PUBLIC BENEFITS, TAXES AND INCOME INEQUALITY

OECD countries differ in how much income they redistribute through government policies. They do so through a range of programmes but most directly through the cash transfers paid to households and the direct taxes and social security contributions collected from them.

Definition

Redistribution is measured by comparing the same inequality measure (*e.g.* Gini coefficients) for market income (*i.e.* gross of public cash transfers and household taxes) and for disposable income (*i.e.* net of transfers and taxes). Two measures of redistribution are presented. In the first (standard) approach, inequality in the distribution of market income is computed by ranking people based on their market income: this implies, for example, that middle class people plunge into the bottom of the distribution of market income when moving into retirement, simply because it is the government, rather than the market, that provide their pensions. In the second approach, inequality of market income is based on people ranked by their disposable income, *i.e.* by where they end up "after" redistribution rather than where they were placed "before" redistribution.

Government redistribution depends on the size of public benefits and household taxes (as a percentage of household disposable income) and of their concentration (*i.e.* how large a share of benefits/taxes is received/paid by different income groups, compared to their share of disposable income). The concentration of transfers can be negative when the share of transfers received by poorer people exceeds their share of income (with more negative values implying greater progressivity); for household taxes, higher values of the concentration coefficient imply a more progressive distribution of taxes. The inequality reduction of public benefits is the fall in inequality when moving from market to gross (pre-tax) income; the inequality reduction of taxes is the fall in inequality when moving from gross to disposable (post-tax) income.

Income is defined as household disposable income in a particular year. It consists of earnings, self-employment and capital income and public cash transfers; income taxes and social security contributions paid by households are deducted. The income of the household is attributed to each of its members, with an adjustment to reflect differences in needs for households of different sizes (*i.e.* the needs of a household composed of four people are assumed to be twice as large as those of a person living alone).

Comparability

Data used here were provided by national experts applying common methodologies and standardised definitions. In many cases, experts have made several adjustments to their source data to conform to standardized definitions. While this approach improves comparability, full standardisation cannot be achieved. Also, small differences between periods and across countries are usually not significant.

The size and definition of public benefits and household taxes used here may differ from that available from other administrative data, and this will influence cross-country comparisons. Small differences between periods and across countries are usually not significant. Exact years for each country are provided under the section on "Measures of income inequality".

Overview

On the standard measure (shown as a diamond in the figure), the combined effect of the tax and transfer systems is to lower income inequality by 15 points (*i.e.* more than one-third) on average. On the second measure (shown as a bar), the reduction of inequality achieved by taxes and transfers is lower, at around 10 points, with declines ranging from 15 points or more in Denmark, Belgium, Sweden and the Czech Republic to less than 2 points in Korea. In some OECD countries, a significant part of the redistribution measured by the standard approach reflects the re-ranking of people, namely in countries where public pensions account for more than 90% of the disposable income of the retirement-age population – Austria, Belgium, France, Italy, Luxembourg and Sweden.

Cash benefits are more progressively distributed (*i.e.* they have a high concentration coefficient) than other incomes in all countries, thus reducing inequality. Household taxes tend to be distributed more progressively in English-speaking countries and less so in the Nordic countries, France and Switzerland. On average, the redistribution achieved by public cash transfers is twice as large as that achieved through household taxes, while in the United States the effects of the two levers are similar.

Source

- OECD (2008), *Growing Unequal? Income Distribution and Poverty in OECD Countries*, OECD, Paris.

Further information

Analytical publications

- Barr, N. (1992), "Economic Theory and the Welfare State: A Survey and Reinterpretation", *Journal of Economic Literature*, Vol. 30, June.

Websites

- OECD Social and Welfare Statistics, *www.oecd.org/statistics/social*.
- OECD work on income distribution and poverty, *www.oecd.org/els/social/inequality*.

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Size, concentration and effectiveness of taxes and transfers in reducing inequality

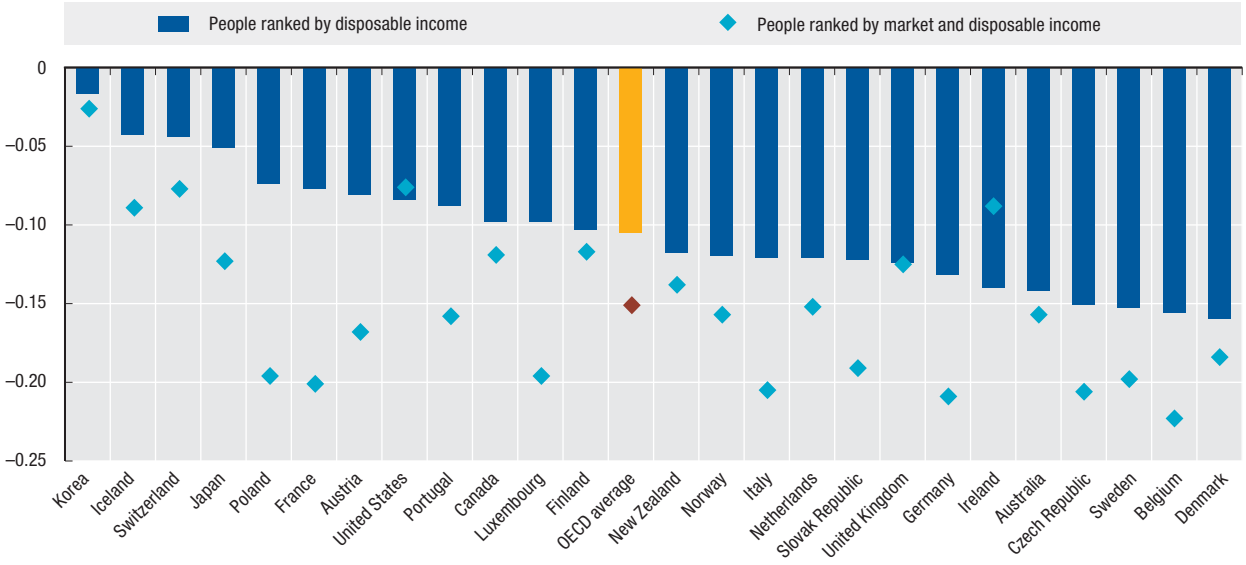
Mid-2000s

	Public cash transfers			Household taxes		
	As a percentage of household disposable income	Concentration coefficients	Inequality reduction	As a percentage of household disposable income	Concentration coefficients	Inequality reduction
Australia	14.3	–0.400	0.097	23.4	0.533	0.045
Austria	36.6	0.157	0.052	33.4	0.381	0.029
Belgium	30.5	–0.120	0.119	38.3	0.398	0.037
Canada	13.6	–0.152	0.060	25.8	0.492	0.037
Czech Republic	24.3	–0.154	0.114	21.6	0.471	0.037
Denmark	25.6	–0.316	0.118	52.5	0.349	0.042
Finland	14.4	–0.219	0.065	30.1	0.428	0.038
France	32.9	0.136	0.056	26.0	0.374	0.020
Germany	28.2	0.013	0.086	35.5	0.468	0.046
Ireland	17.7	–0.214	0.100	19.4	0.570	0.041
Italy	29.2	0.135	0.073	30.2	0.546	0.047
Japan	19.7	0.010	0.048	19.7	0.378	0.003
Korea	3.6	–0.012	0.011	8.0	0.380	0.005
Luxembourg	30.6	0.085	0.066	23.8	0.420	0.032
Netherlands	17.1	–0.198	0.080	24.7	0.471	0.041
New Zealand	13.0	–0.345	0.080	29.0	0.498	0.038
Norway	21.7	–0.183	0.093	33.2	0.376	0.027
Slovak Republic	26.0	–0.056	0.094	20.0	0.422	0.028
Sweden	32.7	–0.145	0.121	43.2	0.337	0.032
Switzerland	16.0	–0.170	0.057	36.0	0.223	–0.012
United Kingdom	14.5	–0.275	0.085	24.1	0.533	0.039
United States	9.4	–0.089	0.041	25.6	0.586	0.044
OECD average	21.4	–0.114	0.078	28.3	0.438	0.032

StatLink http://dx.doi.org/10.1787/544730300331

Differences in inequality before and after taxes and transfers

Percentage difference in concentration coefficients, mid-2000s



StatLink http://dx.doi.org/10.1787/540115381716