trend has stepped up (Lianshui, 2009). In 2012, there were 6 provinces with GRP per capita of more than 10 thousand US dollars. The eastern region accounted for 4 of them. We can see from figure 3 that there are evident differences in GRP per capita among western, central and eastern regions. There is a significant gap between the east and the other two regions, and the gap between the central and the western regions is not prominent. The top ten provinces by GRP per capita are Shanghai, Tianjin, Beijing, Jiangsu, Zhejiang, Inner Mongolia, Guangdong, Liaoning, Shandong and Fujian. Except Inner Mongolia, all the rest are eastern regions. There are nine provinces with GRP per capita reaching more than 40,000 yuan, and all of them are in the east. The national GDP per capita is 38,353.53 yuan, so the levels of central and western regions are both lower than the national level. Of the ten provinces with the lowest GRP per capita, seven are in the western region (Guizhou, Yunnan, Gansu, Tibet, Guangxi, Sichuan, Qinghai), two in the central region (Anhui, Jiangxi), and only one is in the eastern region (Hainan). Therefore, we can see that the most affluent areas are located in the east, while the poorest areas are located in the west.

Figure 3. Per capita GRP in eastern, central and western regions of China, 2012



Source: (China Statistical Yearbook, 2012)

Table 1 compares regional income gap in 2000, 2005 and 2010 revealing that China's regional income gap has been widening since 2000. The widening process slowed down a little in 2005, and then started to expand in 2010.

Table 1. China's regional income gap, 2005-2010

Year	Indicators	Eastern region	Central region	Western region
2000	GRP per capita (USD)	1410.8	712.1	544.8
	GRP per capita ratio	1.98	1	0.77
	Absolute difference between the eastern and the other two regions (USD)		698.2	865.9
2005	GRP per capita (USD)	2844.7	1390.4	1075.7
	GRP per capita ratio	2.05	1	0.77
	Absolute difference between the eastern and the other two regions (USD)		1454.2	1769.0
2010	GRP per capita (USD)	6652.9	3828.6	3044.0
	GRP per capita ratio	1.74	1	0.8
	Absolute difference between the eastern and the other two regions (USD)		2824.3	3608.9

Source: (China Statistical Yearbook, 2010)

1.2.2 Causes of the Regional income gap

(1) Institutional factors

The reform of the income distribution patterns led to a system where distribution according to work is dominant and multiple forms of distribution coexist. At the same time, the income gap between people is widening. At the beginning of the reform and opening up, prefferential economic regimes were granted to the east coast, which resulted in the east coast attracting a lot of foreign capital. The overview of the past 10 years indicates that the gap has narrowed, but even so, the Gini coefficient is still high, and effective policies are needed to alleviate this situation.

(2) Location factors

The east coast has three major economic zones: Bohai Economic Zone, Yangtze River Delta, Pearl River Delta, and there are also many excellent ports, which facilitate the development of foreign trade. In addition, the government promulgated a lot of preferential policies for large-scale infrastructure construction. The central region and western region do not have these benefits; hence, the speed of their development is slower than in the eastern regions.

(3) Economic factors

The eastern region has more capital and talent, and the industrial proportion is higher than in other regions. Conditions are less favorable in the central region and less so in the western region.

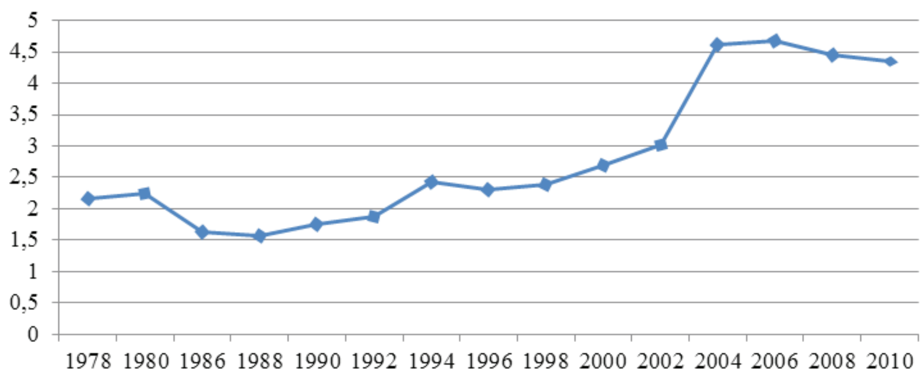
1.3 Industries and classes income gap widening

1.3.1 Current situation and trends of the industries income gap

In the planned economy period, due to the implementation of the equality doctrine, industry income gap was not obvious. With the transition to the market economy and a new distribution system, the average income level of the industry workers has substantially increased, however, its growth rates have differed. As figure 4 shows, at the beginning of the reform and opening up, the income gap was not obvious. The ratio of the highest industry average wage to the lowest one reduced from 2.17 in 1978 to 1.58 in 1988. It expanded to 1.76 in 1990 and to 2.49 in 1999. The income gap has dramatically expanded to 2.69 in 2000 and to 4.69 in 2006. After 2006, the industry income gap reduced, but the ratio was still greater than 4 (Ruixue, 2012).

Overall, income trends by industry have the following characteristics: (1) In the industry with a monopoly or with obvious monopolistic features, such as financial, air transport, and tobacco products industry, average wages are generally higher than in other industries; (2) In the high-tech industry, for example, computer services and software, average wages are generally higher; (3) In the basic industries, such as agriculture, forestry, livestock farming, fisheries, most of the manufacturing industry and mining industry, average wages are generally low; (4) Industries in the fully competitive market, such as textile, retail or catering industry, have low average wages.

Figure 4. The Ratio of the Highest Industry Average Wage of Workers to the Lowest One 1978-2010



Source: (Ruixue, 2012)

1.3.2 Income inequality between classes

Since the reform and opening up, China has broken egalitarian income distribution policy to encourage some people and some regions to get rich first. It fundamentally changed social and economic relations, and enlarged the difference between social classes. It also led to the appearance of new social classes. It changed the economic and social status of various classes, and widening income gap has become a major factor of the process. In 2011, as it is shown in the "Hurun wealth report 2011" published by the Hurun Research Institute, the number of multimillionaires with assets over 10 million yuan (1.5 million USD) reached 960,000, including 60,000 billionaires with assets over 100 million yuan (15 million USD), 4,000 people had assets in the amount of 1 billion yuan (150 million USD), while the number of millionaires with assets over 1 million yuan exceeded 10 million (Yangzi Evening, 2011). However, while the high-income class is growing, China has a large number of unemployed or underemployed population with minimum life guarantees due to age or disability.

1.3.3 Causes of the industries and classes income gap

(1) Irrational income distribution in monopoly industries

In recent years, monopoly has led to the widening of income gap in China. Most of monopolistic industries are high-income industry, with very high workers' wages growing very fast.

(2) Different levels of human resources development

Human capital reflects the quality of labour force, which rests on a combination of technology, knowledge, ability, health and other factors. Now, along with the growth of the knowledge-based economy, human capital has become an increasingly vital resource of income.

(3) Different industry labor productivity

An average wage in industries with hight labor productivity is high. Financial, communications, science and technology industries belong to this category.

1.4 Gender income gap widening

1.4.1 Current situation and trends in gender income gap

With the development of economy and society, the income of women has continued to increase. However, the income of women compared to that of men is still relatively low. According to the World Bank "Country Gender Report, China" (2002) in 1985 in the industrial and agricultural production, the remuneration of women was 80% of men's; in 1987, it rose to 88%. However, with the liberalization of the labor market, the gender income gap has been widening. In 1990, women earned only 70% of what men did (World Bank, 2002). In spite of inconsistencies in statistics and literature, the numbers basically reflect a widening trend of gender income gap since the late 1990s.

The United Nations Development Programme (UNDP) "Asia-Pacific Human Development Report: Power, Voice and Rights: A Turning Point for Gender Equality in Asia and the Pacific", pointed out that the low female employment rate in the entire Asia-Pacific region amounted to a regional loss of billions of dollars each year. However, in China nearly 70% of women had paid employment, which is far higher than the global average of 53% (UNDP, 2010). This is in line with China's long-term high speed development and industrialization process. Nevertheless, the report also highlighted that the remarkable progress in economic development has not significantly improved the situation with gender discrimination in China.

1.4.2 Causes of the gender income gap

(1) There is still a significant gender discrimination in China's labor market

In case of the same conditions such as age, ethnicity, marital status, level of education, nature of the work, place of residence and year, gender is still a significant factor in determining income.

(2) Women in rural areas are in a doubly weaker position

Overall, women earn less than men, and the income of women in rural areas is the lowest. At the same time, urban women earn more than women in rural areas, but less than the urban men and rural men. This indicates that the income gap between urban and rural areas is really important, but the gender income gap is alarming (Juhua, 2008).

(3) Women's education needs to be improved

Education is a very important factor of income and access to the labor market. Women's education is not satisfactory, and exacerbates the gender income differentiation.

(4) Women's social network resources are relatively scarce

Social networks are important resources for individuals. China is an obvious example of "The Differential Mode of Association concept"[10] and relies on "Guanxi". Social networks resources deeply affect individual career development. Women's social network resources are relatively scarce compared to men's which affects women's career development and gender income gap (Xiaobo & Dong, 2007).

[10] The Differential Mode of Association: Fei Xiaotong addresses the problem of selfishness vis-à-vis each person's service to, and responsibility for, the public welfare, i.e., the problem of the line between the group and the individual. In China, each individual is claimed to be surrounded by a series of concentric circles, produced by one's own social influence. Each web of social relations has a self as its center. Each circle spreading out from the center becomes more distant and at the same time more insignificant. Everyone's circles are interrelated, and one touches different circles at different times and places.

2. The Consequences of Income Inequality in China

Widening of the citizens' income gap is an inevitable result of China's market economy and the reform and opening up policy, which affects the society in many aspects.

2.1 Consequences for economic perfomance

The widening gap in income distribution is extremely unfavorable to the perfomance of China's economy. First, it constraints the expansion of domestic demand. Lack of consumption demand will ultimately lead to overproduction when total demand is less than total supply, which affects economic growth and reduces economic efficiency (Mei, 2012).

Second, it constrains the optimization of economic structure. Large income gaps leads to two extremes in demand, when people with low income have to use most of their income to buy necessities, while people with high income tend to buy expensive goods and luxuries. As a result, the output value of low-tech labor-intensive processing industry with low added value, accounts for a large proportion of national economy, and constraints the tertiary industry's development. The situation when the proportion of the primary industry is too large, the proportion of the secondary industry is large and the tertiary industry proportion is small, it is not conductive to optimization of the industrial structure.

Finally, it is not conducive to the virtuous cycle of production, exchange, distribution and consumption. Weak consumption has hindered the entire social economic cycle. At the same time, the large income gap affects the ability of low-income people to invest into human capital, reducing the opportunities for education, thus affecting the development of the economy.

2.2 Consequences for social stability

The development of the market economy will inevitably lead to the growth of the income gap. If not controlled, however, the expanding income gap can seriously undermine the fairness and justice of society, having a negative impact on social development and stability, and damaging the construction of a harmonious society. Unequal distributions of income breeds a sense of unfairness in all walks of life. It generates discontent, which can easily lead to deviant behavior, becoming a serious threat to public safety. Accumulation of contradictions may result in some people feeling a hatred to the society, the state, and the political system, which makes income distribution, an economic issue, gradually transformed into a social or even political issue, that seriously endangers our social development and stability.

2.3 Consequences for social psychology

The huge income gap has a negative impact on the social psychology, which impairs the individuals' value of life. Although income levels of various groups of society are improving as a result of reforms, the widening income gap could generate "amplification effect" in an individual's life experience. Lower life satisfaction may cause a psychological imbalance, especially when illegal factors of widening income gap distort people's concept of wealth, making citizens' doubt the success of reforms and lose faith in achieving common prosperity, which hinders the smooth progress of reform (Mei, 2012).

3. Recommendations on Tackling Income Inequality in China

It can be seen that, under the current economic conditions, we must be aware of the widening income gap, and put resolution of the problem of large income gap onto the schedule of the government. In the 1990s, Russia, Poland, Hungary and other former communist countries were in economic transition. Drawing on the lessons and experience of the economic system reform in these countries, we put forward the following ideas for speeding up the reform of income distribution in China:

3.1 Establish a system in which distribution according to work is dominant and multiple forms of distribution coexist

Efficiency and fairness are two important issues of the market economy. In the market economy, we should follow the principle of "give priority to efficiency", which will promote economic growth; in the distribution of income and social development, we should follow the principle of "give priority to fairness", which will promote social equity and social stability. The construction of our society requires that we must coordinate the relationships between various interest groups and carry out a reasonable allocation of resources. According to China's actual situation, to move towards narrowing the gap in income distribution and pursue common prosperity, on the one hand, we must have a correct understanding of the relationship between fairness and efficiency and adjust it. On the other hand, while members of the community engage in the market, the society must provide equal opportunities, allowing people to realize their own potential, and achieving the goal of equitable distribution.

3.2 Improve the socialist market economy system and strengthen the government's macro-control

China's reform and opening up experience shows that the market economy has played a fundamental role in allocation of resources, and facilitated the economic boom in China. But market failures require the government to perform its functions in the field of income distribution. On the one hand, there is a need to speed up the transformation of the pattern of economic development, adjusting the economic structure; further promote the marketization of production factors; efficiently allocate them under the action of the market; and let factor owners get income according to the amount of factors they have. On the other hand it is imperative to pursue the legal system construction, crack down on illegal income, and deepen the reform of the tax system, with due regard of the tax adjustment. The social security system should also be improved to correspond to the level of economic development, provide basic, multi-level, wide coverage for both urban and rural residents, and steadily raise the level of protection.

3.3 Change the urban-rural dual economic structure, promoting coordinated regional development

In pushing forward the rural urbanization, a focus should be retained on narrowing income gap between urban and rural areas, changing the urban and rural dual economic structure, balancing urban and rural development, and speeding up the integration of urban and rural areas. To prevent the expansion of the gap between east and west, we have to promote the harmonious regional development, continue to perform the regional development strategies of "Western Development", "Revitalization of Northeast", "Rise of Central", thus fostering regional balance (Mei, 2012).

3.4 Other adjusting way

In addition to making use of various measures to reduce income gap, increase people's income and diversify its sources, such as increasing the level of labor remuneration in primary industries; ensuring the normal reproduction of labor force; increasing capital investment in education to promote education equity; and widening investment channels, the government should also guide the allocation of responsibilities, establishing and perfecting the tax incentive mechanism, reducing the “transaction cost” of charitable donations, cultivating entrepreneurs’ sense of social responsibility, mobilizing the donation enthusiasm of corporations and individuals, establishing and improving the distribution system.

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France

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1. What are the Inequality Trends in France?

In mapping the evolution of inequality in a country, it is crucial to examine several dimensions. Income, and more specifically equivalised disposable income[11], is central but other Fields like wealth, labor market or education are interesting in themselves and because they contribute to differences in household income. Income inequality has been stable in France between 1980 and 2010 while wealth and labor market inequality have increased. However, the timing and the magnitude are not the same across the fields we study.

The increase in income inequality in France occurred later than in many developed countries. Income inequality, as measured by the Gini coefficient, has followed a U-shaped curve over the period 1980-2010 (see Figure 1). More specifically, income inequality has decreased during the 1970s and 1980s. Then, after a period of stability in the early 1990s, inequality has started to rise. Thus, the levels of income dispersion in 1980 and in 2010 are very close. France was above the average level of income inequality in OECD countries during the 1970s and the 1980s. At the end of the 2000s, the country was just below the average (0.30 for France against 0.314 for OECD countries).

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[11] Disposable income = earnings (wages, salaries and mixed income) + pensions (unemployment and retirement) + capital income (from financial and non-financial assets) + welfare payments (housing and family benefits + social assistance) + alimonies – taxes (personal income tax + housing tax). In order to go from disposable income to standard of living, we take into account household composition through the OECD-modified equivalisation scale: 1 consumer unit to the first adult in the household, 0.5 to the persons of 14 years or older and 0.3 to children under the age of 14 years.

In order to understand the overall evolution, it is crucial to focus on the tails of income distribution because they are the drivers of this evolution. In France, most of the recent increase comes from the top of the distribution. In 2009, the 10% richest households held almost 33% of the overall income. Between 1980 and 2007, the top 10%, 1% and 0.1% shares[12] have increased by 8%, 21% and 66%, respectively. The largest part of this rise occurred between 1998 and 2007.

Capital income (rents and financial income) tends to explain a large share of this evolution but, and this is new in France, wage inequality has also contributed to this growth. The distribution of earnings among full-time workers has remained fairly stable. However, focusing on full-time wage earners only can be misleading because it hides the role of working hours and, as a consequence, the role of part-time jobs and short-term contracts. Actually, the increase in labor income inequality is explained by this growing duality of the labor market (caused by a liberalization of the labor market since the late 1980s) but also by a boom in earnings at the top of the distribution. Within the top 1% of the wage distribution, wages are booming: +21% for the top 1% and +335% for the top 0.01% (Godechot, 2012).

Private wealth[13] has strongly grown in France during the last 30 years. The wealth distribution, much more skewed that the income distribution, has been rather stable during the 1990s, but inequality has started to grow since the mid-2000s. Last but not least, Piketty (2011) estimates that the weight of inherited wealth in total aggregate wealth follows an upward trend, and the annual flow of inheritance reached in 2010 its higher level since World War I.

The equality of opportunity should also be considered in assessing the evolution of inequality. One way of measuring it is by using the intergenerational

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[12] An income share is the share of total income that is concentrated in a given part of the income distribution. In order to compute it we compare the average income of this group and the average income of the overall distribution. Top X% income share = (X%*average income of this group)/average income of the population.

[13] Aggregate private wealth is defined as the market value of all tangible assets (in particular real estate assets) and financial assets owned by private individuals (i.e. households), minus their financial liabilities.

income elasticity which estimates how much the income of a person is correlated with the income of his parents. Lefranc (2011) shows that this correlation has increased for the cohorts born after the 1970s. In other words, we observe a growth of the reproduction of inequality between generations over the past decades.

The last dimension of inequality relates to education. An increase in education attainment, especially for women, has led to a decrease in education inequality. Nevertheless, the role of social background in education achievement is still strong. It is also important to know that the schooling rate of the 15-18 years old has decreased by 2 points (from 91.5% to 89.7%) over the past decade.

2. What are the Causes?

The causes of the variation of inequality are multiple. We can list at least three ranges of determinants: the transformations of the French labor market, the evolution of capital income and the role of taxation.

First, examining the evolution of the labor market earnings is important because it is the major source of income for most households. Between 1980 and 2010, women's labor market participation has increased. Moreover, the growth of the minimum wage was superior to the growth of the mean wage between 1970 and 1985. The combination of these two factors has contributed to reducing income inequality until 1985. However, the increase in wage inequality since 1998, after a decade of stability, tends to indicate that these factors were not sufficiently strong to counter the growing wage dispersion. Most classical explanations, like skill-biased technological change[14] or international trade are not consistent with a boom in the top 1% of the earnings distribution. As explanatory factors, we may evoke a change in social norms concerning the definition and setting of top wages (higher shares of bonuses and profit-sharing) and also higher tolerance regarding inequalities.

[14] In this model the shift in the production technology favours skilled over unskilled workers because new technologies are complementary with skilled labour. This kind of model can explain why the wage gap between skilled and unskilled workers can increase in the adoption phase of the technology and remains constant after even if the demand for skilled workers keeps increasing. However, the surge in the top tails of the earnings distribution seems difficult to reconcile with this literature.

However, the evolution of wage inequality is smoother than the one of total income[15]. The unequal distribution, growth, and diversification of capital income helps understand the current upward trend in income inequality. Landais (2009) shows that wages have grown by 0.7% per year between 1998 and 2005 while rents and financial income (interest, dividends, etc.) have risen by 2.2% and 4%, respectively.

Last but not least, changes in factors correcting inequalities also provide explanations to this recent evolution. Piketty, Landais and Saez (2011) have demonstrated that the French tax system is not progressive since people at the top of the distribution pay proportionally less taxes than people at the bottom. More specifically, for the bottom 50% of the distribution (with a gross monthly income less than 2,200 Euros) the effective tax rate goes from 41 to 48% and is on average 45%. Then, within the top 5% of the income distribution, the effective tax rate sharply declines and falls to 35% for the top 0.1% (50,000 individuals out of 50 millions). Bozio et al. (2012) have pointed out that this failure to act as a redistributive instrument has been aggravated during the past decade because of the implementation of a tax shield, a decrease of the marginal tax rate and wealth tax cuts. Cazenave et al. (2011) study the expenditures side and provide similar evidence regarding the decreasing progressivity of social transfers (housing, family, social assistance, etc.).

3. What are the Consequences?

There is mixed evidence regarding the impact of inequality on economic growth. Studies on top incomes tend to show that in countries such as the US or France, the growth pace was higher when income concentration was at its lowest (postwar period) or was declining (between 1914 and 1945). However, since the 1980s, unequal countries like the US or UK have grown faster than continental countries or Japan. However, such results based on cross country analysis always suffer from identification issues. A short run analysis in France does not allow us to have a clearer opinion. Indeed, GDP growth varies even during periods of both reduction and rise of inequality.

[15] Total income = labor income (wage, mixed income, retirement pensions, unemployment benefits, etc.) + capital income (rents, dividends, interests, inheritance, capital gains, etc.).

Inequality can affect social outcomes not only through the level and distribution of economic resources but also because of psychosocial impacts (Wilkinson & Pickett, 2009). It is however difficult to provide an empirical assessment of the causal impact of inequality. In France, the evolution of social outcomes over the past decades seems to be weakly correlated with inequality trends.

More specifically, we can divide our observations into two categories: the outcomes that are not affected by inequalities and those that are affected. Firstly, there is an absence of correlation for several outcomes such as crime, intergenerational mobility and, to a lesser extent, family changes. Moreover, material deprivation seems to be less correlated with inequality than monetary poverty[16]. Since 1985, the poverty rate has remained stable and material deprivation has declined, while income inequality has started to rise. Nevertheless, the relationship with the evolution of inequality is more marked for several outcomes. Health indicators, like life expectancy or subjective assessments, are subjected to a continuous improvement over the period 1980-2010, but they are very sensitive to social gradients (like income or education). We notice a degradation of the quality of unskilled people life over the past decade. For well-being, people with more education seem to be more satisfied with their lives, and the gap has slightly grown over the past decade. For housing, the recent rise in income inequality coincides with a decline in the share of ownership, as well as a rapid growth of housing costs for low-income households.

The relationship between the evolution of economic inequality and political outcomes is maybe even more complex to determine, given the role of institutions and national culture. A priori, inequality can lead to political disengagement if people feel that their preference for redistribution is ignored.

For the political and civic participation, we observe continuous decreasing trends between 1990 and 2010, that are probably more linked to the general economic context since the 1990s (slow economic growth, high unemployment, etc.). The effect on trust in political institutions is also inconclusive since

[16] With monetary poverty we consider a household as poor if its income is inferior to 60% of the national median income, while material deprivation is a multidimensional index in which we consider four fields (lack of resources, arrears of payments, housing conditions and consumptions restrictions) to measure material poverty.

there is no clear trend over the past decades. However, for these outcomes the role of social gradients is significant since rich/educated people are more active (through their vote or their participation in association), and tend to trust more institutions and also other members of society. The analysis of the political values leads to a similar interpretation about the weak relationship with inequality. More specifically, the vote for extremes has been rather stable since 1990. During the same period, the stance regarding immigration has improved, but the satisfaction regarding the European Union has declined. Finally, the tolerance regarding inequalities, measured as the opinion about income dispersion, is rather low in France, but it has remained roughly similar since the 1980s.

This relative absence of causal link between inequality and social/political outcomes must be moderated. Indeed, we observe significant differences along social gradients like income or education. Moreover, timing and magnitude can explain this weak relationship. The increase in inequality has been more recent and more limited in France than in most OECD countries.

4. What are the Proposed Cures?

Inequality is multidimensional and it can be fought in many ways. Policies affecting labor market or education can impact inequality since they may modify the pattern of human capital accumulation or jobs protection. However, fiscal and social policies are the most direct tools to fight income or wealth dispersion.

Landais, Piketty and Saez (2011) have fueled the public debate by showing that the French tax system is not progressive. One of the most important solutions they propose is to implement a structural reform of the tax system. First, France has at least two income taxes, a flat tax and a progressive tax, with different rules (tax base, rates, etc.) depending on the income source (labor, capital, pension, etc.). In order to guarantee the progressivity of the French tax system, these two taxes should be merged. The tax base would be that of the flat tax, in which all types of income are considered, with progressive tax rates. Second, some benefits (like family or health allowances) are financed through social contributions paid by workers. *A priori*, there is no reason for this category of allowances to be financed only labor income. This type of reform could have several benefits. It would not only reduce inequality and increase poor households purchasing power but also restore the trust in the tax system because of gains in simplifications and transparency.

The second range of recommendations relates to social and education policies. It is crucial to encourage the accumulation of human capital. Maurin (2004) analyses the urban segregation in France and argues that the current policies are inefficient in fighting socioeconomic inequalities. He recommends a better social and education policies with a focus on children and young adults living in disadvantaged areas.

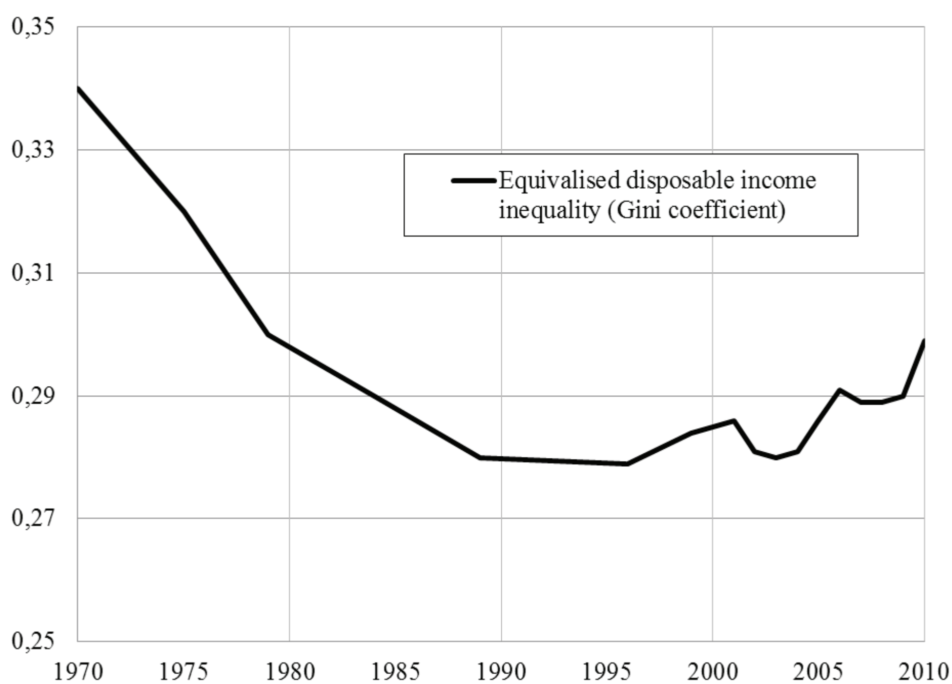
The proposed cures regarding the labor market are less consensual. Even if employment is one of the best ways to durably escape poverty, the proposed recipes differ. For instance, Philippe Askenazy recommends replacing inefficient employment policies by public jobs in economic sectors like health, education, environment or security. Public support to private firms (through loans) should also be encouraged.

5. Is Inequality a Government Priority? How is it Addressed? Are these Approaches Effective?

A new government was elected in France in May 2012. Part of its program was to build a fairer society. A project of this government was to increase the marginal tax rate for individuals earning more than 1 million Euros to 75%. The project has been modified since but even in its original form this new tax bracket was not likely to change the lack of progressivity of the tax system. Indeed, most capital income (dividends, interests, capital gains, etc.) was exempted from this tax, and people were allowed to deduct the amount of tax they already pay with other income taxes. Therefore, the overall effect on the structure of the tax system would have been limited. Since May 2012, the new socialist government has cancelled part of the fiscal policies implemented by the former government, especially the cuts on wealth and inheritance taxes. Without any data on distribution it is difficult to know precisely if the tax system has become more progressive. However, the income tax has not been deeply modified and the tax base has largely remained the same.

It is important to mention other policies that indirectly affect inequality. The general evolution of the labor market tends to indicate that employment protection has decreased over the past decades[17]. In the late 1980s, some policies eased labor market regulations by favoring part-time jobs, short-term contracts and temporary jobs. Therefore, the French labor market has become more and more dual with a large share of protected jobs (85%) and a minority of flexible jobs. The recent labor market reforms are in line with decreasing employment protection (providing possibility for firms to reduce wages or increase working hours in case of difficulty, and complicating conditions to contest collective job cuts, etc.). It has also been shown that some in-kind benefits like professional training could be considered as "non-progressive" since high-skilled workers receive more training than unskilled workers. There has been no reform to tackle this issue.

Figure 1. Income Inequality in France (1970 – 2010)



Source: INSEE (Insee, DGI, Enquêtes Revenus Fiscaux 1970-1990; Insee, DGI, Enquêtes Revenus Fiscaux 1996-2005; DGFiP, Cnaf, Cnav, CCMSA, Enquêtes Revenus Fiscaux et Sociaux 2005-2010)

[17] For a more general overview regarding the evolution of employment protection in France see (Askenazy, 2011).

Definition: the definition of the Gini coefficient is based on the Lorenz curve. This curve plots the income of the population that is cumulatively earners by a given fraction of the population. The 45° line reflects perfect equality. The Gini coefficient is the ratio of the area between the equality line and the Lorenz curve to the total area under the 45° line. A Gini coefficient equal to 0 represents a situation of perfect equality while 1 represents a perfect inequality (1 person owns everything).

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India

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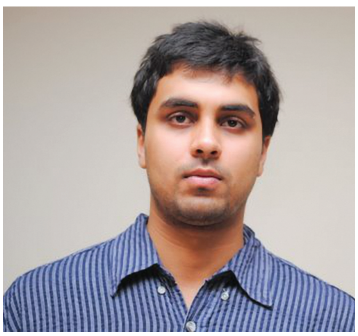

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India is a study in contrasts. In the post liberalisation era, since 1991, the country has witnessed a rapid GDP growth, secular expansion of its services sector, and a commensurate increase in per capita consumption. As a result, in 2012, the country overtook Japan's GDP (in purchasing power parity terms), to become the third largest economy in the world. At the same time, a recent survey across 100 districts in the country revealed that 42 per cent of India's children under the age of 5 are underweight and a shocking 59 per cent are stunted in their physical development (Naandi Foundation, 2011). Extrapolating these results to reflect the overall state of socio-economic development, the picture at once becomes stark. This paper will delve into some macro trends through which it aims to unbundle facets of the country's distorted growth narrative.

In March 2012, the Planning Commission of the Government of India set the poverty line at INR 28.65 (approximately USD 0.52) for urban areas and INR 22.42 (approximately USD 0.4) for rural areas in terms of per capita expenditure. Using rounded approximations of INR 28 and INR 22 (USD 0.5 and USD 0.4) for urban and rural areas respectively, National Sample Survey data from household surveys conducted in 2009-10 reveal that 22.98 per cent of India's urban population and 36.58 per cent of its rural population spend less than the approximated poverty line (Table 1). Meanwhile, India's 'emerging' identity, which derives from its significant middle class, is also exposed for what it is. Only about 4 per cent of India's population earns more than INR 100 a day (approximately USD 1.8 a day in nominal terms). The rural-urban divide is also particularly prominent and can be observed throughout this paper.

Table 1. Per Capita Expenditure and Population, 2009-10

	All India	**Urban**	**Rural**
Expenditure	% of Population	% of Population	% of Population
< Rs. 28 per day	48.92	22.98	36.58
Between Rs. 28 to 100 per day	47.09	65.54	62.21
More than Rs. 100 per day	3.99	11.49	1.21
Total	100	100	100

Source: (NSS, 2009-10; ORF India Data Labs)

The world is still grappling with the ripples caused by the global financial crisis. While the crisis found its origins in the West, it perhaps has greater absolute implications for the emerging and developing world. India has witnessed a slowdown in growth to around 5 per cent in 2012-13. The fundamental assumption about GDP growth, echoed by Indian policymakers, has been that faster GDP growth is a prerequisite to reducing poverty and concomitantly, enhancing development (The Hindu, 2012). Such views are reflections of a wider international consensus that "there is every reason to believe that economic growth reduces poverty" (Roemer & Gugerty, 1997). In this case, the converse argument also holds, and every percentage point slowdown in India's GDP growth impacts the sustenance prospects of millions of rural and urban poor.

There is of course a large volume of academic literature which questions such simplistic correlations. For instance, the India Chronic Poverty Report (2011), states that "the issue arising in some developing economies with large populations is not that there is poverty in spite of moderate to high economic growth, but that this poverty is often created by the very nature of economic growth itself'' (Mehta et al., 2011). While this view is open to debate, it is sufficiently clear that there has been a consistent rise in inequality between the rich and the poor in India. This is evidenced from the fact that those at the bottom 10 per cent of per capita wealth account for merely 3.6 per cent of total consumption, while the top 10 per cent account for 31.1 per cent (Mehta et al., 2011). Additionally, Pal and Ghosh (2007) have observed that "comparable estimates of the 50th (1993-1994) and 55th (1999-2000) rounds of National Sample Survey data reveal that inequality increased both in rural and urban India" (Pal & Ghosh, 2007).

Perhaps the starting point for any meaningful analysis or explanation of India's unequal society must be an overview of aggregated expenditure profiles for different social groups. From table 2, it is evident that the traditionally disadvantaged groups (scheduled tribes, scheduled castes, and other backward classes), on average fare worse than those that fall within the category of "others" in terms of per capita expenditure. On an all-India level, less than 2 per cent of the disadvantaged groups spend more than the nominal equivalent of USD 2 a day. The majority (at an all-India level) are below the approximated urban poverty line expenditure assumed here. It is safe, therefore, to infer strong causality between income classes and social groups.[18]

Table 2. Per Capita Expenditure and Social Group, 2009-10

Social Groups	< Rs. 28 per day	Between Rs. 28 to 100 per day	Greater than Rs. 100 per day	Total
Scheduled Tribes	67.35	31.32	1.33	100
Scheduled Castes	61.1	37.69	1.22	100
Other Backward Classes	50.86	46.65	2.5	100
Others	32.06	59.07	8.87	100
Total	48.91	47.1	3.99	100

Source: (NSS, 2009-10;ORF India Data Labs)

[18] Expenditure can be used as a substitute for income, using the established economic relationship that savings = income – expenditure; and assuming negligible savings at the bottom of the pyramid.

When the multidimensional nature of poverty is taken into account, it is not surprising that self-fulfilling spirals can trap millions within a variety of systemic constraints. Table 3 helps to illustrate that while nearly all of those spending more than INR 100 (approximately USD 1.8) per day have access to electricity for domestic consumption, while over 35 per cent of those who spend less than INR 28 (USD 0.5) in rural areas, still have no access to electricity.

Table 3. % Population with Electricity for Domestic Use and per Capita Expenditure, 2008-09

Expenditure	All India	Urban	Rural
< Rs. 28 per day	64.61	90.25	86.66
between Rs. 28 to 100 per day	92.32	98.66	97.83
greater than Rs. 100 per day	99.05	99.98	99.98
Total	73.21	96.14	96.14

Source: (NSS, 2008-0;ORF India Data Labs)

Peeling through the multiple dimensions of social inequality and concomitant to the above described 'sociology of the poor' are issues of access to services and resources. Saran and Sharan (2012) point out that between 30 to 40 per cent of those belonging to various disadvantaged groups still use kerosene for lighting in rural areas (Saran & Sharan, 2012). This is a particularly illustrative statistic on two counts. Firstly, typical kerosene lamps deliver between 1 to 6 lumens per square metre of useful light compared with typical Western standards of 300 lumens for basic tasks such as reading. There is no convergence of living standards for those at the bottom of the pyramid. The second count is that those with least access are disadvantaged on multiple fronts.

Access to modern forms of energy is necessary for development. Access to resources such as water is necessary for basic sustenance which underpins development. Wide divergences in access to drinking water across different income profiles are indicative of a serious structural deficit. This deficit has helped to perpetuate inter-generational infirmities. Table 4 shows that those with per capita expenditures greater than INR 100 (USD 1.8) a day are around two and a half times as likely to have access to drinking water within their premises as those who spend less than INR 28 (approximately USD 0.5) per day. Those at the bottom are much more likely to walk significant distances to access water than those at the top. There are multiple implications of such divergences in access, including for household productivity.

Table 4. % Population and Distance from Drinking Water Sources Mapped to per Capita Expenditure, 2008-09

Expenditure	Within Dwelling	Outside Dwelling but within the Premises	Outside Premises		
			Total	0.2 to 0.5 km	0.5 to 1.0 km
< Rs. 28 per day	15.74	22.68	50.47	9.18	1.43
Between Rs. 28 to 100 per day	36.24	32.12	26.31	3.86	0.9
More than Rs. 100 per day	76.57	18.91	3.34	0.69	0.26

Source: (NSS, 2008-09; ORF India Data Labs)

Household productivity is also closely linked to the levels of education attainment. Within a rights-based framework for development, the role of education is increasingly emphasised. Tilak (2005), notes that “poverty is seen as deprivation of opportunities that enhance human capabilities to lead a tolerable life” and, importantly, that “education is one such important opportunity, deprivation of which in itself represents poverty” (Tilak & Jandhyala, 2005). While it is up for debate whether primary, middle and secondary education actually offers productivity gains that are commensurate with the contextual imperatives for human capital formation given the scale and nature of poverty; and whether higher education or vocational education should be prioritised; the statistics in table 5 illustrate that there is a clear causality between income and education levels. Indeed, many studies have argued that this causality runs both ways.

Table 5. Education Levels Mapped to % Population Sorted by Per Capita Expenditure, 2009-10

Education Levels	All India			
	Expenditure			
	< Rs. 28 per day	between Rs. 28 to 100 per day	more than Rs. 100 per day	Total
illiterate	42.93	25.65	9.25	33.45
upto primary	34.89	29.43	15.22	31.54
middle	12.46	15.87	10.48	13.99
secondary	5.96	12.7	14.26	9.47
higher secondary	2.7	8.6	15.53	5.99
diploma & certificate course	0.1	0.91	2.95	0.6
graduate & above	0.96	6.83	32.32	4.98
Total	100	100	100	100

Source: (NSS, 2009-10;ORF India Data Labs)

India is rated as having a moderate inequality relative to several other developing countries, with a Gini coefficient of 36.8 in 2004-05 (World Bank Indicators). While the coefficient has likely worsened since then, India is leagues ahead of several other G20 countries, including the United States and China. However, the Gini coefficient cannot capture the nuanced trends of inequity, and the causal relationships that perpetuate it.

Development is a long-term complex process. It is clear from the socio-economic realities which have been outlined in this paper, that India's development trajectory is steep, and challenges are stark. Concomitantly, the public policies which have also been highlighted here, have been formulated by policymakers to bridge inequalities between various socio-economic identities and promote inclusive growth. They aim to provide better access to services, employment and information; and are certainly enablers of transformation when implemented right. Even so, they are necessary but not sufficient. A number of systemic initiatives are required to create the momentum and maintain the development gains required for a broad-based transition to higher levels of prosperity and equity, particularly for those at the bottom of the pyramid. In this context, we suggest there are two fundamental questions that Indian policymakers must pose to themselves, to tailor effective and efficient interventions that can ensure that development in fact leads to growth:

1. What is the threshold level of inequality for political and social stability?

2. How can policy interventions resolve the strategic, but not necessarily binary choice between generating employment and increasing productivity?

Two decades have passed since India embarked on a new growth trajectory underpinned by a neoclassical economic framework. Liberalisation-led reform has delivered unequal results. With over 1.2 billion people and an extremely heterogeneous socio-economic profile, any attempts to recalibrate policy prescriptions must be fully cognizant of diverse realities and trends that have become firmly embedded. Whether GDP growth has exacerbated inequalities, or served as a template for improving living standards, is not the most urgent question in the contemporary context. Rather, policymakers and political leaders must focus their energies on understanding the causal influences that have an influence on socio-economic trends; and accordingly designing a progressive and contextual framework for development and growth. We suggest that such a framework must include and be complemented by the following crucial elements:

- Nearly 12 million people enter the Indian workforce ever year. A majority lack the skills to gain meaningful employment, and face an abject lack of access to decent work. As a result, those at the bottom of the socio-economic pyramid are largely employed in the informal sector, without any form of job security or social security. The availability of productive and remunerative employment is central to enabling equitable growth. The Indian economy must employ a larger proportionate share of its workforce. In turn, minimum wages and domestic labour standards must be enforced universally; and the skills gap must be addressed through strategic emphasis on subsidised and targeted vocational education.
- The Indian economy relies asymmetrically on growth of the tertiary sector, particularly capital and skilled labour intensive sectors such as information technology, which have not been able to bridge the systemic employment gap. Employment creation is a policy imperative for enabling equitable out-

comes; and the revitalisation and reemphasis on the growth of the secondary sector is a necessary prerequisite for achieving broad-based socio-economic transformation. The industrialisation process requires a number of enablers, including improved infrastructure and service delivery; and the creation of a workforce with skill sets commensurate with a strategic vision for industrial growth.

• The competitive advantage of the Indian economy in the export sector remains largely untapped. With an export to GDP ratio of 16.5 per cent (in 2012), the Indian export economy has a vast potential. In this regard, high productivity, labour-intensive sectors particularly demand a sustained policy focus. Greater integration with regional supply chains and increased leverage of regional trade agreements can provide the necessary momentum for secular growth of such sectors. Monetary policy, fiscal management and financial market depth must complement such growth.

• Policy emphasis must be placed on facilitating access to markets with strong internal demand. This will help the Indian economy to hedge against global demand volatility perpetuated by disruptive business cycles. The Southwards shift of Indian exports is a positive sign in this context. According to the Indian Exim bank, the share of Asia, Africa and LAC regions has increased sharply from 47% in 2001-02 to 62.7% in 2011-12; and the share of Asia has risen from 40% to 52% during this period.

• The equitable growth of the Indian economy will to a large extent be determined by the degree and nature of private sector participation. The virtual stagnation in the investment/GDP ratio (of which the private sector is a larger contributor than the public sector), which has grown by a mere 5 per cent since 2005-06 to 37.6 per cent in 2011-12, is indicative of inherent challenges. Greater participation of the Indian private sector can be driven by a better environment for doing business. Policy frameworks must address issues concerning corporate governance and labour reforms without compromising market competitiveness.

• Long-term capital formation through increased participation in the financial markets must be prioritised. This will entail a broad-based emphasis on imperatives such as financial literacy, financial inclusion, and investor protection. The nominal proportionate retail participation in the domestic capital markets is a cause of concern. Household savings must be productively and efficiently deployed in order to finance the widening current account deficit. Simultaneously, short-term speculative participation must be offset by genuine market opportunities for growth. Commensurate emphasis must be placed on channelling global savings into long-term asset creation in the Indian economy, with a supportive policy framework. Increased government emphasis on development of micro, small and medium enterprises as well as industrial clusters must be sustained despite political cycles. Policy disruptions can quickly reverse gains achieved over time, and political risk poses the greatest challenge to unleashing the entrepreneurial potential in the country. A coherent, inclusive and long-term political vision must complement policy formulation. Robust legal frameworks must be employed to secure long-term growth largely devoid of political risk uncertainties.

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Indonesia

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1. Introduction

In the last five years inequality in Indonesia has increased from 0.35 in 2005 to 0.41 in 2011 (Sinaga, 2012) based on the Gini coefficient (a measure of the inequality of income distribution, in which a lower index indicates better equality) (Schneider, 2004). Indonesia is by no means an exception; the data also shows that among almost all the countries that are experiencing rapid economic growth in the last 10 years, inequality is on the rise, including in China, India and South Africa (The Economist, 2011). Closing the inequality gap, however, is possible and can be done. Brazil, for example, has been able to reverse the trend and shrink the inequality gap. Brazil's innovative development plan contains a variety of programs which strive to create opportunities for all, especially for the marginalized (Hailu & Suarez, 2009).

With a population of 230 million, Indonesia is more prosperous now than 10 years ago. Income per capita is USD 3,000, with the 20th largest GDP in the world, it now surpasses Belgium and Sweden, with an annual budget of about USD 150-170 billion. This paper will describe (a) the forms of inequality, (b) the causes of inequality (c) responses and government policies; (d) policy options to decrease inequality in Indonesia.

2. Forms of Inequality

Inequality in Indonesia takes a number of shapes: (a) income inequality, for example, in terms of wages and salaries received. The highest salary is about 100 times bigger than the minimum wage. The minimum wage in Jakarta is Rp 2 million (about 200 USD); in contrast the salary of the directors in state-owned companies and high officials at the Bank of Indonesia (central bank of Indonesia) is Rp 250 million (about 25.000 USD);[19] (b) inequality in social security, such as health insurance. An estimated 100 million people in Indonesia are still not protected by health insurance; (c) inequalities in the burden of tax payments. The data indicates that the biggest tax contributors are employees rather than wealthy citizens, business owners or the owners of stock; (d) regional inequalities as manifested in inadequate infrastructure such as roads and bridges. Also, there are regions where access to quality health care and education (teachers, doctors, midwives) is lacking such as in Kalimantan, Sulawesi, Papua and NTT and NTB.

Indonesia is an archipelago, with over 13 thousand islands of all sizes and is facing constraints in terms of the inter-island connectivity. The flow of goods and services between the islands is still constrained and expensive. Imported goods enter Indonesia more quickly and at a cheaper cost than through the inter-island trade. Indonesia's infractructure (ports, roads, airports) are struggling to keep up with the economic expansion.

Other forms of inequality include the control of land by private companies (domestic and foreign) compared to the land owned by the people. Oil and mining and palm oil companies in Kalimantan and Sulawesi control a million hectares. Given these forms of inequality, it is no surprise that inequality is becoming ever more acute in Indonesia.

3. Causes of Inequality

Income inequality is the result of market mechanisms. The government can still influence wage levels, however, through setting a minimum wage in the public and private sectors. Although the government may have limited control

[19] According to Sinaga (2012), based on the data reported from the Indonesian Central Statistics Agency (BPS) on the distribution of income, the distribution of income is worsening. In 1999, the top 20 percent of income earners held 40.57 percent of total household income. In 2011, the top 20 percent held a staggering 48.42 percent of total household income. By contrast, the bottom 40 percent of income earners held 21.66 percent of total household income in 1999 and only 16.85 percent in 2011. The middle class is also affected, with the middle 40 percent of income earners holding 34.73 percent of total household income in 2011, down from 37.77 percent in 1999. (Sinaga, 2012).

over wage levels, it can do more to reduce inequality in terms of knowledge and skills (education) assets, land assets, and financial assets (micro-credit).

Inequality could be significantly reduced by developing the following mechanisms: (a) the distribution of tax payments/tax burden can be made more equitable to support those who do not have the means; (b) essential government services such as health, education, water and sanitation, delivered based on needs rather than based on the market mechanism ('you get what you pay'); (c) social security system, especially universal healthcare, so that it will achieve both efficiency and fairness.

Indonesia's approach to addressing inequality is not solely market based, the government intervenes with a variety of policies and programs such as subsidies, and various other social programs. Nevertheless, these strategies are insufficient to address inequality.

There are a number of factors contributing to the growing inequality gap. First, universal fuel subsidies to the rich and the poor absorb nearly 10 percent of the budget each year. Eliminating subsidies is difficult because of the potential political fallout. For now the government prefers to continue the fuel subsidies, but it means that there are fewer funds for the other social programs.

Second, approximately 42 percent of the labour force is employed in the agriculture sector, yet the government provides only a minimal amount of support for the rural economy and rural communities. A disproportionate ammount of agricultural subsidies in the form of fertilizer subsidies and seeds is allocated to state-owned companies (Pusri, Sang Hyang Sri, etc.) that are not accountable. The end result is that farmers are not benefiting from the subsidies.

Third, the government's social security and social assistance programs are selective rather than universal. A selective approach, it is argued, is not as costly as an universal approach. Experience indicates, however, that a selective approach has led to jealousy and envy among those receiving and not receiving benefits. The selective approach has also resulted in a high number of mis-targeted recipients, that is, those who have received benefits but in reality are not entitled.

Fourth, there are many well-intentioned programs that provide public goods such health clinics, but funding is limited. For example, the health insurance program for the mother in waiting, Jampersal, is not widely accessible because the funds are exhausted. Or, there are examples of hospitals that stop serving the poor because they have yet to be funded by the local government or by the health department.

4. Indonesia's Response

The Indonesian government has repeatedly stated that the Indonesian economy can no longer rely on cheap labour. Labour costs are often mistakenly attributed to being a constraint on foreign investment flows into Indonesia. Based on data from various surveys, however, the major constraint on the Indonesian capital investment is not high wages, but business licensing and corruption. Where there are high labour costs, it is when workers are laid off. Businesses argue that the state should take responsibility for these costs. The OECD has recommended an unemployment insurance plan as a means to address these costs (OECD, 2008).

During the 2012 legislative sessions of the People's National Assembly (DPR) there were calls for the government to measure the performance and success of development programs by taking inequality into account (Suara Karya, 2012). To date the government only measures poverty reduction and unemployment. Although the government has yet to accept this recommendation, this may change in the coming years.

Bappenas (National Planning Ministry) is planning a social protection policy that is expected to be launched in 2013-2014. It is more inclusive, providing protection to indigenous groups and people with disabilities. Bappenas will also give attention to this policy in its 5 year Mid-term Development Plan (RPJM) beginning in 2014. Assuming that the new government in 2015 supports the policy, then social protection will be mainstreamed into Indonesia's development policy and bring it in line with other nations.

The Indonesian government has plans for universal health insurance for all residents based on the National Social Security Act 2004 and the Law BPJS 2012. Currently only civil servants and private sector employees (about 50 million people) have health insurance. The spirit and content of these two laws will bring about a dramatic shift in both policy and priorities. Universal health insurance will mark a wholesale change in Indonesia's economic and social context.

If the health insurance plan is well financed, covers a range of services and is truly accessible to even the most marginalized groups, then serious steps will have been taken to eliminate some forms of inequality. In 2014 the government plans to test universal health insurance through the government sponsored PT Askes or a state-owned Health Insurance Company to cover health services not only in public hospitals health facilities but also in the private sector.

On the basis of the same Act, the government also plans to launch a pension plan in 2019. To date, most of the Indonesian population is not covered by any pension plan; rather the extended family provides the support network. The lack of financial support exacerbates inequality since the elderly do not have the financial resources for medical treatment. Given that the elderly will constitute about 20 percent of the workforce in the next 10-20 years the pension plan is a strategic policy to ensure that Indonesia's economy is productive and efficient.

5. Future Policy Options

To overcome income inequality and asset inequality, affirmative action is needed by the government. Income inequality can be reduced by expanding opportunities for essential government services such as health care, education and improving subsidy programs (fuel and agriculture).

The funds allocated to fuel subsidies could be diverted to cover the costs of health care and educational services (additional teachers, doctors, schools repair) and infrastructure development in rural and remote areas (roads, ports, etc.). The agricultural subsidies should target the farmers and not the state-owned enterprises. The subsidized funds that are channelled through the Ministry of Agriculture or state-owned enterprises are often siphoned off by political elites. Hence, changing the nature of the subsidy is not only a technical issue, but it is also a political economic one since opportunities to "capture" subsidy funds by the political elites will have been reduced.

To support these concrete measures the government should incorporate the Gini coefficient into the annual development plan (RKP) and five years plans (RPJM). In addition, sufficient funds for health care and health insurance need to be allocated so that health care is accessible to all citizens.

Finally, tax policy needs to be revamped to ensure that the system is fair and equitable. Currently, taxes contribute only 12-13% of the GDP. This figure needs to increase to 20-25% of the GDP which would bring Indonesia in line with other middle income countries. The ruling elites of both national and international corporations do not pay their fair share of taxes (illicits flows from Indonesia are estimated at USD 10 billion per year according to Global Financial Integrity report) (GFI, 2012). Strengthening anti-corruption measures and enforcing tax laws along with developing international tax agreements through the G20 will put Indonesia on a stronger financial footing.

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Republic of Korea

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1. What are the inequality trends in South Korea?

South Korea faces inequality and an ever widening gap between the rich and the poor that increases harmful social consequences due to the rapid introduction of a neo-liberal economic approach since the IMF financial crisis in 1997. While the economic power gap between sectors, industries and businesses has been widening, employment and income disparity have sped up. In this regard, decreasing employment opportunities, declining quality of work, and widening income gaps have become more visible and the number of working poor has increased, consequently worsening the distribution structure.

While economic inequality occurs due to the different economic choices of individual entities – enterprises, individuals – it also reflects differences in economic activities as well as rapid acceleration of the industry and structure of the economy. The problem of inequality emerges when the income distribution structure deteriorates. This has been the case has since 1990, when the growth in income inequality accelerated alongside a rapidly changing economic environment after the financial crisis. Further, it has turned into 'low growth inequality' that has exacerbated problems in the recent economic downturn.

2. What are the causes?

The income distribution has widened since the financial crisis due to an increasing number of temporary employment contracts, a result of corporate restructuring and widening income gaps among industries, which is different from the improvement of the income distribution and economic growth before the financial crisis. According to recent studies, not only industrial economic factors but also demographic changes such as a rapidly aging population and increasing numbers of single households contribute to aggravating the income distribution.

Economic inequality is a phenomenon in which economic entities are divided into extreme ends of economic outcomes as the result of changes in their internal and external environment, also known as heterogeneous nature. These changes which accompany economic development, globalization and trade expansion, technology advancement and institutional policy serve as a fundamental trigger for economic inequality. The economic outcome gap results from disparities in economic entities capacities such as technology and scale in industries and companies, or health and educational differences in workers.

Another key cause of economic inequality is that the trickle-down effect which appeared in the economic development process in the past was not effective in spreading outcomes from advanced sectors to developing sectors.

Since the financial crisis, a major factor worsening the labor structure is the unwillingness of enterprises to recruit regular employees due to increased human resource costs. This, in turn, has resulted in growing numbers of temporary, low-wage contract workers. Compared to other developed countries, South Korea fairs poorly in equitable income redistribution and providing training and education to the poor. Existing distribution is insufficient, making it more difficult for the poor to adapt to changing circumstances, leading to further income gaps between the classes.

3. What are the consequences?

According to the survey from the 2010 National Statistics Office, Gini coefficient in urban two-or-more-person households was 0.315, which is the highest record since the data was first collected in 1990. The so-called ‘income inequality index' that calculates the top 20 percent income bracket divided by the bottom 20 percent income shows 4.82 which is higher than 3.72 in 1990.

In addition to the increasingly visible income gap, unequal distribution of properties, namely real estate, has become a serious problem. According to the degree of concentration of land ownership in 2005, the top one percent (approximately 140,000 people) own 45 percent of all taxable land, the top five percent (approximately 700,000 people) own 59 percent, and the top 10 percent (approximately 1,400,000 people) own 72 percent of all taxable land. The degree of concentration in 2006, including the lands which are not subject to taxation, has become even worse. This shows that the top one percent (140,000) possess 51.5 percent of all private land and the top five percent (700,000) own 82.7 percent, a 17.5 percent increase over the last 20 years.

Looking at the trend of production index growth rates, showing the change of production quantity over certain periods, there has been a widening gap between large enterprises and SMEs. The production rates between the two have decreased from 9.2 percent in 2004 to 1.4 percent in 2006. While, they increased in the consecutive three years showing 3.6 percent in 2007, 4.2 percent in 2008, and 6.9 percent in 2009.

The polarization phenomena between large enterprises and SMEs are apparent in the economic concentration of major conglomerates. The concentration ratio of conglomerates taking part in the entire economic sector has steadily increased since 2002. The concentration rate of the top ranking 50 enterprises has increased from 35.7 to 44.7 percent in 2008, while the concentration rate of the top 100 ranking enterprises increased from 42.5 to 51.1 percent.

The concentration of economic power by conglomerates has intensified. The total assets of the top 15 major conglomerates have increased to 329.1 trillion KRW (about 296 billion USD, 55.6 percent), land assets increased to 44.8 trillion KRW (about 40 billion USD, 115. 1 percent), sales increased to 334.4 trillion KRW (about 300 billion USD, 59.1 percent), and net profit increased to 24.3 trillion KRW (about 21.9 billion USD, 59.5 percent) during 2007-2010 in the period of consecutive years that have shown the highest concentration of economic power ever.

4. What are the proposed cures?

First of all, we need “economic democracy” that guarantees a fair and equitable market economy and competition. In order to achieve that, conglomerate reform must be conducted through tightening investment regulations as well as separation of banking and commerce, establishment of a fair trade system by adopting punitive damages[20], fair taxation, equal pay for equal work and the abolishment of discrimination towards temporary workers.

Secondly, the government of South Korea must put into practice welfare policies that abolish widespread inequality, to encourage sustainable growth and to improve quality of lives of citizens: employment measures such as reduced work hours that enables job-sharing, expand public housing, secure health insurance for the wider public, free education guaranteed to under five-year olds, and improve public pension payment methods to deal with an increasingly aging society.

5. Is inequality a government priority? How is it addressed? Are these approaches effective?

The former president Lee Myung-bak government (2008-2012) focused on expanding industry growth as a means to resolve economic inequality issues. Measures to alleviate inequality include: building social security nets, ensure win-win growth support for large and small enterprises, provide training and education opportunities and employment support for vulnerable social groups that have been neglected. The Lee Myung-bak government, however, consistently favoured conglomerate-led growth policies which included tax cuts for the rich and the Four MajorRivers Project[21] that solely focused on “advancement” rather than considering social, economic and ecological consequences.

[20] Punitive damages, also known as exemplary damages, may be awarded by the trier of fact (a jury or a judge, if a jury trial was waived) in addition to actual damages, which compensate a plaintiff for the losses suffered due to the harm caused by the defendant. Punitive damages are a way of punishing the defendant in a civil lawsuit and are based on the theory that the interests of society and the individual harmed can be met by imposing additional damages on the defendant.

[21] It is the multi-purpose green growth project on four major rivers in South Korea mainly Han River, Nakdong River, Geum River and Yeongsan River. The project was initiated by the former president Lee Myung-bak as part of ‘Green New Deal’ policy in 2009. The five objectives are securing abundant water resources to combat water scarcity; implementing comprehensive flood control measures;

As a result, benefits fed a few major conglomerates and gave handouts to the rich which accelerated the inequality between the rich and the poor. Even more, social policies for the vulnerable and ordinary people were carried out ineffectively, based on a weak social security net.

What should be done?

As economic inequality is a priority issue in South Korea, 'economic democracy' has become the main issue on the agenda since the last year. During the presidential election period in December 2012, a large number of commitments on economic democracy were presented by various candidates. In this regards, we recommend three suggestions in order to overcome economic inequality and other inequality issues in South Korea.

First of all, the new administration should implement its electoral commitments made on economic democracy and public welfarein the presidential term.

Secondly, regardless of the ruling party or opposing parties, the national assembly should be proactive on amending related laws as commitments are executed in the form of legislation.

Lastly, civil society organizations should be vigilant in auditing, criticizing and checking the legislation process at the National Assembly and the performance of government's commitment on economic democracy.

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Mexico

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Without any doubt Mexico will be one of the central players in the debate on sustainable growth in the G20 meetings for two main sets of reasons.

On the one hand Mexico has had a sustained growth with a relatively solid and healthy economy which gives it enough credibility to count in the debates as demonstrated by its G20 presidency last year and present membership of the "troika". Not having been invited to the BRICS and not being in the center of the Latin American debates for both its geopolitical location and economic choices, the Membership of the G20 is, more than in the case of Brazil or other developing countries, a centerpiece in the Mexican global inclusion strategy.

On the other hand, necessity is a major driving force for Mexico insisting on the fight against income inequalities beside mere economic development. The Mexican society is one of the most unequal in the world.This issue will be the most pressing for the new government coming in office for six years (starting from December 2012) as demonstrated by the first political decisions of President E. Peña Nieto.

This second aspect is the subject of this country note.

1. Inequalities in a rich and economically striving country

1.1. Mexico, a good pupil of the G20

Mexico is not considered today as an economic success story such as the BRICs or other Pacific Basin Countries and nobody would talk of a Mexican miracle the same way as it has become a clichés to talk about the Chinese or Indian ones. It is not credited for the efficiency of Brazil or Indonesia. It is partly justified by the fact that the Mexican growth is more timid than the one of the BRICs.

Still, Mexico to day is not only the 13th economy in the world. It has also became in a few decades a medium income country with stable macroeconomic aggregates and a low but steady growth over the years, surmounting very fast, for example, the economic crisis of 2008 despite its dependency on the US economy. This compares advantageously with the situations up until the eighties when the country was both unreliable and unstable. More generally this sound situations contrasts with the country's economic history with the typical features of underdevelopment: high inflation, high budget deficits, extreme poverty, high birth rates and massive emigration.

Today Mexico's growth is one of the fastest of all the OECD countries (overtaken only by Chile, Turkey, South Korea and Israel) with an estimate of 3.3% in 2013 (as opposed to 3.9% in 2012) and a forecast of 3.6% in 2014.

It should be noted that Mexico chose a different way to development, anchoring itself to the developed countries of the Northern Hemisphere. It is a member of the OECD, and more significantly of the North American Free Trade Agreement (NAFTA) while having other free trade agreements with the European Union and Japan. These choices came at a price. Mexico is sometimes overlooked compared to other prominent developing members of the G20, such as the already mentioned BRICS. Nevertheless, it is proud of the relative economic successes and should take advantage of its position as an efficient mediator between North and South. The G20 summit at Los Cabos and the COP16 on Climate change in Cancun have become tokens of this position. Lately, Mexico has also become one of the key actors in Latin America, leading a group of countries that looked for an alternative to the Venezuelan position often shared by Argentina and Brazil. Informal spokesman for likeminded countries such as Colombia, Chile and Peru, its importance and legitimacy have subsequently grown in the G20 debates with Colombia invited at Los Cabos although it is not a member of the G20 (although its economic weight is now bigger than Argentina's).

1.2. Poverty remains, economic stability or even growth are not sufficient

Not everything is rosy of course. The Foreign Direct Investments in the country have fallen 35% in 2012. So have the remittances from Mexican expatriates since September 2012.

More fundamentally, despite a steady growth, Mexico has not succeeded to decrease significantly the poverty indicators of the country. Mexico remains one of the most unequal countries in the most unequal region of the world, Latin America. According to the official structure in charge of measuring poverty in the country, Coneval (national council for the evaluation of social development), whose last reports were issued in 2010 and 2011, poverty still strikes almost half of the Mexicans: out of 112 million inhabitants, 21 millions Mexican are extremely poor, meaning they cannot afford daily basics. More generally 51% of Mexicans (57 millions) are poor and cannot afford basic services in health, housing or clothing.

2. Social policies to fight poverty in post-revolutionary Mexico

2.1. Building a – partially – welfare state (1940-1990)

While it is true that poverty in Mexico has slightly decreased in the last two decades while it had increased between 1980 and 1990. Nonetheless, it is difficult to be satisfied with the results of the Economic liberalization that has been implemented since 1982. The results are poor compared to the period of the so called “substitution to imports model” pursued between 1940 and 1980 during which, the country seemed on his way to break away from the secular income gap dating back to the three hundred years colonial period and the first century of independence up to the Mexican Revolution of 1910. During this period of forty years one could say that Mexicans were building up a real “welfare state” based on the universality of education and health, while such public services as water and electricity were considered as social rights. Life in the city improved, poverty diminished and a middle income class began to flourish. Nevertheless, most of the citizens living in the rural areasdid not benefit from these progresses. Poverty was not overcome enough when from starting from the seventies this model began to wear out.

After the serious economic crisis of the 80's, Mexico accelerated its economic liberalization started in 1985 with the accession to the GATT. The real watershed took place during the presidency of President Salinas de Gortari with the signing of a Free Trade Agreement with the United States and Canada. From this moment on, the State began to disengage itself from its welfare project and to consider that basic services could be privatized, starting with the telephone company which was sold to the businessman Carlos Slim, that has been named by Forbes four years in a row, including 2013, the wealthiest man in the world, a very emblematic symbol of the Mexican income distribution. At the same time, the NAFTA implied an end to the subsidies and protection for the agriculture. Today, 45% of the Mexican food is imported and the traditional diet has drastically changed, getting closer to the US habits and transforming Mexico into a country with most obese population in the world after the United States. For kids and teenagers it could even have reached the first place in the world. On the other end, one fourth of the population, 25 millions of Mexicans, are insufficiently fed and the proportion climbs to 40% for the ten million indigenous people in the country (what the other North Americans call the "First nations"). So while 70% of Mexicans are overweight, in 2012, 11,000 died of malnutrition.

This sad result, as well as the termination of the "import substitution model" and the perceived need for economic liberalization led the Mexican government from nineties on to abandon the building of a universal welfare state. Social Security covers half of the population. It is divided between two institutions, one for the private sector (IMSS, Mexican Institute for Social Security) and the other for the workers of the government (ISSTE, Mexican Institute at the Service of the State's Workers). Welfare State thus exists in Mexico and it is relevant for half of the population although as in many other countries it has been confronted for decades now with many serious problems rooted in its deficient financing; bad services, insufficient investments and deficits.

The ambitions of the successive Mexican governments in the past two decades have dwindled. They stopped trying to further build a welfare state in a world were even wealthy developed countries cannot afford it and progressively dismantle it. For half of the population that is not benefitting from what was achieved by the 90's, the government resorts to application of focused programs aimed at avoiding extreme poverty and thus social explosions.

2.2. New liberal programs to fight inequalities

In the beginning of his term, President Salinas (1988-1994) launched a "National Program for Solidarity". It was intended to the indigenous peoples, rural inhabitants of mountainous or desert regions as well as dwellers of marginal urban areas. It was linked to the "social participation" of the benefitted communities. The opposition saw in it a clientelistic and electoral bias. At the end of his term, "Solidaridad" represented 10.4% of the GDP, distributed through 250,000 communities but the number of poor had slightly increased.

The 1994 economic crisis provoked a steepsurge in the number of the poor reaching 69% of the population. That is why the incomimg president, E. Zedillo (1994-2000) decided to overhaul the main social development program of the government. In 1997 he launched the PROGRESA program (a program of education, health and nourishment). This program is still the base of social policies in Mexico. It phased out the intermediation of communities in delivering and administrating the goods. It thus handed out monetary help to the families (only to women) upon proof that their kids were attending school and all had to attend periodical medical checks up. At the end of Zedillo's term, 2.6 million Mexican families, two third of them indigenous, were included in the program. The effects of the 1994 was softened but still 53% of the Mexicans lived in poverty.

The new president V. Fox (2000-2006) maintained the program for two more years, before modifying it under the name of "*oportunidades*" (opportunities) along the same lines but extended to urban zones and secondary, and not only primary, education. One year before the end of Fox's term, it was also extended to persons older than 70. All in all, *oportunidades* budget was 70.6% more than *Progresa* and the proportion of poor spectacularly decreased to 42%. President F. Calderon continued and improved *oportunidades* with 60% more spending for alimentation in communities that did not even have the necessary infrastructure (schools, doctors) to use *oportunidade*s. Nevertheless at the end of his term, the number of the poor had increased again to 51.3% of the population as already mentioned, an increase of 21%.

Oportunidades will be maintained in the beginning of the new president E. Peña Nieto's term. But added to it, one of his first decisions was a "crusade against hunger" for 7.4 million Mexicans, hoping to eradicate hunger at the end of its term in 2018. Additional measures for indigenous and elder people were also decided.

Conclusion

The five last presidents of Mexico have led a strong liberal policy. They all have declared that the fight against poverty would be their priority and three programs have been implemented. But despite this strong will and the relatively good results of the economy, half of the Mexican are still living in poverty. These policies just acted as patches on terrible problems the way they were conceived.

Mexico is thus a clear demonstration of the fact that liberalizing trade and embracing globalization is not enough to tackle the income inequality problems and extreme poverty. Measures equalizing opportunities should be an indispensable component of the state policiesfor the country to harness its own potential and the opportunities of globalization.

Russia[22]

By **Darya Popova**, Leading Research Fellow, Independent Institute for Social Policy (IISP), Leading Research Fellow, HSE Centre for Analysis of Income and Living Standards

Inequality[23] is a part of economic reality of any society. It is also a constant focus of attention of academic community, from time to time becoming a matter of heated social and political debates. Social scientists consider the growth of income inequality as one of the major socio-economic risks posed by globalization (Firebaugh, 2003). Inequality issues have acquired a particular importance in connection with the market transition of post-socialist countries, including Russia, where the 'starting point' of transformation was the centrally

[22] This note is based on the results of the project of the Centre for Fundamental Research of the National Research University Higher School of Economics "The assessment of dynamics of well-being of the population of Russia and simulation of the effects of tax, economic and social policies on the household sector" (2013).

[23] The focus throughout the paper is on the national distribution of household incomes. However, in all societies, and particularly in Russia, there are many other types of inequality (e.g. in political power, social status, access to education, basic citizenship rights, etc.), and some may be more consequential than income in terms of their impact on a household well-being. However, in market economy income serves as a good predictor of well-being in other domains, such as social inclusion, education, health, etc. Noteworthy, in most OECD and Latin American countries the measures of well-being of households are based on income data. In contrast, in transition economies and in many developing countries the well-being measures are based on expenditure and consumption data. The Russian national statistics agency relies fully on expenditure and consumption data, while income data are considered a priori unreliable and are not collected. Income-based well-being measures for Russia can be derived exclusively from household surveys. See: Ovcharova, & Tesliuk (2006), Poverty and inequality in Russia: sensitivity of poverty and inequality statistics to alternative definitions of households welfare. Illustration using the NOBUS survey, Moscow, The World Bank.

planned economy. A sharp increase in income inequality has been the characteristic feature of the transition process. In the late 1980s Russia, along with the Scandinavian countries, was in the group of states with a low level of income inequality (OECD, 2008). At present, the scale of inequality in Russia is comparable to the economies of Latin America. This note aims to provide a comprehensive analysis of income inequality in Russia for the period since the beginning of market reforms. The sources of data are both official macro-statistics and independent sociological surveys.

1. What are Inequality Trends?

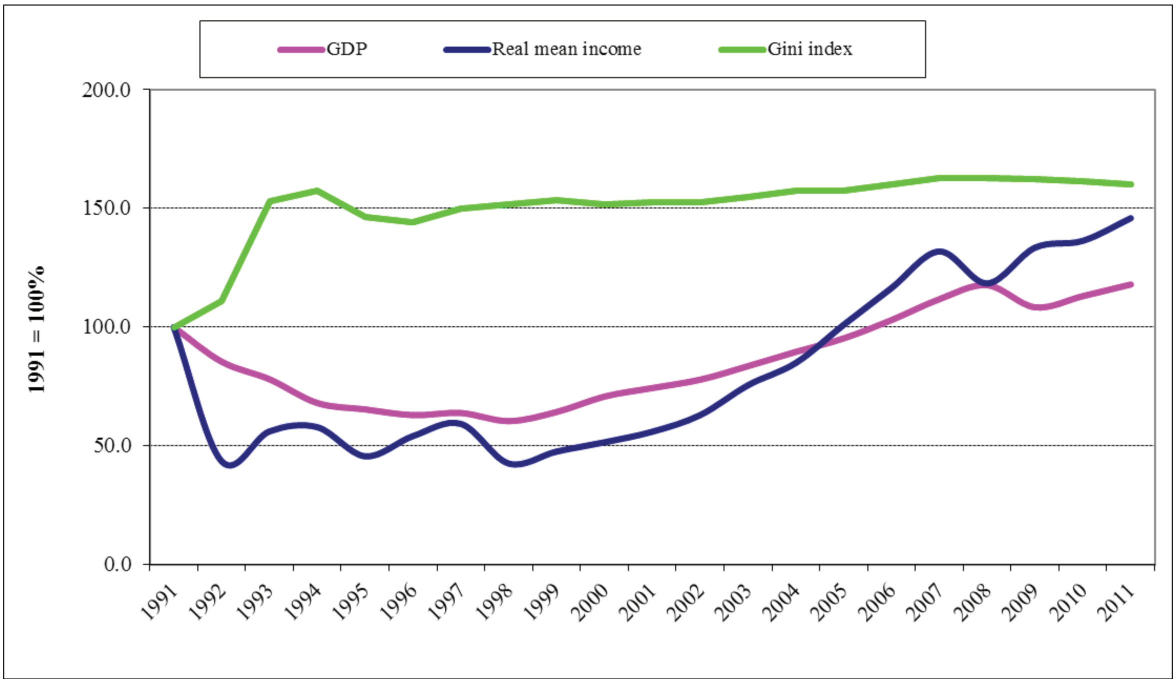
At the beginning of the transition period Russia, together with other post-socialist economies, experienced both a deep recession and an abrupt increase in income inequality. It was obvious that the transition from a planned economy to a market economy would have led to an increase in income inequality because of the collapse of ideological barriers that constrained income disparities. Gini index[24] has increased by almost 60% between 1991 and 1994 (Figure 1). The dynamics of other inequality measures used by the national statistics agency is also indicative of the immense scale of changes. The ratio between the mean incomes of the top and bottom deciles (so-called funds ratio) has increased from 4.5 times in 1991 to 15 times in 1994; the share of the first quintile in the total income distribution fell from 12% in 1991 to 5.3% in 1994 and the following years.

It was not until the early 2000s when the Russian government attempted to take income disparities under control using redistributive policies such as: (1) an accelerated increase in earnings of the public sector workers; (2) a sharp increase in the minimum wage; (3) a series of increases in the average and minimum pensions; and (4) an increase in spending on safety nets for vulnerable groups of the population. Nevertheless, all inequality indices showed a steady growth throughout 1999-2008, despite the fact that in this period the Russian GDP grew on average by 7% annually. The conjunctural economic

[24] Here and thereafter in this note, if not indicated otherwise, inequality is measured using per capita disposable income, i.e. the household income from all sources minus current taxes divided by the household size. If not indicated otherwise, the figures are taken from the website of the Federal State Statistics Service (FSSS). See: http://www.gks.ru/.

growth, which was not supported by an equal growth in labor productivity, inhibited the government attempts to reduce inequality by means of income redistribution. Income inequality has stopped growing just recently as a result of the new economic crisis which had a more adverse effect on income of the well-off strata, while incomes of the poor were supported by increases in the minimum wage and several indexations of pensions.

Figure 1. Dynamics of GDP, Real Mean Income[25] and Gini Index (in % to 1991)



Note: income data for December of the relevant year
Source: Own calculations based on the FSSS data (http://www.gks.ru/)

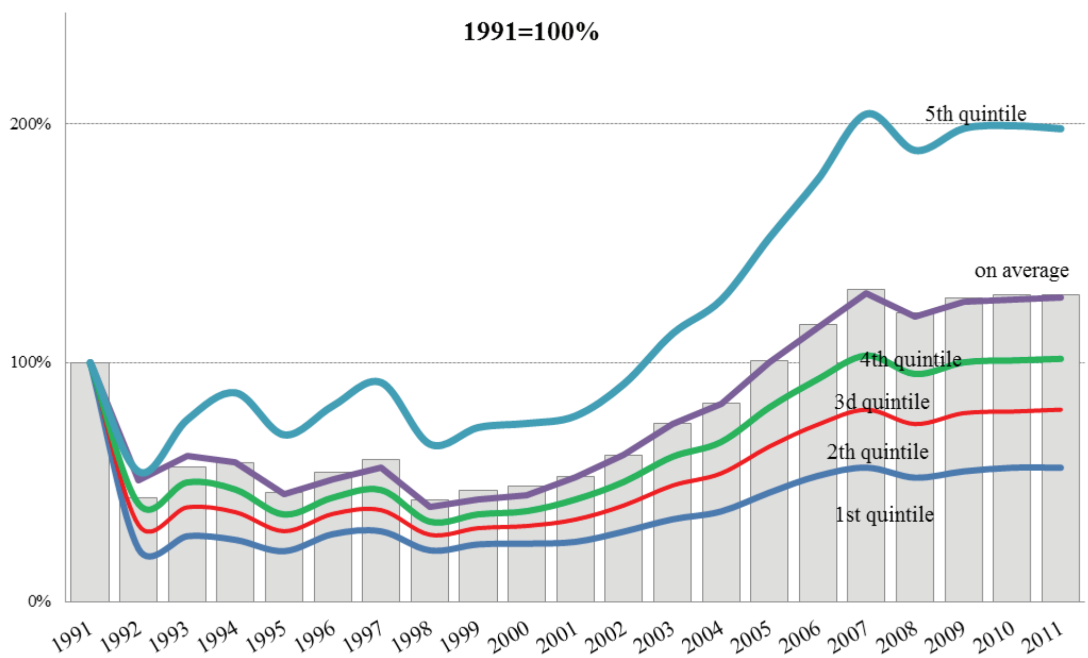
Given the magnitude of income disparities observed in Russia, the dynamics of mean income is close to the dynamics of the fourth quintile of income distribution (Figure 2). Real incomes of the fourth quintile and of the population on average have grown by 30% compared to the last pre-reform year (1991). Yet three bottom quintiles (or 60% of the Russian population) have seen a considerably smaller growth in their income. The third quintile has restored its pre-reform income level just in 2007, two years later than the fourth quintile.

[25] Real values are calculated by adjusting the nominal values for inflation using the Consumer Price Index.

Two bottom quintiles have not restored their pre-1991 income level until the current period. At the same time, incomes of the top income quintile more than doubled over the two decades. The accelerated growth in income of the wealthiest quintile can be largely attributed to the conjunctural nature of the Russian economic growth, which was mainly provided by the energy sector and mining industries. All in all, the Russian economic growth has not been inclusive.

The figures above give some idea of the extent and dynamics of income inequality in Russia in the last 20 years, yet it is worth noting that none of the current methods of inequality assessment in Russia produces fully reliable quantitative estimates of inequality level. Many independent researchers argue that the published inequality indices are substantially underestimated: firstly, due to reweighting of the Household Budget Survey data using the log-normality assumption, and secondly, due to ignoring regional disparities in the cost of living, as well as regional disparities in the population incomes.

Figure 2. Dynamics of real mean income by quintile groups



Source: Own calculations based on the FSSS data, URL: http://www.gks.ru/

2. What are the Causes of Inequality?

The effectiveness of redistributive policies to a large extent depends on the completeness and adequacy of knowledge about the nature and factors of inequality. These factors are formed at different economic levels. At the macro-level income inequality is a result of earnings inequality and public policies aimed at its regulation. Labor incomes – *earnings* and *entrepreneurial income* – are the most important and widespread income source for the population. They account for at least a half of the GDP and for almost 80% of the population income (earnings – for 65-70%; entrepreneurial income – for another 10%). Earnings to a large extent determine the size of *social transfers* – the second largest source of the population income. In recent years those accounted for approximately 18% of the total income.

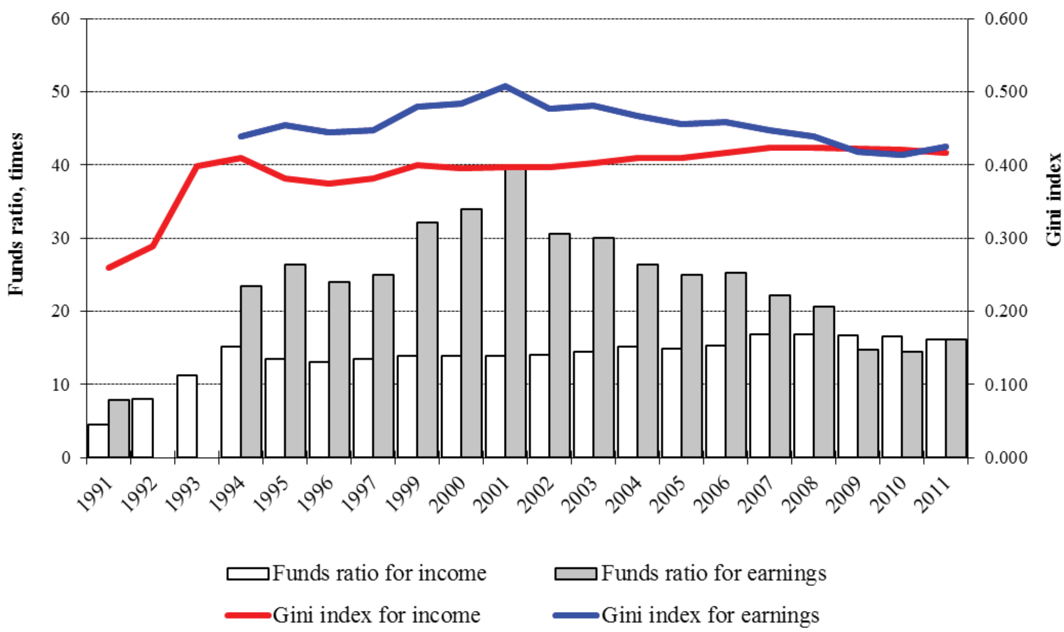
The earnings inequality is caused by disparities between and within the sectors of economy. Inter-sectoral earnings disparity can be explained by variation in economic value and competitiveness of production of various industry groups. The highest average earnings (exceeding the mean level at least by 1.2 times) are observed in the mining industry, infrastructure and government sector. The 'medium' group is formed by the manufacturing industry and construction. The 'inferior' group is represented by the public sector (except for government and military sectors), trade, hotel and restaurant business, and other communal, social and personal services. Agriculture, where the average earnings constitute no more than 50% of the country average, has a particularly low status. High earnings disparities are also observed within individual sectors. The highest ratio between earnings of the top and bottom deciles (20 times and higher) in the last years was in the service sector, including banking and finance, trade, hotel and restaurant business, and other communal, social and personal services.

One of the most negative features of the Russian labour market is the high incidence of low-paid employment. As of 2011, 13% of employed had earnings below the official poverty line – the *Subsistence Minimum*. In the public sector (education, health care, social services, culture and sports), as well as in agriculture, low-paid employment was characteristic for at least a quarter of workers. The scale of low-paid employment, in turn, is influenced by three factors:

firstly, the policy of containment of inflation at the expense of income security of the population, despite the fact that the rest of inflation-boosting factors are 'set free'; secondly, the high proportion of low-skilled jobs in the economy; thirdly, the growth in the share of working-age population with increasing family constraints on full-time employment, emerging as a result of the weak development of the social care services.

It is worth noting that the trend in earnings inequality does not fully coincide with the trend in income inequality (Figure 3).

Figure 3. Dynamics of income and wage inequality



Source: the FSSS data, URL: http://www.gks.ru/

Between 1991 and 2001, the ratio of earnings of the top and bottom deciles has increased from 7.8 to 39.6 times and then fell sharply to 30.5 times in 2002, which marked the beginning of a decline in earnings inequality in Russia. In 2009-2010 earnings inequality was even lower than income inequality. It is logical to assume that the persistence of income inequality could be attributed to *entrepreneurial incomes* and *incomes from property*. However, the mechanisms of formation of these sources of income (which in sum account for approximately 15% of the population income), have not changed so essentially as to create the effect of opposite dynamics of income and earnings inequality. Most likely to acoount for the growth in income inequality together with the reduction in earnings inequality was provided by the *unreported part* of earnings, which is estimated at 40% of total earnings or a quarter of the population income.[26]

In addition, at the macro-level inequality is caused by the weakness of the tax-related redistributive mechanisms, including a flat income tax rate, regressive social security contributions and low property taxes. For example, the total personal income tax and social security contributions in 2010 on average amounted to 43% of net earnings (Popova, 2012). In 2011, the social security contributions rate was increased by 30% (from 26% to 34% of gross earnings). In other words, labor income is subject to increasingly higher taxes. On the other hand, high-income groups pay virtually the same percentage of their income in social security contributions as low-income groups do, because a significant part of income of the former comes from entrepreneurial activities, property, investment and unreported earnings. Even if a portion of their income is made up of statistically observed earnings, a large part of them is not subject to social security contributions due to their regressivity. In 2010, the effective tax rate (income tax and social security contributions relative to disposable income) of the bottom decile was 10.6%, while the same figure for the 9th and 10th deciles was 16.4 and 14.7%, respectively. Property taxes on the rich are almost non-existant. Yet the main causes of high inequality at the macro-level are the high prevalence of low-paid employment and the lack of jobs in the formal sector of the economy.

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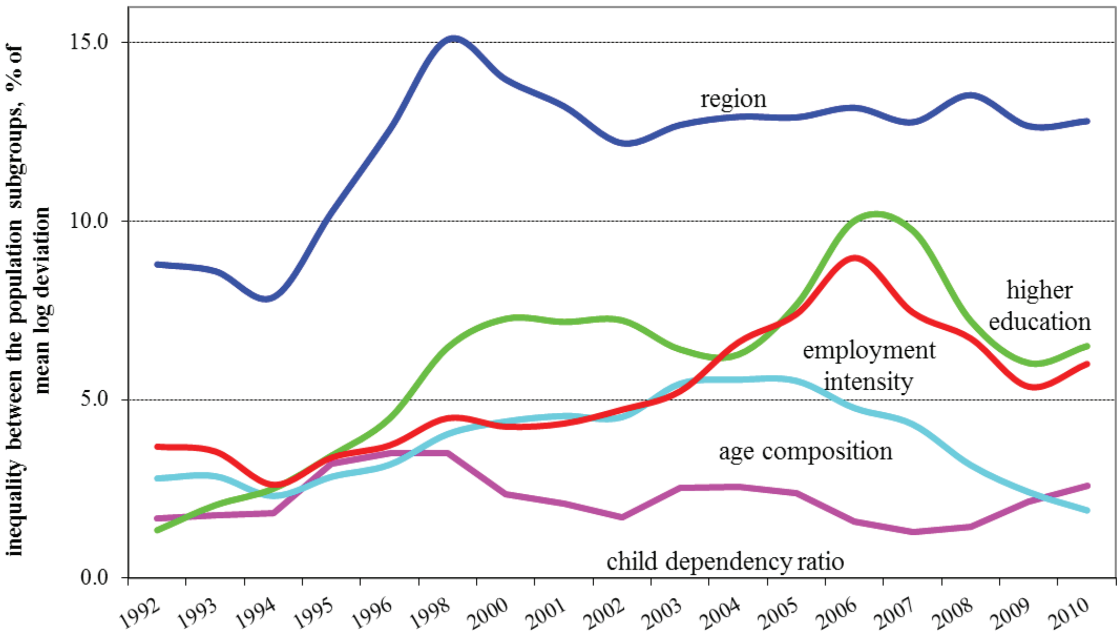
[26] The specificity of the Russian labour market is that demand and supply are balanced not due to lay-offs of the labour force as in other post-socialist economies, but due to the super-flexible mechanisms of labour remuneration, which allow firms to keep labour force, at the same time significantly reducing wages. The increased flexibility of earnings together with the stable employment rate have caused the development of non-standard forms of remuneration, which are hidden from statistical observation. Only a half of unreported earnings can be classified as informal economy, while the other half is made up by earnings of employees at small and medium firms which fall out of Labour Force Surveys. The poorest and the richest part of the population tend to have the highest share of unreported earnings. Typically, this part of earnings is most susceptible to reduction in the crisis conditions, but it restores and grows very fast as soon as recovery begins. See: (Gimpelson, & Kapeliushnikov, 2011).

At the micro-level, income inequality is a result of disparities in incomes of households with different demographic and socio-economic characteristics. For example, earnings tend to grow with age due to the accumulation of experience and/or improving the match between employees' skills and employers' requirements. The family composition has an impact on household incomes; the latter are usually reduced due to the presence of children. Since employment is the main source of livelihood for most households, household incomes are largely determined by the labour market status of the household members. Education is a determinant of an individual's prospects in the labour market. According to the human capital theory, individual productivity is growing with the number of years of education, which is reflected in higher earnings of people with higher education. The prospects of individuals in the labour market may also depend on the spatial aspects of the labour market – access to employment and earnings may be higher in more urbanized territories. If there are obstacles to mobility of people, spatial inequality can be a source of stagnant poverty for households living in less economically advanced territories.

The contribution of those household characteristics to overall inequality can be determined by decomposing aggregate inequality indices by population subgroups (Shorrocks, 1984). The application of this method in Russia (Figure 4) has shown that in the period of 1992-2010 the fastest growing factor of inequality was 'higher education', whose weight increased five-fold (or seven-fold excluding the crisis years 2008-2009). At the same time, during the whole period the most important inequality factor was regional inequality, even though its contribution has started to decreased since 2000. It is important to stress the different roles of these two factors in the Russian economy. Rising inequality as a result of the growth in incomes of highly-educated people (due to increased return on investment in education) is typical for developed market economies, hence a significant increase in inequality due to education is a positive trend. At the same time, high contribution of regional disparities to the overall inequality is a negative phenomenon in terms of economic development, and can be regarded as a manifestation of a social risk, and a barrier for inclusive economic growth and human development.

Figure 4. Factors of Inequality at the Micro-Level (% contribution of Inequality between the Population Subgroups to Total Inequality, mean logarithmic deviation)



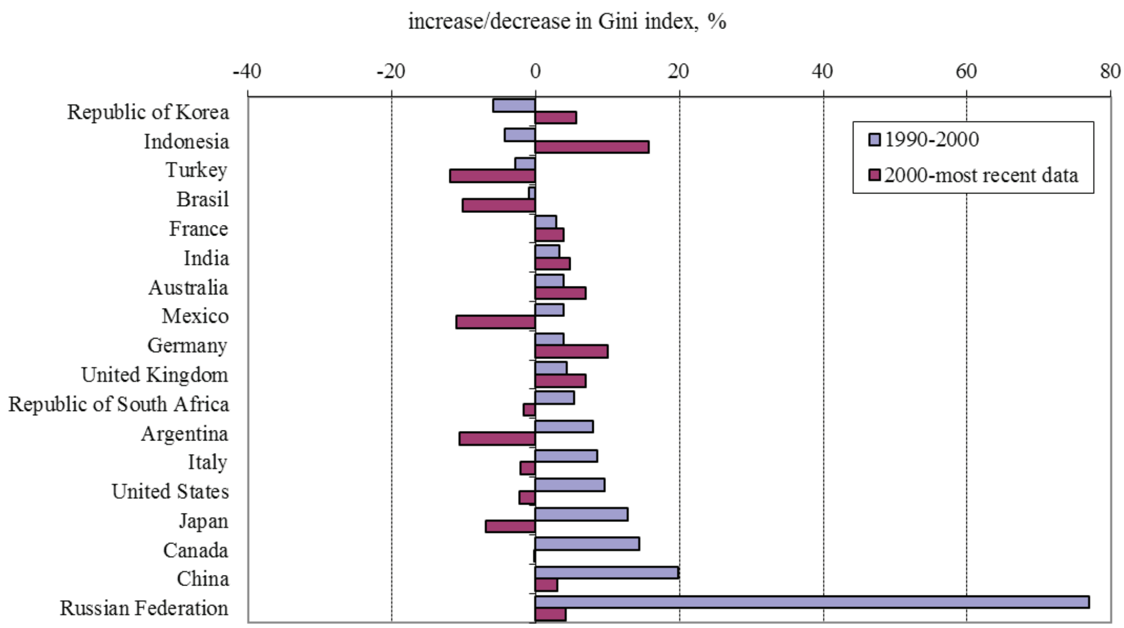
Source: Own calculations based on the Russian Longitudinal Monitoring Survey (http://www.hse.ru/rlms)

3. Inequality in Russia and Other G20 Countries

The experience of the G20 countries suggests that high levels of income inequality and the growth in inequality are not inevitable attributes of a certain stage of economic development and depend on the effectiveness of redistributive policies, rather than the size of national economy. Countries with the lowest level of inequality (Gini coefficient of about 0.300 or below) are rich countries with a strong welfare state (France, Germany, Japan, Republic of Korea and Canada). The medium group (Gini coefficient of 0.320-0.380) consists of rich countries with a weak welfare state (Italy, Australia, the United Kingdom and the United States) and three middle-income countries (India, Turkey and Indonesia). Russia, together with South Africa, Mexico, Brazil, Argentina and China, belongs to the group with the highest inequality level (Gini index of about 0.400 or higher).

Figure 5 indicates that over the past 20 years income inequality has increased in almost all G20 countries, including the wealthiest. However, Russia is the clear leader in this regard. For example, in China, ranked second after Russia by the inequality growth, Gini index has increased by 20% in the 1990s and by 3% in the 2000s. Russia's Gini index has risen by 77% in the 1990s and by 4% in the 2000s, despite the fact that the initial level of inequality in Russia before the market reforms was lower than in rich European countries. There are some positive experiences in G20 as well; in Brasil and Turkey inequality has been decreasing in the last two decades, while in the last decade there has been a reduction in inequality in Argentina, Mexico and Japan.

Figure 5. Dynamics of Inequality in G20 Countries



Note: Gini index for equivalised disposable income (square root equivalence scale)

Source: Own calculations based on (Solt, 2009)

4. What Changes Can Affect the Level of Inequality in Russia?

Economic inequality can be affected by redistributive policies targeted at the poor and the wealthy, as well as by general economic development trends.

Improvement of the *social protection system* can significantly reduce inequality. Key measures are related to the improvement of the system of targeted cash transfers for the poor, which accounted just for 0.5% of GDP in 2010.

Non-contributory social assistance programs in total accounted for 2.8% of GDP, but most of these resources (1.7% of GDP) were spent on the privileges[27] which generally do not reach the poor well and achieve little in terms of poverty reduction. Noteworthy, in other middle-income countries spendings on targeted transfers for the poor range between 1 and 2%, while in OECD countries on average they reach about 2.5% of GDP (Weigand & Grosh, 2008). Apart from cash transfers, efforts should be made to increase the availability and quality of childcare facilities, which will have a positive impact on the productivity of women. The first priority is elimination of shortage of places in kindergartens, while the strategic goal is universally available pre-school education.

Regulation of inequality through *taxation* is generally carried out by means of reducing incomes of the rich. One of the most effective tools of inequality reduction is a progressive tax scale, but it is not a priority measure to be implemented in Russia. Introduction of progressive income taxation may cause a rise in informal economy and can stop the growth of the middle classes. The structure of inequality in Russia calls for the introduction of tax measures targeted at the richest groups of the population, such as property and luxury taxes. Noteworthy, some attempts in this respect have been recently initiated by the government and respective measures are expected to come into force in January 2014[28]. Apart from that, redistributive capacities of the tax system could be achieved by reducing taxes for the poor. A good alternative

[27] This is an element of the social protection system inherited from the Soviet times. The privileges are not means-tested benefits in the form of cash transfers or free services or discounts on payment for services provided to vulnerable categories of the population, such as people with disabilities, war veterans, dependents of war victims, victims of the Chernobyl accident, etc., but they also cover numerous categories for services to the state and those based on occupational status.

[28] The amendments to the existing legislation are currently being developed by the Ministry of Finance. They include the introduction of higher tax rates on luxury cars and real estate. For example, the document suggests a tax on luxury cars that cost more than 5 million rubles. There will be a double tax rate for cars that cost 10.5 million rubles and are not older than 5 years, and a triple rate for cars that cost 10-15 million rubles and are not older than 10 years. This is a regional tax, so regional authorities have the right to raise or reduce the tax rates. In addition, taxes will be levied on real estate with the cadastral value of over 300 million rubles. If the total value of the real estate is over 300 million rubles, the dwelling will be taxed at 0.5% rate and the land – at 1.5% rate. if the estimated cost of a dwelling or an unfinished building is over 300 million rubles, it will be taxed at 0.5-1% rate.

to the reform of tax rates could be the increased support to families with underage children (who constitute the majority of the poor in Russia (UNICEF, 2011)) through the system of tax benefits, which are successfully applied in many European countries. Tax benefits are less capital-intensive and can be easily spelled out in the Tax Code. Promoting equal opportunities in access of the population to good quality *education and health care services* is an important source of inequality reduction. Despite the prevalence of cash income as the main proxy of well-being, an expansion of approaches based on multidimensional estimates of well-being, taking into account not only income, but also non-monetary variables, such as health and education, has been odserved over the past few decades. For example, such multidimensionality is the foundation of the UNDP Human Development Index (HDI). In 2010 Russia was ranked 66 by the overall HDI value (UNDP, 2011). The inequality adjusted HDI improves the position of Russia by 7 ranks due to the fact that countries with higher income inequality such as Mexico, Brazil and Venezuela, go down in the overall ranking of countries. However, the HDI based on indicators of health and education only (without the GNP measure) worsens the position of Russia by 13 ranks (mainly due to the extremely low life expectancy values). This demonstrates that the material gains from the Russia's economic growth have not yet transformed into gains in social development.

Regional inequality remains one of the most problematic features of inequality in Russia. Some politicians see the solution to the problem in supporting the depressed territories through the system of intergovernmental transfers. However, the comprehensive research suggests that this approach is inequitable, as the major part of those resources are being captured by regional elites. The package of policies to reduce regional disparities should include policies promoting labor migration, investment in social infrastructure of the depressed territories and subsidies to firms creating new jobs, instead of subsidies to the budgets of those territories. Assisted migration, in turn, must be accompanied by policies facilitating the reallocation of people through the development of social housing and mortgage loans.

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Turkey

By **Feride Inan**, Research Associate, TEPAV

Introduction

In the aftermath of 2001 economic crisis the Turkish economy experienced unprecedented growth achieving an average annual real GDP growth rate of 5.2% between 2002 and 2011.[29] Favorable economic conditions fueled by growth led to improvements in labor market indicators; formal employment expanded while per capita income between 2002 and 2011 rose from 3,500 USD to 10,500 USD. Meanwhile inequality, as measured by the Gini coefficient[30], dropped by 8.1 percentage points between the mid-1990s and late 2000s (2007) (OECD, 2011b).

In spite of substantial progress, Turkey faces a high rate of inequality when compared to other countries in the world. In 2011 the top 20% income group

[29] The Turkish economy was Europe's fastest growing economy in 2011 expanding at a 8.5 percent rate. According to OECD's projections Turkey will continue to be the fastest growing economy amongst OECD members during 2011-2017, with a predicted annual average growth rate of 6.7 percent.

[30] Different methods have been used to calculate the Gini coefficient over time and by different countries and different organizations. For instance, earlier inequality studies in Turkey showed inequality between households and not individuals. Starting with TUSIAD in 1987 disposable income per adult equivalent was used to calculate inequality. Furthermore, Gini scores are calculated using different equivalance scales for household members such as household size (HS), OECD, Eurostat and Oxford. The Turkish Statistical Institute (TurkStat) uses the OECD modified scale, which gives a weight of 1.0 to the first adult, 0.5 to the second and each subsequent person aged 14 and over, and 0.3 to each child aged less than 14 in the household. Since TurkStat data is most available for Turkey, OECD country data will be used to compare with other countries where available.

of Turkey's 74 million population accounted for approximately 45.2% of national income while the bottom 20% income group accounted for only 6.5%. There are deep income gaps between regions as well as between rural and urban areas. Furthermore, informal employment without access to social benefits is as high as 38.4% (as of January 2012) with 82.8% of agricultural employment in the informal sector (The Turkish Statistical Institute, 2012a) Turkey is also behind on human development indicators (HDI). Access to income generating opportunities such as education is low and inadequate especially for children coming from lower income groups (particularly from developing regions and rural areas). The Turkish tax system largely relying on indirect consumption taxes accentuates imbalances in income distribution rather than contributing to social welfare. The government has taken various measures in the past few years to channel investments to developing regions and to the agricultural sector and to create employment opportunities. Revamping of the education system has also been central to the government's efforts and has resulted in expanding enrollment in all levels of education and of female students. Yet drop-out rates for children from developing regions continue to be high and low quality in education persists.

Income Distribution and Poverty Trends in Turkey

Income inequality in Turkey has generally been declining over the past few decades. Mukhopadhaya (2004) study of global inequality trends between 1950 and 1998 showed that Turkey was one of the countries in the second highest Gini score group (also including Argentina, Venezuela, Malaysia) with an average Gini score between 0.45 and 0.5 (Mukhopadhaya, 2004). Taking a closer look at changes over time, the Gini coefficient declined from 0.56 in 1968 (Bulutay & Ersel, 1971) to 0.43 in 1987(SIS, 1990) but went up in the aftermath of market reforms of the 1980s reaching 0,49 in 1994 (SIS, 1996).[31]

[31] While similar reform policies led to increases in income inequality in many OECD countries, the effects on middle and low income groups were most pronounced with the three middle income groups share of GDP falling more than in any other OECD country between the 1980s and 1990s. Furthermore the lowest income group's share fell more than any other OECD country except for Italy and New Zealand although the increase in the GDP share of the highest income group was not as striking as was for most OECD countries (OECD, 2008).

However, the Gini score declined at a faster rate since the mid-1990s than it had increased between the 1980s and 1990s. Turkey was one of the few OECD countries for which income inequality experienced an overall drop between the mid-1980s and late 2000s. Between 2006-2011 the Gini score was on average 0.41[32] and 0.40 in 2011. The decline in the Gini since 2002 is captured in a decline in the quintile income dispersion ratio,[33] which expresses the income of the rich as multiples of that of the poor, falling from 9,5 in 2006 to 8,1 in 2008 and 8 in 2011.[34] With income inequality declining, the share of national income of bottom and middle earners has gone up. From 2002 to 2011, the share of national income earned by the top 20% fell 9,6% (from 50 to 45.2%). Meanwhile, the poorest 20% saw its income share grow 22,6% (from 5,3 to 6,5%). On the other hand, income for the majority of the population in the middle 60% grew just 8,5% (from 44.6 to 48.4%) (The Turkish Statistical Institute, 2011b).

Yet, inequality in Turkey, measured by the Gini coefficient, is higher than those in developed nations, and even in some developing countries such as India, Indonesia and Russia. In the late-2000s Turkey ranked third highest for income inequality amongst OECD countries (after Mexico and Chile). This notwithstanding the fact that between the mid-1980s and late 2000s, household incomes in Turkey increased at a faster rate for the bottom deciles; in the same period, household incomes in most OECD 27 countries increased faster at the top deciles (OECD, 2011d).[35] At the same time, Turkey shows a lower rate of inequality when compared countries with similar GDP per capita levels e.g. China, Argentina, Mexico, Brazil and South Africa (*See* Annex 1).

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[32] According to Turkish Statistical Institute (TUIK) data the Gini coefficient for the distribution of equivalised household disposable income fell steadily until 2005; from 0.49 in 1994 to 0.44 2002 and 0.40 in 2004. The Gini score jumped up to 0.43 in 2006, and fell back down to 0.41 until 2009 when it was 0.42 and was at approximately 0.4 level in 2010 and 2011.

[33] The average income of the richest 20 percent of the population divided by the average income of the bottom 20 percent.

[34] Along with the Gini coefficient which went up in 2009, the quintile ratio also rose to 8.5.

[35] The Average annual income change was 0.8% for the bottom decile and 0.1% for the top decile. The only other countries for which incomes for the bottom deciles increased at a faster rate were Belgium, Chile, France, Greece, Ireland, Portugal and Spain.

Improvements in income distribution led to a decline in income poverty measured in absolute terms. The share of population living under 1 USD per day has been down to zero since 2006. From 2002 to 2011, the population living below 2.15 USD fell from 3.04% to 0.14%. Similarly, the share of the population living below 4.3 USD per day fell from 30.3% to 2.79%. Food poverty and complete poverty (food + non-food) rates have also fallen since 2002. 339 thousand (0.48% of the population) and 12.75 million (18.08% of the population) persons continue to suffer from food poverty and complete poverty, respectively. These percentages are very high for rural areas with 1.42% and 38.69%, respectively (The Turkish Statistical Institute, 2011a).

The poor performance of the rural economy facing cuts in government subsidies in the aftermath of the 2001 Turkish economic crisis affected relative poverty rates. These increased (based on expenditures)considerably between 2002 and 2009 (from 14.74% to 15.12%) due to a sharp increase in the relative poverty of rural areas from 14.34% to 34.20%[36] (The Turkish Statistical Institute, 2011a) In terms of relative poverty, Turkey is above the OECD average of 11.1% (OECD, 2011c).

Income Distribution amongst Regions

In Turkey, income distribution is extremely uneven among regions; the more prosperous regions are in the West and poorer regions are in the East and North-east. Dividing the Turkish territory into 12 areas (Statistical Region Level 1)[37] – excluding Istanbul – the top shares of Gross Value Added (GVA) range between 13.8% and 10.4% for four rich regions in the West and the rates tumble down to a very low share between 4.9% and 1.5% for the remaining seven regions (generally in the East but also in West Marmara). The Istanbul region is by far the most prosperous of the nation contributing alone for a 27.7% of the domestic GVA. Western regions of Aegean and East Marmara, are second and third in their share of GVA, respectively. The poorest regions

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[36] There was a fall in the share of relative poverty in urban areas by 4.74% points.

[37] The 12 regions are: Istanbul, West Marmara, Aegean, East Marmara, West Anatolia, Mediterranean, Central Anatolia, West Black Sea, North-East Anatolia, Central-East Anatolia and South-East Anatolia (Turkey Statistical yearbook, 2004).

are North-East Anatolia, Central East Anatolia and East Black Sea (The Turkish Statistical Institute, 2007 – 2008)[38] (*See* Annex 2).

Regional differentiation is also manifests in income per capita. South-Eastern Anatolia has the lowest average income with USD 2870 – almost half the Turkey's average of USD 5700 and almost a third of the richest Istanbul region (USD 7870) (The Turkish Statistical Institute, 2011 b). However, the level of income per capita does not always move in parallel with GVA (e.g. West Marmara has relatively high income per capita but low GVA and South East Anatolia performs better on its GVA than income per capita level).

South-East Anatolian region also has the highest number of poor and regional poverty rate of 3,749 persons and 32.3%, respectively, when relative poverty is calculated according to the national poverty line.[39] Similarly, Central East Anatolian and Mediterranean regions have 1548 and 1410 persons living under the national poverty line, respectively. Wealthy regions such as Istanbul and the Aegean have far fewer poor persons (446 and 706, respectively) (The Turkish Statistical Institute, 2011 b).

Any evaluation of inequality in Turkey has to take into account the significant regional variations in income and in consumption capacities. Hence, purchasing power parities that assume homogenous consumption patterns across the country may have a distorting effect on price levels in different regions. Regional poverty thresholds that are calculated according to regional poverty lines, however, point to a different picture. Above all, such calculations show that industrialized regions such as Istanbul and the Aegean have more persons living under the poverty line. Also, for Eastern and the Mediterranean regions the numbers for the poor are lower when calculated with respect to regional poverty than if calculated with respect to national poverty line (The Turkish Statistical Institute, 2011 b) (See Annex 3).

[38] Dividing the country into 26 regions (statistical region level 2) second to Istanbul is the Turkish capital of Ankara (in the Western Anatolian region) contributing a share of 8,5% GVA followed by Bursa, Eskişehir and Bilecik in East Marmara (located in Western Turkey) contributing 6,6%. Ağrı, Kars, Iğdır and Ardahan in the North East Anatolian Region add as low as 0,6% to the national GVA.

[39] Measured 50% of the national median equalized disposable income.

Considering the Gini coefficient with respect to regions, presents an even more puzzling and complicated picture. While the lowest Gini index – 0.326 and 0.327 – recorded for the East Marmara and East Black Sea regions, respectively, correspond with low relative poverty levels (in relation to both national and regional poverty lines), the Western Black Sea region with the third lowest Gini score, has high relative poverty rate (in relation to the regional poverty line). On the other hand, the East Central Anatolia, which has the highest Gini index – 0.427 – well above the national value of 0.404, has high relative poverty and one of the lowest income per capita levels. (The Turkish Statistical Institute, 2011b).

Different arguments have been put forth regarding the relation between income levels and inequality. Dayioglu and Baslevent (2005) argue that high income regions that receive migration have more inequality than migrant –sending low income regions (Dayioglu & Baslevent, 2005). This argument holds true for relatively high income regions such as the Mediterranean and Aegean regions that also have high Gini index scores – 0.404 and 0.397, respectively. On the other hand, the Eastern Black Sea with a relatively high income per capita – just below the national average – has the lowest Gini index of 0.326. Similarly, Istanbul with the highest average income per capita, has a relatively low Gini index of 0.371 and Central East Anatolia with the second lowest income per capita has the highest Gini score (See Annex 4).

This picture suggests that neither GVA, income per-capita nor poverty are exhaustive enough to explain inequality in Turkey. Inter regional inequality is multi-faceted and the overall income inequality among regions should be assessed looking at conditions and opportunities including for employment and education.

Employment

Employment trends in Turkey, although improving in the past decade, are worrisome further aggravating income gaps, poverty and regional differentials. Of persons aged 15 to 64 only 44.9% had a paid job in December 2012 (The Turkish Statistical Institute, 2012a), which is lower than the OECD employment average of 66% (OECD, 2011c).

Agriculture with its low-productivity is still one of the most important sectors of the labour force while contributing a small share to households' income. In 2012 employment in the agriculture sector comprised 24.6% of total national employment. Agricultural employment was almost or more than double the national average for Eastern Black Sea and North Eastern, Central Eastern Anatolian regions but also high in Western Black Sea as well as in Aegean and Mediterranean regions. On the other hand, industrial employment was high in Western provinces as well as above the national average in South Eastern Anatolia (The Turkish Statistical Institute, 2012a) (*See* Annex 5).

Furthermore, female and informal employment as well as unemployment are more prevalent in the agricultural sector; 17.7% of men were employed in the agricultural sector compared to 35.6% of women. The share of unregistered workers in the labor market without any social security is 37.4% of which 84% were in agricultural employment and 23.5% in non-agricultural employment. The unequal distribution of work between men and women in agriculture is even more emphasized in informal employment where the share of male workers is 73.1% to 96.8% female employment (The Turkish Statistical Institute, 2012a).

On the other hand, unemployment rate in agriculture stood at 10.1% in 2011 while non-agricultural unemployment rate was 12.4% (possibly due to the fact most agricultural employment being informal). Youth unemployment rate was as high as 19.8% (The Turkish Statistical Institute, 2012a).

Human Development and Access to Opportunity

Human Development Indicators

In Turkey poor people often lack resources such as financial capital, quality education and basic health services to improve their human capital, generate income and get out of poverty. Turkey's Human Development Index (HDI) value was 0.722 in 2012. Between 1980 and 2012 the HDI progressed from 0.474 to 0.722 – an increase of 52% – and the country passed onto the high human development category. Most of the rise in the HDI was due to a growth in GNI per capita increasing about 133% between 1980 and 2012 (UNDP, 2013).

Life expectancy also increased significantly during the same period by 17.7 years reaching about 74 years in 2012, though still about six years lower than the OECD average of about 80 years. Life expectancy for women is better at 77 years, compared with 72 for men (OECD, 2012a).

Although Turkey outperforms other high human development category countries for GNI per capita and life expectancy rates, the country's poor performance in education is a drag on the country's HDI value which remains below the average of 0.758 for these countries (UNDP, 2013).

Turkey's HDI value is also behind the 0.771 average for European and Central Asian countries. Furthermore, when Turkey's HDI value of 0.72 is discounted for inequality, it falls to 0.56, a loss of 22.5%. Losses in potential human development due to inequality is largest for inequality in education – falling 27.4% – followed by losses due to inequalities in income and life expectancy at birth of 26.5% and 12.8%, respectively (UNDP, 2013).

Access to Education

In Turkey, there are income differentials among persons with different levels of education, and having education is an important prerequisite for finding a job. According to TurkStat's Structure of Earnings Survey (2010), earnings of workers increased with higher level of educational attainment and workers with the highest degrees in education received highest earnings and worked the least contractual hours per week. Furthermore, access to and equity in educational opportunities holds the key to understanding why some groups and regions find it difficult to improve their incomes and growth conditions, respectively.

In Turkey 33% of adults aged 25-64 have the equivalent of a high-school degree, much lower than the OECD average of 74%. This is truer of men than women: 35% of men have successfully completed high-school compared with 26% of women (OECD, 2011a). Notwithstanding, Turkey has made significant progress in providing access to education between 2000 and 2011 when net enrollment rates increased for all levels of education. The country almost achieved universal primary school enrollment with a 98.67% net enrollment rate as of 2011/12 and secondary and tertiary education enrollment reaching 67.37% and 35.51%, respectively.[40] However, the rate of transition to secondary education is still insuf-

[40] The Turkish Statistical Institute. Education Statistics.

ficient, due to drop-out rates in the primary schooling. Gökşen, Cemalcilar, and Gurlesel (2006) found that the cumulative drop out rates for primary education for the period 1997–2005 was 14.7% (Cemalciler & Gökçen, 2012).

Studies have pointed to financial limitations of households in explaining the growing gap between the educational expenditures of rich and poor households. Duygan and Guner's (2005) study focusing on bottom and the top income groups, showed that there is a negative relation between low income and education levels (Duygan & Guner, 2005; Duman, 2008). In 2005 more than half of the overall population and the poorest 20% income group, stopped their education at the primary level and only 8,05% and 0,47%, respectively, reached the higher education level. On the other hand, 26,84% of the richest 20% income obtained a higher level education.

Table 1. Education of Head of Households of Rich and Poor Income Groups and Overall Population (2005)

	Pre Primary (%)	Primary (%)	Secondary (%)	High (%)	University (%)
Poorest 20%	30.05	58.24	7.03	4.2	0.47
Richest 20%	5.39	35.89	8.54	23.33	26.84
Overall Population	14.92	53.26	9.57	14.21	8.05

(Duygan & Güner, 2005)

Furthermore, Caner and Okten (2012) show that children coming from privileged social and economic backgrounds are more likely to succeed in the highly competitive nationwide university entrance exam [41]and get admission to the most prestigious public universities, thus, receive higher subsidies from the government (Caner & Okten, 2012).[42] Also given a low quality of primary public education family background becomes even more important.[43]

[41] About 1.2 million students attended private tutoring courses in 2011-2012 (ERG, 2010).

[42] Duman (2008) also points to government bias in expenditures towards tertiary education, preschool and primary, which in turn decreases the chances of poor households utilizing these services. Public spending per student in 2011 for primary, secondary and vocational education was USD 1,580, USD 1,450 and USD 1,010, respectively (ERG 2010). There is no data available for spending per student at the tertiary level.

[43] The average Turkish student scored 454 in reading literacy, maths and science in the OECD's Programme for International Student Assessment (PISA) 2009, ranking 32nd out of 34 OECD countries.

Furthermore, although the regional gap in access to education has improved, enrollment continues to vary significantly across regions. Regional disparities in net schooling rates are significant with some western provinces of Turkey showing a net schooling rate of around 90%. This rate drops to around 30% in some eastern provinces (ERG, 2010). For example, for Central Eastern Anatolia the net enrollment rate for primary education as of 2011-12 is 94.1% whereas it is almost 100% for western regions including Istanbul (99,4%) and West Marmara (99%) (ERG, 2010).

Recent studies have also emphasized internal migration dynamics in the last 15 years as a reason for high drop-out rates (Gökşen & Cemalcilar, 2010). These have pointed to tensions in the southeastern regions of Turkey that led to the displacement of people resulting in the loss of 'traditional' lifestyles based on agriculture. Populations that did not have the right skills under new labor market conditions were pushed into informal and irregular work and families with limited financial means could not send their children to school (Yukseker, 2007)[44]. In many instances children were compelled to work to contribute to family income.

Disparity in educational levels between men and women is also recorded. Gender Inequality Index (GII) reflects gender-based inequalities in education with 26.7% of adult women reaching secondary or higher level education compared to 42.4% of their male counterparts (UNDP, 2013). Education data for 2011/12, however, shows a narrowing of the gender gap: female to male ratios for enrolment in primary, secondary and tertiary education are 100.41%, 93.29% and 87.38%, respectively (Turkish Statistical Institute, 2012b).

Women in rural areas were at a greater disadvantage when compared to their urban counterparts; urban and rural primary enrollments for women standing at 94% and 90.6%, respectively, in 2010. For secondary education the difference was even starker with 41.1% and 64.7% enrolled from rural and urban areas, respectively. There is also a sharp urban – rural divide for males in secondary enrollments (53.6% in rural and 67.5% in urban) although it is not as high as for females (ERG, 2010). Finally, research points to the

[44] Yukseker (2007) also argues that due to financial constraints families had to choose which of their children to send to school in which case the daughters were often eliminated.

positive influence of mother's education at any level for female students (Caner & Okten, 2012).

Government Policy

Impact of Tax Policy on Inequality

In Turkey, the overall reduction in income inequality after taxes and transfers is less than for most OECD countries with the Gini Coefficient falling slightly from 0.464 to 0.409 (for the late-2000s). The OECD-wide inequality in income after taxes and transfers, as measured by the Gini index, was about 25% lower than for income before taxes and transfers in the late 2000s. Furthermore, according to the OECD figures (based on the 50% mark; in the late 2000s) 22% of the Turkish population were relatively poor before taxes and transfers and 17% were poor after taxes and transfers. Almost all OECD countries have higher percentages of relative poverty than Turkey before taxes and transfers and much lower after taxes and transfers. The USA and Mexico are the only two OECD countries that have higher percentages of relative poverty after taxes and transfer (OECD, 2012b).

The impact of taxes and transfers on income inequality depends on their size, mix and progressivity (Joumard et al., 2012). In Turkey the tax to GDP ratio at 25.7% was significantly lower than the OECD average of 33.8% in 2010 (OECD, 2013). Furthermore, the Turkish social security system comprises of cash transfers which are largely insurance based (e.g. pensions) with an aim to preserve former income levels and have little redistributive impact (OECD, 2012c) On the other hand, in kind transfers (in health and education) – which could enhance equality – as a share of GDP remain low.

Another feature of the Turkish tax system which limits its redistributive impact is that it relies heavily on the regressive consumption tax while taxes on income make up a small share of total taxes. In fact the tax revenue from personal and corporate income taxes declined from 7.1% of GDP in 2000 to 5.9% in 2011. The 2010 figure was 5.6%, half the OECD average of 11.3%.(Joumard et al., 2012) On the other hand, the share of consumption tax – taxes on goods and services – in total tax revenues increased from 36% in 1985 to 42% in 2000 and 48.4% in 2010 making indirect taxes the main source of tax revenue in the government budget with the percentage share of the direct taxes (on income) declining over time (OECD, 2012b). Today, the percentage share of taxes on goods and services is the highest amongst the OECD countries (the OECD average is about 33.1%); the income tax revenue is much lower than for the OECD average (OECD, 2012b). In this sense, Turkey represents a typical developing country, which has limited coverage of direct taxes and a predominance of domestic indirect taxes in its tax policies (Chu et al, 2000).

The redistributive impact of indirect taxes – taxes on goods and services – are typically regressive, with the poor paying a larger portion of their incomes in tax than the rich. In Turkey, in order to counteract the regressive impact of the indirect VAT tax on consumption goods, differential lower rates are applied to subsistence goods, i.e. 1% on raw food, 8% on processed food, and 18% as the standard rate. There is also the Private Consumption Tax (PCT), an excise tax for luxury goods. The PCT is not levied as widely as the VAT, however, its share in total indirect tax revenue is higher than that of VAT. Another excise tax is the Private Communication Tax (PCOT) levied on all types of installation, transfer and telecommunication services provided by mobile phone operators.

Studies on Turkish tax policy indicate that the tax system, which relies on the consumption tax, increases inequality and poverty in Turkey, particularly in Eastern and Southeastern regions where poverty is more extreme (Gökşen et al., 2008; Albayrak, 2010) Albayrak (2010) argues that indirect taxes will keep having a negative impact on inequalities in Turkey and that to reverse this trend would depend on the government's ability to expand the tax base for progressive direct taxes on income by decreasing informal employment and tax evasion(Gökşen et al., 2008; Albayrak, 2010).

Social Security System

The Turkish social security system has undergone major reforms in the past few years. The objectives behind these reforms were to reorganize administration of the social insurances (pensions)[45] and non-contributory schemes (for people who are not participating in the social insurance system as well as

[45] Prior to the reforms three main professional groups (employees, self-employed persons and civil servants) were under separate legislation and different public institutions. In 2006, the Social Secu-

some professional groups) as well as to introduce an universal health insurance scheme (including the Green Card system covering uninsured persons).[46]

Social Insurance and Universal Health Insurance Law (Law No 5510)

Health insurance scheme has a universal reach extending to all citizens including those who are uninsured (see below). Social insurance, however, are open only to insured individuals and their dependants. Of the 73 million people of Turkey's population, around 16.2 million (in 2011) or 22% of the population are economically active contributing to the social insurance system. In 2011 the total number of persons who were insured, their dependants and the social security beneficiaries exceeded 61 million persons or approximately 83% of the population. There are approximately 12 million people who have no insurance (Coucheir & Hauben, 2011).

The Social Insurance and Universal Health Insurance Law also enlists some categories of individuals who are not considered to be insured persons. This means that they are exempt from the compulsory social contribution payments. The law, however, is not clear to what extent these persons have or do not have access to social insurance benefits, for instance, for those who are defined as uninsured persons – such as temporary domestic workers or a low-income temporary workers in the agricultural sector. It is not at all clear whether these groups can benefit from the temporary or permanent incapacity provision of the law in case of accident at work place (Coucheir & Hauben, 2011).

Furthermore, there are significant regional variations in social insurance benefits: in the Eastern provinces of Agri, Hakkari, Mardin, Mus, Sanliufa and Van less than 10% of the local population have social insurance as opposed to more than 30% in the provinces of Ankara, Antalya, Muğla and Tekirdag. In fact, 10 out of 81 provinces make up for 64% of insured employees with Istanbul alone counting for 30% of insured persons. With respect to gender 24% and 76% of

rity Institution (SSI) was established merging the three main institutions governing social insurances under one administrative umbrella.

[46] In 2008 the Social Insurance and Universal Health Insurance Law became fully enforced aiming to create a unified compulsory social insurance and medical insurance system for all workers irrespective of their status as civil servant, employee or self-employed.

females and males are insured respectively. These trends support the fact that there is a higher informal employment in the East (as opposed to the West) and amongst women (as opposed to men) (Coucheir & Hauben, 2011).

Unemployment scheme

The Unemployment Insurance Law (Law No. 4447) was enacted in 1999 and put into force in 2000. The Turkish Employment Agency (ISKUR) provides unemployment benefits and Universal Health Insurance premium payments (as required by Law No. 5510). The agency is also responsible for providing services in finding employment, for occupational and vocational training for unemployed insured persons (OECD, 2011f) Unemployment Insurance scheme is compulsory.

The unemployment insurance scheme is open to employees only, hence, it does not cover the self-employed or the civil servants. Employees that have a minimum employment record of 600 days in the past three years before job loss, of which, a minimum of 120 days accumulated in the past year are qualified. The duration of the benefits range between 6 to 10 months depending on the length of employment – thus depending on their contribution to the unemployment insurance scheme. The benefit is only 40% of the average of income in the last 4 months of employment but cannot exceed 80% of the official minimum wage for employees over 16 years old (665.18 per month) and cannot fall below YTL 332.59 per month (USD 608,6)[47] (OECD, 2011f).

In effect, the unemployment insurance scheme has a low coverage rate with the number of beneficiaries of the scheme considerably low compared to the overall unemployment rate. For instance, when the unemployment rate hit 14% of the labour force during the economic crisis in 2009, less than half a million people were entitled to an unemployment insurance benefit (Coucheir & Hauben, 2011). This is largely due to the fact that eligibility requirements for unemployment benefits are extremely stringent (Ercan, 2011).

Furthermore, given that half the Turkish labor force is employed in the informal sector, the pressing challenge relating to unemployment benefits lies in

[47] Article 39 of the Labour Law No. 4857.

formalizing employment which would increase the unemployment insurance coverage base and ensure all who are unemployed benefit from the scheme (Ercan, 2011).

Notwithstanding, although the Turkish unemployment benefit system may not be generous in terms of coverage, there are transfer programmes that are not registered in national statistics. For instance, municipalities in certain cities provide benefits in kind and cash (i.e. they administer programs which distribute aid packages of coal and food) for citizens in need. However, expenditure statistics for these are often absent (Ercan, 2011).

Non-contributory schemes

The non-contributory system refers to benefits that are financed out of taxation and provided to people who are not in the social insurance system. These schemes are often needs based and aim at poorer families.[48] There are also non-contributory benefits designed for special categories of professionals based on the recognition of specific risks or certain professional achievements (i.e. the military, teachers working abroad and successful athletes).

Furthermore, the Green Card System (Law No. 3816) addresses the poorest in need under the universal health insurance scheme. Those who are eligible are those with income per member of the household below 1/3 of the minimum wage. At the beginning of 2011, there were about 9.5 million people benefiting from a green card. In terms of regional spread, 22 out of the 81 provinces count for more than half of the total number of green card holders. In some provinces, mostly poverty sricken regions, almost half of the local population (Bingol, Bitlis, Hakkari, Sirnak) or more than half (Agri and Van) is benefiting from a green card.

Non-wage Labour Cost Reductions: Creating Employment

Since 2008 the Turkish government has undertaken initiatives to reduce non-wage labour costs in order to increase employment and reduce informal work. Some of these reforms are discussed below.

[48] The two laws that regulate the safety net for the poorest are Law No. 2022 – Pensions for the destitute and desolate people above 65 and Persons with Disability (PwD) – and Law No. 3294 – the Fund for promoting Social Assistance and Solidarity: – which provides social assistance cash for the poor.

General reductions to social security contributions of employers: Employers' social security contributions for disability, old age and death were reduced from 19.5% to 14.5% of the gross wage. The 5% gap was covered by the Treasury and recipients of these benefits were not affected (OECD – ILO, 2011).

Targeted reductions for hiring women, youth and the long-term unemployed: For women and youth, who were registered as unemployed for at least 6 months and hired between May 2008 and May 2010, the employer's share of contributions were paid by the Unemployment Insurance Fund (UIF). The payment was for a period of five years contributing 100% the first year and then coming down to 20% by the fifth. In 2009 and 2010 61,615 and 63,230 jobs were created respectively (more than half were for women). Also for hiring all persons who were unemployed for three months, social security contributions were covered by the UIF for a period of six months. Other targeted programmes have been introduced which cover employer contributions for a period ranging from 6 to 54 months depending on the employee's age, status and qualifications (OECD – ILO, 2011).

Reductions for workers in training and R&D: Employers who provide vocational training to employees benefit from lower social security contributions. Furthermore, half of the employer's contributions are reimbursed for hiring employees in technology and R&D fields for a period of five years. In 2011, 21, 647 research workers were hired under the programme (OECD – ILO, 2011).

Investment Incentives to underdeveloped regions: For the past few years, the Turkish government has created incentive schemes to attract investment to less developed regions; most significantly, the Regional Investment Incentives Scheme, which is specifically directed towards regional development, but also including the General Investment Incentives Scheme, Large-Scale Investment Incentives Scheme and Strategic Investment Incentives Scheme that provide benefits to companies investing in underdeveloped regions (Ministry of Economy, 2012).

The Regional Investment Incentives Scheme aims to eliminate inter-regional imbalances and was first introduced in 2004 to employers in textile, clothing and leather industries. The employers, social security contributions were reduced in exchange for moving their business from developed to less developed regions. Reductions were extended to all sectors in 2007 and the requirement to transfer from developed regions was eliminated (OECD – ILO, 2011).

Support instruments for employers under the Regional Investment Incentives Scheme include corporate tax reductions from 20% to 5% for a period of five years, subsidized interest rates on loans, exemptions from VAT and customs duties for the procurement of machinery and equipment as well as social security premium support for employer and employee's shares. Reduction in non-wage labour cost whereby the state covers social security contributions for workers is of particular importance for resolving immediate employment issues in underdeveloped regions. The rates of support, are differentiated according to the level of development of the six regions with Region 1 representing the most developed major industrial cities in Western Turkey, Region 6 representing the least developed cities in Eastern Turkey (with the esceptions of Bozcaada& Gökçeada in the West).[49]

The scheme led to the creation of 626,649 jobs in 2009, 722,891 in 2010 and 730,000 in the first two months of 2011 costing the Turkish government 322 million and 402 million euros in 2009 and 2010, respectively (OECD – ILO, 2011). Table 7 shows government non-wage labor contributions for different regions.

Conclusion:

Inequality and Poverty. The Turkish economy has experienced significant growth in the past decade while inequality measured by the Gini coefficient

[49] Region 1 cities are Ankara, Antalya, Bursa, Eskişehir, Istanbul, Izmir, Kocaeli and Muğla.

Region 2 cities are also western cities of Aydın, Bolu, Çanakkale (except for Bozcaada & Gökçeada), Denizli, Edirne, Isparta, Kayseri, Kırklareli, Konya, Sakarya, Tekirdağ and Yalova.

Region 3 cities are Bilecik Burdur Gaziantep Karabük Karaman Manisa Mersin Samsun Trabzon Uşak Zonguldak.

Region 4 cities are Amasya Artvin Bartın Çorum Düzce Elazığ Erzincan Hatay Kastamonu Kırıkkale Kırşehir Malatya Nevşehir and Rize.

Region 5 cities located in Eastern and North Eastern Turkey are Adıyaman, Aksaray, Bayburt, Çankırı, Erzurum, Giresun, Gümüşhane, Kahramanmaraş, Kilis, Niğde, Ordu, Osmaniye, Sinop, Tokat, Tunceli, Yozgat.

Region 6 cities are Ağrı, Ardahan, Batman, Bingöl, Bitlis, Diyarbakır, Hakkari, Iğdır, Kars, Mardin, Muş, Siirt, Şanlıurfa, Şırnak, Van, Bozcaada& Gökçeada.

has dropped. Progress in income distribution has also led to a decline in poverty measured in absolute terms. Yet, poverty remains high in rural areas. Cuts in the government subsidies to agricultural production that were not accompanied by high levels of capital investments in this sector, are among the causes of the increase in the relative poverty of rural areas.

Uneven income distribution among regions. In Turkey for a very long time the regions in the Western part of the country were more prosperous, more developed than those in the East. Recently measures taken by the government have helped to reverse this pattern. Most significantly, the government measures seek to create employment through incentive schemes which provide benefits to companies investing in underdeveloped regions.

Labor Force in Agriculture. Agriculture with its low-productivity is still an important sector for employment (23% of total employment) while contributing a small share to households' income. Female and informal employment as well as unemployment are more prevalent in the agricultural sector than in other sectors. Recently, the government policy seeks to overcome problems in this sector through attempts to attract private capital investments into infrastructure and through incentive based subsidies and credit to producers.

Informal Sector. Employment in the informal sector is as high as 55%. Those who are employed in this sector do not have access to social security benefits they benefit from universal health insurance scheme which cover uninsured persons as well as the insured. A lower share of women as well as a lower share of those in the eastern parts of the country, point to higher levels of women and of persons in the East employed in the informal sector. Furthermore, the unemployment benefit scheme does not cover informal workers making the challenge relating to unemployment benefits all the more pressing.

Un-Institutionalized government transfer programmes. Municipalities in certain cities provide benefits in kind and cash for citizens in need. These programs are often not systematically organized and depend on the discretion of municipal workers, or the *muhtar,* the elected officials in city quarters or villages.

Access to Opportunity. In Turkey poor people lack access to quality education. Losses in potential human development due to inequality is the largest for inequality in education with significant income differentials among persons with different levels of education. Although the regional gap between the eastern and western parts in access to primary and secondary education has improved, enrollment continues to vary significantly across regions. Disparity in educational levels between men and women is also recorded with women in rural areas at a greater disadvantage when compared to their urban counterparts. However, the gender gap is narrowing and women have surpassed men in countrywide net enrollments for primary education.

Tax Policy. In Turkey, the redistributive impact of taxes and transfers is limited. This is partly due to the limited reach of the tax system given the significance of the informal economic sector the activities of which are not recorded. The nature of the social security system which primarily consists of cash transfers also dampens any redistributive impact this transfer might have had. Another limitation on the redistributive impact of the Turkish tax system is that it relies heavily on the regressive consumption tax while the progressive taxes on income make up a small share of total taxes.

Annexes

Annex 1. Gini coefficients, Interquintile Ratios and GDP per capita (2005 PPP $) levels of G20 Countries

G20 Countries	Gini Coefficients*	Interquintile share ratio (S80/S20)*	GDP per capita (2005 PPP $) (2011)
France	29.3	4.3	29,819
Germany	29.5	4.5	34,437
European Union (27 members)***	30.7	5.3	28,000
Korea, Republic of	31.5	5.7	27,541
Japan	32.1	6	30,660
Canada	32.4	5.4	35,716
India**	33.4	4.9	3,203
Australia	33.6	5.7	34,548
Italy	33.7	5.6	27,069
Indonesia**	34	5.1	4,094
United Kingdom	34.5	5.8	32,474
United States	37.8	7.7	42,486
Russian Federation**	40.1	7.3	14,808

G20 Countries	Gini Coefficients*	Interquintile share ratio (S80/S20)*	GDP per capita (2005 PPP $) (2011)
Turkey	40.9	8.1	13,466
China**	42.5	9.6	7,418
Argentina**	44.5	11.3	15,501
Mexico	47.6	13	12,776
Brazil **	54.7	20.6	10,278
South Africa	63.1	25.3	9,678

Quintile income dispersion ratio is the average income of the richest 20 percent of the population divided by the average income of the bottom 20 percent. There is no data available for Saudia Arabia and therefore is not included.

* (OECD, 2008)

**(United Nations, 2013)

*** (Eurostat, 2011)

Note: GDP per capita taken from Human Development Report 2013 (2011 figures)

Annex 2. Regional Share of GVA (%) and Average Annual Equivalised Household Disposable Incomes (USD)

SR, Level 1	Share of Gross Value Added by regions (%) (2008)*	Average annual equivalised household disposable incomes (USD) (2011)**
TURKEY	100	5,700
TR1 Istanbul	27.7	7,870
TR2 West Marmara	4.9	5,670
TR3 Aegean	13.8	6,840
TR4 East Marmara	12.8	5,700
TR5 West Anatolia	10.9	6,590
TR6 Mediterranean	10.4	5,440
TR7 Central Anatolia	3.9	4,980
TR8 West Black Sea	4.9	4,900
TR9 East Black Sea	2.6	4,960
TRA North East Anatolia	1.5	3,760
TRB Central East Anatolia	2.3	3,430
TRC South East Anatolia	4.4	2,870

* (The Turkish Statistical Institute, 2007 – 2008)

** (The Turkish Statistical Institute, 2011b)

Note: December 2011 exchange rate from YTL to USD taken from Turkish Central Bank website

Annex 3. Comparison of Regional and National Poverty Thresholds for Statistical Regions Level 1

	Number of poors and regional poverty rates by relative poverty thresholds based on income (SR, Level 1) /2011			Number of poors and regional poverty rates by relative poverty thresholds (calculated for Turkey) based on income (SR, Level 1) /2011		
Risk of poverty (50%)	**Poverty threshold (USD)**	**Number of poors (Thousand)**	**Poverty rate (%)**	**Poverty threshold (USD)**	**Number of poors (Thousand)**	**Poverty rate (%)**
Turkey	2,150	11 670	16.1	2 140	11 589	100.0
TR1 Istanbul	3,040	1 499	11.7	2 140	446	3.8
TR2 West Marmara	2,190	361	11.6	2 140	374	3.2
TR3 Aegean	2,500	1 124	11.9	2 140	706	6.1
TR4 East Marmara	2,330	614	9.0	2 140	511	4.4
TR5 West Anatolia	2,570	933	13.7	2 140	593	5.1
TR6 Mediterrannean	2,020	1 134	12.3	2 140	1 410	12.2
TR7 Central Anatolia	1,950	503	13.3	2 140	591	5.1
TR8 West Black Sea	2,050	609	13.8	2 140	658	5.7
TR9 East Black Sea	2,090	271	10.7	2 140	299	2.6
TRA North East Anatolia	1,410	310	14.7	2 140	703	6.1
TRB Central East Anatolia	1,190	483	13.2	2 140	1 548	13.4
TRC South East Anatolia	1,070	1 155	15.1	2 140	3 749	32.3

Source: The Turkish Statistical Institute

Note: December 2011 exchange rate from YTL to USD taken from Turkish Central Bank website

Annex 4. Gini Coefficients and Average Annual Disposable Incomes for Statistical Regions Level 1

SR, Level 1	Gini coefficient by equivalised household disposable income (2011)	Average annual equivalised household disposable incomes (2011) (USD)
TURKEY	0.404	5,700
TR1 Istanbul	0.371	7,870
TR2 West Marmara	0.365	5,670
TR3 Aegean	0.397	6,840
TR4 East Marmara	0.326	5,700

SR, Level 1	Gini coefficient by equivalised household disposable income (2011)	Average annual equivalised household disposable incomes (2011) (USD)
TR5 West Anatolia	0.374	6,590
TR6 Mediterrannean	0.404	5,440
TR7 Central Anatolia	0.366	4,980
TR8 West Black Sea	0.335	4,900
TR9 East Black Sea	0.327	4,960
TRA North East Anatolia	0.39	3,760
TRB Central East Anatolia	0.427	3,430
TRC South East Anatolia	0.396	2,870

Source: The Turkish Statistical Institute

Annex 5. Labor Force by Sector for Statistical Regions Level 1

	Agriculture (%)	Industry (*) (%)	Service (%)
SR, Level 1			
TURKEY	24.6	26.0	49.4
TR1 Istanbul	0.6	36.7	62.7
TR2 West Marmara	25.6	28.5	45.9
TR3 Aegean	30.5	24.2	45.3
TR4 East Marmara	17.1	38.0	44.9
TR5 West Anatolia	13.4	23.3	63.3
TR6 Mediterranean	29.7	19.4	50.9
TR7 Central Anatolia	39.4	21.3	39.3
TR8 West Black Sea	43.0	17.9	39.0
TR9 East Black Sea	55.2	13.4	31.4
TRA North East Anatolia	47.6	12.7	39.6
TRB Central East Anatolia	41.7	17.6	40.7
TRC South East Anatolia	23.3	28.1	48.6

* Including construction

(The Turkish Statistical Institute, 2012a)

Annex 6. Government Non-wage Labor Contributions for Different Regions[50]

			Regions					
			1	**2**	**3**	**4**	**5**	**6**
Social Security Premium Support (Employer's Share)	Out of OIZ (years)		2	3	5	6	7	10
	Within OIZ (years)		3	5	6	7	10	12
	Upper Limit for Support (%)	Out of OIZ	10	15	20	25	35	No limit
		Within OIZ	15	20	25	35	No limit	No limit
Social Security Premium Support (Employee's Share) (years)			N/A	N/A	N/A	N/A	N/A	10

Note: OIZ stands for Official Investment Zone

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United States

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Inequality in wages, income, and wealth has grown dramatically during the last 35 years in the United States. Today, the US is the world's most unequal rich country, with 421 billionaires and 16,000 families with average annual incomes of USD 24 million, yet 50 million Americans live in poverty, and one-third of the nation's 310 million people struggle to make ends meet in either poverty or near-poverty. Among the G20 countries, Indonesia, Argentina, Turkey, China, Russia, Mexico, Brazil, and South Africa are more unequal as measured by Gini coefficients, whereas all other G7 countries, plus Korea, Australia, and India are more equal. Unlike Brazil, Korea, Mexico, and Argentina, which have succeeded in reducing inequality since the 1990s, inequality continues to increase in the United States (OECD, 2012; The Economist, 2012; Census Bureau, 2011; Oxfam, 2012).

Some inequality is inherent and beneficial in a dynamic capitalist economy, but extreme inequality is socially unjust and reflects imbalances in power that privilege some and marginalize others. A rich country that leaves so many of its people struggling can do better. "Free" markets where rules are rigged in favor of the well-to-do need to be guided by the public interest.

Growing Wage, Income, and Wealth Inequality

Wage inequality has increased, as wage growth among those at the bottom and middle of the income distribution has stagnated, while growth at the top has rapidly accelerated. The bottom 90 percent of workers saw an average inflation-adjusted wage growth of just 15 percent during the last three decades, while the top 1 percent experienced an average growth of 150 percent and the top 0.1 percent has seen growth of more than 300 percent. One often-cited example of increasingly unequal compensation is that the ratio between an average S & P 500 CEO pay to an average worker pay has grown from 42-to-1 in 1980 to 380-to-1 in 2011; however, even this statistic pales beside the fact that the top 25 US hedge-fund managers make more than all 500 of these CEOs combined (Stiglitz, 2012; AFL, CIO, 2013; The Economist, 2012).

Income inequality is greater than wage inequality, given that the share of national income going to capital rather than wages has risen from 30 to 36 percent between the mid-1970s and 2011. Income from all sources grew 275 percent for the richest 1 percent of Americans between 1979 and 2007, compared with less than 40 percent for the middle class. Families in the bottom quintile have seen their incomes decline. Between 1980 and 2010, the share of income going to the top 1 percent more than doubled from 8 to 18 percent, while the share of income going to the bottom 90 percent fell. During 2010, the first year after the recession officially ended, 93 percent of America's income gains went to the top 1 percent (Federal Reserve Bank of Cleveland, 2012; CBO, 2011; Mishel et al, 2012; Carr, 2013; OECD, 2011; The New York Times, 2012a).

Wealth inequality is even more extreme. While the Gini coefficient for income inequality is 0.48, the coefficient for wealth is 0.80. Between 1983 and 2010, three-quarters of the nation's aggregate growth in wealth accrued to the top 5 percent, while the bottom 60 percent saw their share of wealth growth decline. By 2010, the bottom 90 percent held 23.3 percent of the nation's wealth, while the top 1 percent held 35.4 percent. The average net worth of the top 1 percent of households was USD 16.4 million, whereas the poorest quintile had negative net worth averaging USD 27,000 and the second poorest quintile had average net worth of just USD 5,500 (Carr, 2013; Mishel et al., 2012).

Growing inequality has been accompanied by a decline in social mobility. Whereas America has prided itself on being the land of opportunity, a number of studies have found that Americans born in the bottom quintiles are much more likely to stay there than children in European Union and other rich G20 countries (The New York Times, 2012b).

Inequality has increased markedly since the late 1970s, but this was not always the case. Between 1947 and 1973, when the US experienced rapid economic growth, the poorest 20 percent of households experienced at least as fast income growth as the richest 20 percent (Stone et al, 2012).

The Causes of Rising Inequality

The causes of rising inequality are hotly debated, but the two major theories focus on "skill-biased technological change" (SBTC) and institutional factors. SBTC attributes the rise in inequality to technological advances that have changed the demand for workers with different types of skills. This explanation is buttressed by the rising wage premium for those with more education, as the number of high-skill and low-skill jobs grows and middle-skill jobs decline (Autor et al, 2006).

The institutional explanation attributes rising inequality to changes in public policy and wage-setting institutions such as the decline in the minimum wage and unionization and increased rent seeking, by which the rich shape government policies in ways that favor them at the expense of others. Evidence of this winner-take-all politics since the 1980s can be seen in tax cuts for the wealthy, regulatory changes that favor business and finance, legal constraints on unions, and corporate subsidies – all of which have paralleled the increasing influence of money in American politics. These policy and political changes have occurred in tandem with changes in social norms that have devalued fairness and diminished constraints on economic disparities (Autor et al, 2006; Stiglitz, 2012; Hacker & Pierson, 2011; Bartell, 2008; Carr, 2013; Gilens, 2012; Akerlof & Shiller, 2010).

The flip side of policies that benefit the well-to-do are policies that do too little to benefit lower-income Americans. A key reason that the US is more unequal than Western European countries is the difference in public spending on the poor. While the US actually has a less regressive tax regime than most of these countries, European nations succeed in reducing inequality because of generous transfer payments and higher minimum wages. For example, Great Britain has a USD 42,000 family cap on welfare benefits, an amount far more than any poor US family could possibly obtain in benefits. Likewise, the French minimum wage is about USD 12.70 an hour, nearly double America's USD 7.25 minimum wage. Moreover, the US is one of few countries that spend less on education for the poor than for the well-to-do (OECD, 2012; Oxfam, 2012; The Economist, 2012).

The growing power of the financial sector, enabled by deregulation and often called "financialization," is another cause of both increased inequality and economic volatility. Trade and immigration also have been posited as contributing to inequality by "taking" manufacturing and other mid-skill jobs from native-born Americans with less than a four-year college education, although the evidence suggests that the impacts are small. Others have pointed to the decline of the family, as married, two-parent households fare significantly better than others (Palley, 2012; Dadush et al., 2012; Haskins & Sawhill, 2009).

The Effects of Growing Inequality

Whatever the relative impact of different causes of growing inequality in the US, it has had significant effects on the nation's economy, politics, and public opinion. While the US has experienced stronger economic growth than most other OECD nations and has seen notable productivity gains, the fact that these gains have overwhelmingly gone to the wealthy has meant that the middle class has shrunk and the ranks of those in poverty and holding low-wage jobs have increased. The US poverty rate, at nearly 16 percent, is the highest that it has been in two generations, and the nation has a higher percentage of workers in low-wage jobs – 25 percent – than any other rich OECD country (Schmitt, 2012).

Books and headlines decry the decline or "death" of the "American Dream," and polls regularly find that majorities of Americans have diminished economic expectations for future generations. In 2011, the Occupy Wall Street movement raised public awareness of American inequality. Some argue that the power shifts associated with current levels of inequality are effectively disenfranchising lower- and middle-income Americans, portending a dangerous threat to social cohesion and US democracy. While left-leaning scholars, advocates, and politicians have taken the lead in drawing attention to inequality, the related issue of declining social mobility or opportunity has galvanized conservatives as well as progressives. During last year's election campaign, Republican candidates Paul Ryan and Rick Santorum sounded alarms about America "lagging behind" other nations in providing economic opportunity. In addition, some economists believe that high inequality harms economic growth. At the least, there is no evidence that policies that have led to increased inequality have unleashed the growth that proponents had promised (Hacker & Pierson, 2011; Sachs, 2011; The New York, 2012b; Berg & Ostry, 2011; Stiglitz, 2013).

Addressing Inequality

So, how has the US tried to address inequality and what could be done to increase equity?

US tax and spending policies reduce inequality and improve the well-being of its needier citizens, although they do less to equalize Americans' fortunes than redistributive policies in other advanced countries. Social Security is estimated to keep 21 million Americans, two-thirds of them elderly, out of poverty. Unemployment insurance reduced the poverty rate by 1.1 percentage points in 2009. One-third of the 27 million recipients of refundable tax credits such as the Earned Income Tax Credit are lifted out of poverty. Forty-eight million Americans' incomes are supplemented by Food Stamps. Progressive income taxes and many other public programs, ranging from low-cost college loans and housing assistance to child nutrition and the Affordable Care Act, also reduce poverty and inequality (Van de Water & Sherman, 2012; CBO, 2010; Gabe & Whittaker, 2012; Charite et al., 2012).

Nonetheless, the continuing rise in US inequality, with its attendant pernicious effects, demands that much be done to promote inclusive growth and create a more socially just society. Other G20 countries such as Korea and Brazil have shown that public policies can reduce inequality.

President Obama has made fighting inequality a signature issue. In his 2013 Inaugural Address, he said: “Our country cannot succeed when a shrinking few do very well and a growing many barely make it. We believe that America’s prosperity must rest upon the broad shoulders of a rising middle class”.

The most frequent set of policy prescriptions to increase wages and mobility focuses on making access to high-quality education and skills development more equitable. Universal preschool, enhancing the caliber of K-12 education, particularly for lower-income children, making college education affordable for all, and expanding job-training programs, among other investments in public goods, are all widely touted as ways to increase opportunity and reduce inequality.

However, given the powerful role that institutions, politics, and norms play in driving inequality, better education is not enough. Tax reforms that simplify and increase the progressivity of the income tax, greatly reduce tax evasion, and impose a financial transactions tax are ways to reduce inequality. Other reforms aimed at reducing rent-seeking by financial institutions and big business include curbing financial risk-taking, enforcing competition laws, reducing tax breaks and subsidies that benefit big businesses and the wealthy, and improving corporate governance. Increasing the minimum wage, making it easier to join unions, expanding cash transfers, strengthening social-protection programs, and promoting saving and asset building among lower-income Americans all could significantly reduce inequality. Finally, greater international economic cooperation on labor, financial, and environmental standards would help prevent the “race to the bottom” that depresses the wages and opportunities of those on the lower rungs of the socioeconomic ladder.

While many of these proposed policies are unlikely to be enacted given the power dynamics described above and America’s political polarization and gridlock, they provide a broad roadmap to not only a more just society but also a more vibrant economy.

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