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.