Divided We Stand
Why Inequality Keeps Rising

Special Focus: Inequality in Emerging Economies (EEs)

Emerging countries are playing a growing role in the world economy. It is a role that is expected to be even greater in the future. It is important, therefore, that any comprehensive assessment of inequality trends worldwide considers the emerging economies. This chapter discusses inequality patterns and related issues in the biggest emerging economies. It begins with a brief overview of such patterns in selected countries, before going on to examine in greater detail the main drivers of inequality. The following section outlines the key features and challenges of underlying institutional settings. Finally, the chapter sets out some key policy challenges that the emerging economies need to address to improve income distribution and curb inequalities, while promoting more and better jobs.

1. Introduction

Emerging countries are playing a growing role in the world economy. It is a role that is expected to be even greater in the future. It is important, therefore, that any comprehensive assessment of inequality trends worldwide considers the emerging economies.

This special focus chapter examines inequality patterns and key related policy challenges in Argentina, Brazil, China, India, Indonesia, the Russian Federation and South Africa. These countries form the group of the world's largest emerging economies. Henceforth collectively referred to as EEs, they total about one fifth of global GDP and close to half the world's population. At a time when restoring sustainable growth after the Great Recession is a key priority, they are playing a very crucial role in supporting the global economy. As active participants in the Group of Twenty (G20), the EEs are also actively engaged in shaping the post-crisis global governance architecture.

The emerging economies represent a highly heterogeneous group, in terms of economic size, population, levels of per capita income and growth performance over the past decade (OECD, 2010a; OECD, 2010b). China and India, for example, are among the largest economies and the two most populous countries in the world, while Argentina and South Africa are considerably smaller economies. Moreover, the EEs have reached different stages of development, with the variation among their incomes being similar to that among the 34 OECD countries. Their long-term patterns of development also differ.

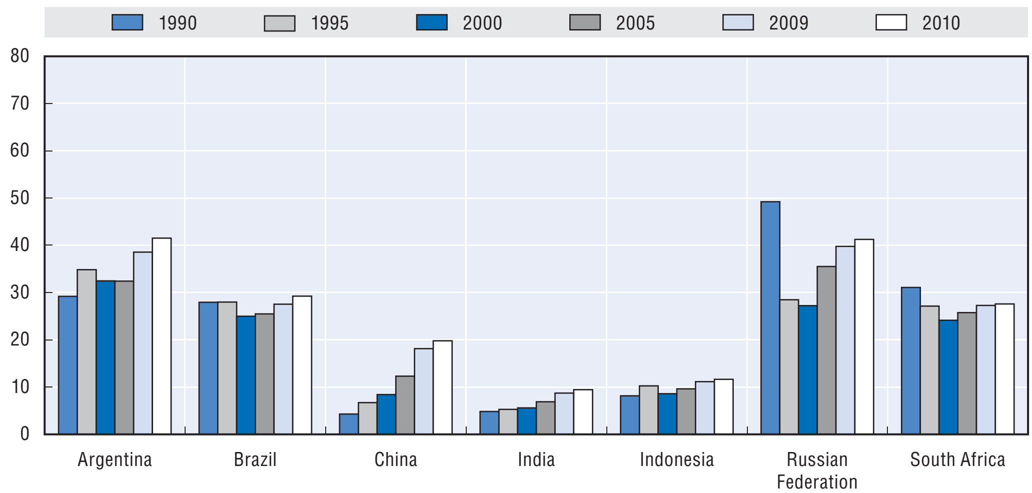
While diverse, the EEs share several important economic features:

- First, prior to the onset of the Great Recession, virtually all EEs enjoyed a prolonged period of relatively robust growth – with growth rates generally higher than the OECD average. Moreover, the EEs have shown a greater resilience than the OECD member countries during the global crisis of 2008-09. Their growing integration into the world economy, supported by domestic policy reforms, has been a key determinant in helping the move towards stronger and more sustainable growth.
- Second, economic growth has enabled the EEs to achieve considerable progress in the fight against poverty. During the two decades to 2008, the fall in the extent of absolute poverty was particularly dramatic for Brazil, China and Indonesia, while India and South Africa recorded more modest reductions.[1] As of today, important cross-country differentiation in absolute poverty remains observable, however. At one end, India has the highest headcount poverty rate of the seven countries – with about 42% of its population still living on less than USD 1.25 per day. At the other end, Argentina and Russia have virtually eradicated absolute poverty, using the same yardstick.
- Third, it is undeniable that the potential for catch-up to the income levels of the OECD countries remains significant for the EEs going forward (Figure 0.1).

Figure 0.1. **GDP per capita**

Constant 2005 PPPs

Relative to the median of the upper half of OECD countries



Source: World Bank, International Comparison Program Database.

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This chapter focuses on within-country inequality in the EE countries. Its main findings and policy challenges are as follows:

- *All EEs have levels of income inequality significantly higher than the OECD average.*
- *Brazil, Indonesia and, on some indicators, Argentina have recorded significant progress in reducing inequality over the past 20 years.* By contrast, China, India, the Russian Federation and South Africa have all become less equal over time and inequality levels in Argentina and Brazil do remain high. Inequality in South Africa and Russia has also reached high levels.
- *While the challenge of tackling inequality is common to EEs and OECD countries, the underlying forces of inequality in the EEs are different from those in the OECD countries.* Key sources of inequality include a large, persistent informal sector, widespread regional divides (*e.g.* urban-rural), gaps in access to education, and barriers to employment and career progression for women.
- *The benefit and tax systems in EEs play a lesser role than in the OECD countries in easing market-driven inequality.* The coverage and generosity of social protection systems is generally lower than in most OECD countries. Social spending is highest in Brazil and Russia, where it represents about three-quarters of the OECD average, while in China and India it is three to four times lower than the OECD average. At the same time, the tax system delivers only modest redistribution, reflecting such problems as tax evasion and administrative bottlenecks to collect taxes on personal income. The background is one of high levels of self-employment and sizeable informal sectors, which together limit the capacity of the tax authorities to verify taxpayers' declared income.
- *Reducing inequality while at the same time promoting more and better jobs in the EEs requires a multipronged approach.* Such an approach should encompass four key areas: 1) better incentives for more formal employment; 2) provisions of social assistance that target those most in need; 3) spreading the rewards from education; and 4) preparing to finance higher social spending in the future. While these are the selected areas reviewed in the

present chapter, it is important to underline that tackling inequality goes beyond the remit of labour, social welfare and tax policies. Other policies, such as those aimed at improving the business environment, product market regulation, infrastructure development, health care and public administration reforms also have a role to play in reducing inequality. They may not be expensive for governments and can help reduce inequality by facilitating the creation and expansion of firms – and therefore jobs – in the formal sector. That being said, the main conclusions from analysis of the areas covered in this chapter are as follows:

- Shifting the emphasis from protecting jobs to enhancing employability could lead to more hiring in the formal sector and to the creation of better quality jobs. Labour market policies could thus complement policy measures in other areas to expand the size of the formal sector – *e.g.* in the tax domain, along with product market regulatory reforms to enhance competition.
- Social welfare programmes could be further strengthened by better targeting individuals most in need, together with promoting mechanisms of in-work benefits. Given the large informal sector in all EEs, it is more difficult to use taxes for redistribution purposes and greater focus should be placed on benefit systems.
- Conditional cash transfers may be particularly well suited to reducing inequality and promoting social mobility in the EEs. The fact that they combine income support with the requirement to maintain investment in human capital and child health means that they can be useful tools not only for tackling household poverty, but also for promoting school enrolment and improving healthcare for children. This approach will have longer-term beneficial effects on labour market outcomes in the EEs.
- Addressing inequalities in both access to, and quality of, education can also make an important contribution to lowering inequality in labour income.
- Enhancing the distributive capacity of the tax system would require an emphasis on improving revenue collection procedures and strengthening the extent to which taxpayers comply voluntarily with their obligations. A focus on the fight against corruption would also help improve tax collection.

The reminder of this special focus chapter is in four parts. Section 2 gives a brief overview of inequality patterns in the EEs. Section 3 discusses the main drivers of inequality, while Section 4 sketches out the key features of the underlying institutional settings. Section 5 sets out the key policy challenges to improve redistribution and curb inequalities while promoting more and better jobs in this group of countries. Although the chapter chiefly analyses the EEs, the experience of some OECD countries – *e.g.* Chile, Mexico and Turkey, which are more suitable to be compared with the EEs – may also be relevant to provide valuable insights about how to address inequality. Thus, where appropriate for adding value to discussion of institutional arrangements and policy challenges, the chapter refers to the practices and reforms that have worked well in these OECD countries.

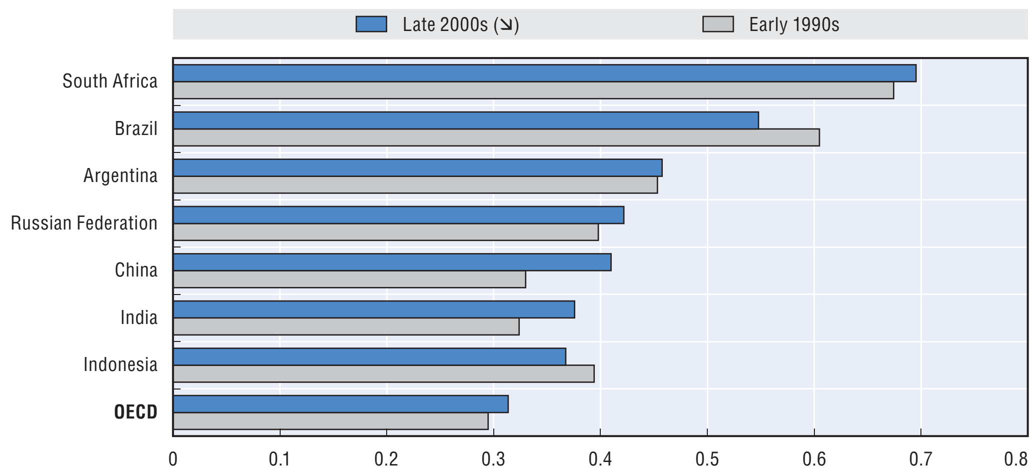
2. Inequality patterns in EEs

Assessing the extent of income inequality and its evolution over time in the EEs is made particularly complex by the fact that they use different statistical measures of household well-being. Some countries tend to rely on the collection of household income data and others on consumption expenditure, with inequality estimates based on household consumption typically showing a lower level of inequality than those based on income measures. In addition, assessing inequality raises specific measurement issues within each statistical source of information.[2]

With measurement-related differences in mind, two main points stand out in Figure 0.2, which shows the EEs' Gini indicators, based on available household statistics. First, EE countries have higher levels of income inequality than the OECD average – the Gini indicator for Brazil is almost twice as large, while an even bigger difference is observed for South Africa.

Figure 0.2. **Change in inequality levels, early 1990s *versus* late 2000s**[1]

Gini coefficient of household income[2]



1. Figures for the early 1990s generally refer to 1993, whereas figures for the late 2000s generally refer to 2008.
2. Gini coefficients are based on equivalised incomes for OECD countries and *per capita* incomes for all EEs except India and Indonesia for which per capita consumption was used.

Source: OECD-EU Database on Emerging Economies and World Bank, World Development Indicators.

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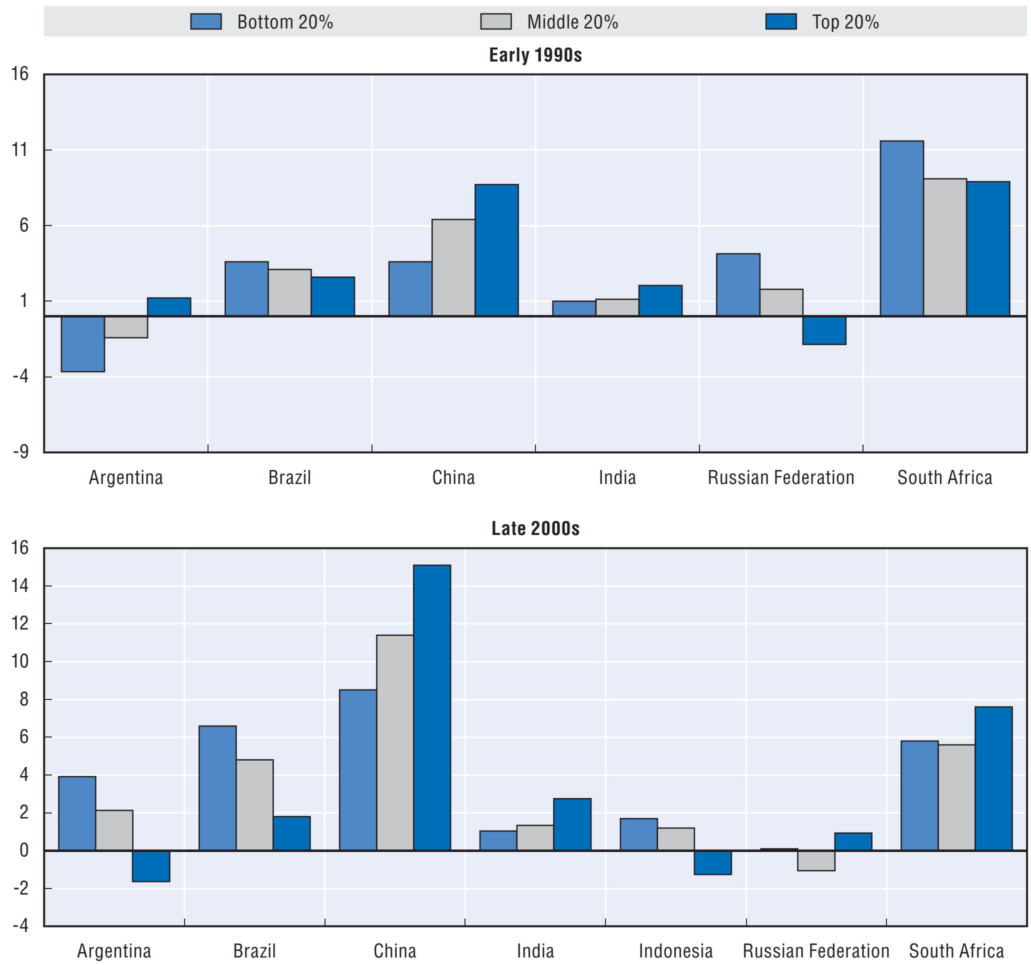
Second, inequality trends show wide differences across EEs. At one extreme, strong output growth during the past decade went hand-to-hand with declining income inequality in two countries (Brazil and Indonesia). At the other extreme, four countries (China, India, the Russian Federation and South Africa) recorded steep increases in inequality levels during the same period, even though their economies were also expanding strongly. Argentina is the only country where inequality was broadly stable.[3]

Another way to describe inequality is by looking at changes in household income for different groups, notably those at the bottom, the middle and the top of the distribution (Figure 0.3). Larger rises in income for those at the bottom and middle of the income distribution may, in particular, signal that opportunities and equalisation are both growing. This analysis is also important for gauging a possible dynamic towards the emergence of a significant middle class in the EEs.[4]

Figure 0.3 suggests that in Argentina, Brazil and Indonesia, where the Gini coefficient has declined or remained stable overall for the period observed, the main beneficiaries were those at both the bottom and the middle of the income distribution. Indeed, the three countries stand out for their observed increases in real household incomes in the bottom and the middle quintiles which, during the 2000s outpaced the performance of the top

Figure 0.3. **Change in real household income by quintile**[1, 2]

Average annual change in %



1. Figures for the early 1990s generally refer to the period between 1992-93 and 1999-2000, whereas figures for the late 2000s generally refer to the period between 2000 and 2008.
2. For China, data refer to urban areas only and data for India refer to real household consumption.

Source: OECD-EU Database on Emerging Economies and World Bank, World Development Indicators.

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quintile by a significant margin. For Argentina and Indonesia, the real household income of the top quintile declined on average over the period. Conversely, where inequality worsened, according to the Gini indicator, the distribution of income became increasingly concentrated: specifically in China, India, the Russian Federation and South Africa, the highest increases in real household income were systematically observed in the top quintile.

Although real income growth in Argentina and Brazil largely benefitted the lowest and middle incomes during the past decade, the top quintile still accounted for about 55% of total income in the mid-2000s in Argentina and 60% in Brazil. These levels place the two countries between South Africa – where the share for the top quintile total income was 75% – and the Asian EEs. In the latter, the shares for the top quintile range specifically between 40-45%, which is more in line with the OECD average (about 40%; see OECD, 2010a).[5]

3. Economic factors behind inequality

The economic factors behind high and often growing income inequality in the EEs tend to differ from those at work in most OECD countries. Widespread informality, together with persistently large geographical differences in economic performances, plays a particularly important role in shaping income inequality in all EEs. Informality and geographical disparities are, in turn, closely intertwined with other key drivers of inequality, namely gender, ethnic disparities, alongside disparities in educational outcomes and in labour market conditions (contract type, productivity, and so on). This section reviews each of these drivers of inequality in turn.

Spatial inequality

The forces underlying regional inequality are difficult to disentangle and often overlap. They typically involve the interplay of geographic, historical and institutional factors such as weak resource endowments and distance from markets, which constrain development in lagging regions. At the same time, spatial differences in economic outcomes can stem from long-standing power imbalances between advantaged and lagging regions, allied to institutional weaknesses, and ethnic and racial disadvantages.

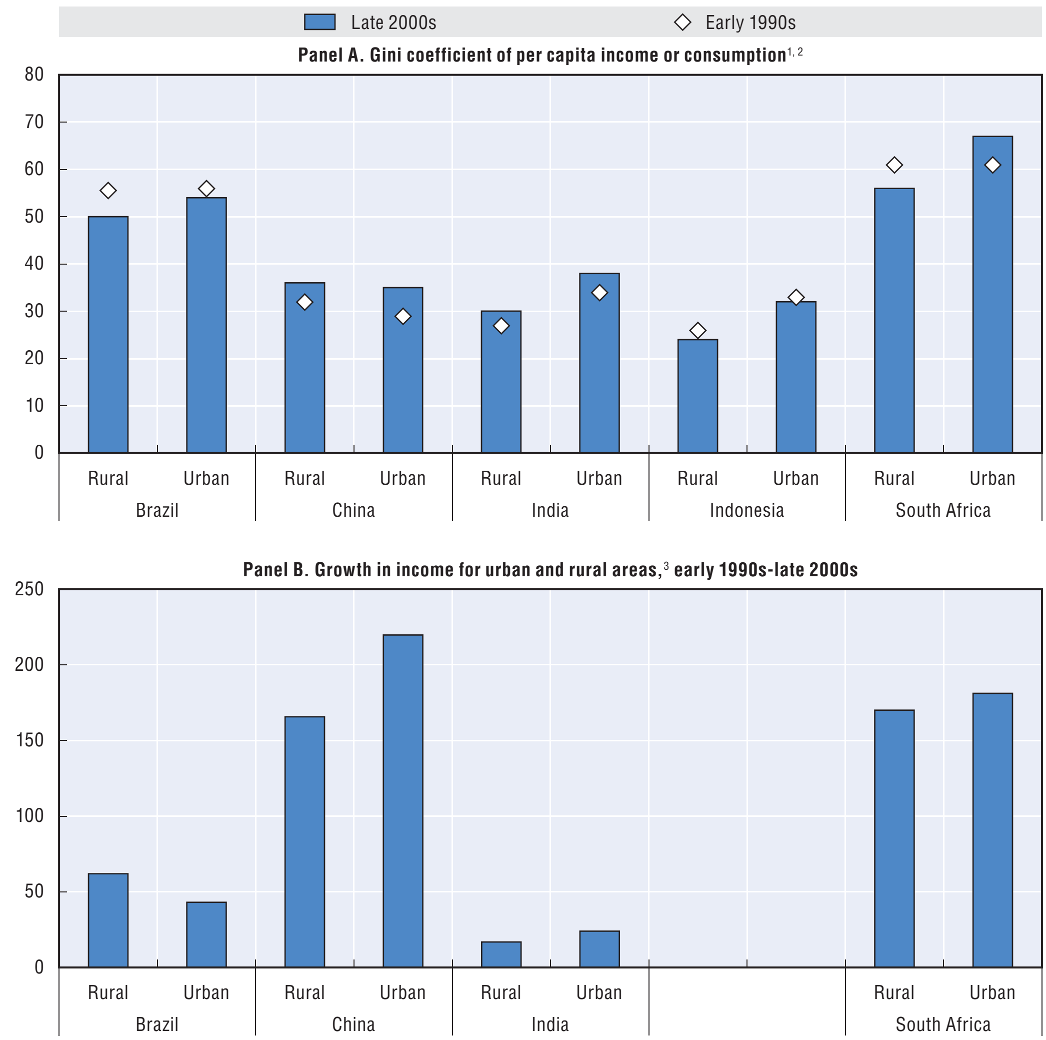
With regard to the EEs, inequality *within* both rural and urban areas is higher in Brazil and South Africa, than in China, India and Indonesia. That said trends differ across countries. Both China and India experienced some increase in income inequality within urban and rural areas alike from the early 1990s (Figure 0.4, Panel A). In Brazil and Indonesia, by contrast, income inequality declined over time in both urban and (especially) rural areas. For South Africa, the evidence is more mixed: urban inequality rose over time, in parallel to an easing of the rural divide.

Comparing the evolution of real incomes *between* rural and urban areas also yields interesting results. China and India, and, to a lesser extent, South Africa, saw greater rises in their *per capita* urban incomes than rural incomes, thereby suggesting an increase of inequality to the advantage of urban inhabitants (Figure 0.4, Panel B). Brazil is the only country among those observed where rural areas outpaced urban areas in *per capita* income growth – by as much as 40% from the 1990s. Such distributional gains were partly helped by the rural pension scheme (*previdência rural*), which provides benefits equal to the minimum wage to 8.4 million rural workers in Brazil (OECD-ILO, 2011d).

The forces behind observed patterns of spatial inequality vary. For China, there is increased evidence that growing spatial inequality stems mainly from differences within provinces rather than a divide across provinces. As documented by OECD work on rural policy in China (OECD, 2009b), there are great disparities in access to basic services between rural and urban populations within provinces. One example of such unequal access is that, while the permanent urban population (which excludes most migrants), is covered by medical insurance, the vast majority of the rural population is not. Access to education is also still very unequal (Herd, 2010). By contrast, trends in India tend to reflect the accentuation of imbalances between that country's states. Indeed, there appears to be growing concern in India that the benefits of growth were concentrated in the already richer states, ultimately contributing to widening the gap with the poorest and most populous states (*i.e.* Bihar, Madhya, Pradesh, Uttar Pradesh and Kerala).

Where historically disadvantaged ethnic, racial, and social groups are concentrated in particular regions, group-based inequality becomes reflected in regional inequalities

Figure 0.4. **Inequality in urban and rural areas**



1. China figures refer to 1993 and 2005, India figures refer to 1994 and 2005, Indonesia figures refer to 1993 and 1999 and South Africa figures refer to 1993 and 2008.
2. India data refer to household consumption.
3. Data refer to real incomes except for South Africa where it is nominal income.

Source: OECD-EU Database on Emerging Economies and World Bank, World Development Indicators.

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(World Bank, 2006). This is a particularly serious challenge for South Africa, where geographical divides reflect inequality between races. Although real incomes have been rising for all groups since the end of apartheid, many Africans still live in poverty. At any poverty yardstick, Africans are very much poorer than Coloureds, who are very much poorer than Indians/Asians, themselves poorer than whites. According to Leibbrandt *et al.* (2010), these are important factors in explaining the changing patterns of inequality according to rural and urban "geotypes" in South Africa.

Gustafsson *et al.* (2011) take a closer look at the comparison between China and Russia, with the former being the world's largest country in terms of population, the latter in terms of territorial area, and both sharing a history of a centrally-planned economy. Based on a new, more comprehensive micro-data set of household income levels, the authors report a wider gap in average income between urban and rural households in still predominantly rural China than in more urbanized Russia. China has long had in place such restrictions on-rural-to-urban migrations as the so-called *hukou* system. In addition, while the social insurance system tended over time to reduce urban-rural income inequality in Russia, it had the opposite effect in China, where for long it almost exclusively targeted the urban population. However, because the study refers to the early 2000s, it neglects to take into account the significant progress made in extending social protection in China's rural areas during the second half of the decade.

Informality

Although the extent of informality is difficult to measure, various indicators suggest that informal economic relations are particularly widespread in India and Indonesia and to a lesser, albeit still sizeable extent, in Brazil, China, South Africa and Russia (Figure 0.5). In Brazil, informal jobs are mainly concentrated in low-skill-intensive sectors such as agriculture, construction, hotels and restaurants, domestic services, and wholesale and retail trade. In China, undeclared rural migrants and workers laid off by urban state and collective enterprises account for the largest share of informal employment. In both India and Indonesia, informal employment includes a disproportionate number of women, home-based workers, street sellers and workers sub-contracted by firms in the formal sector.

Figure 0.5. **Informality in emerging economies**

1. The share of informal employment is based on a standardized definition, and excludes agriculture. Latest available estimate shown: 2000-07 (Brazil and South Africa); 1995-99 (India and Indonesia); unavailable for China. See Jutting and Laigesia (2009) for more details.
2. The share of employment in the informal sector is based on the ILO KLIM database. Definition for Argentina (2001): urban population only; Brazil: unincorporated urban enterprises employing five or less employees and producing goods and services for sale (excludes agriculture). India (2000): all unincorporated proprietary and partnership enterprises producing all or some of their goods or services for sale. Indonesia (2004): all own-account and unpaid family workers and employees in agriculture, and own-account workers (unless professional, administrative, or clerical) not assisted by other persons. South Africa (2004): business activities which are not registered for taxation, for professional groups' regulatory requirements, or for similar acts.
3. Country-specific measures of informality shares based on *OECD Economic Surveys* (OECD, 2007a, 2008a, 2008b, 2009a) and *OECD Employment Outlook* (2007b). Definition for Brazil (2009): own-account workers and employees without social contributions. China (2008): self-employed. India (2004): workers not covered by the employee's provident fund. Indonesia (2004): own-account workers and unpaid workers. South Africa (2008): workers without pension and medical plans.

Source: OECD (2010), *Economic Policy Reforms 2010: Going for Growth.*

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Prima facie informality does not necessarily translate into higher income inequality. This is because informal work favours increases in household income, mainly at the bottom of the income distribution. Nevertheless, there is supportive evidence for the view that the persistent informal economic relations lead to greater income inequality (Jutting and Laigesia, 2009). In the EEs, this outcome reflects the interplay of several forces. First, informal jobs typically carry a sizeable wage penalty. Second, informal jobs are significantly more unstable than formal ones. Third, informal jobs considerably limit opportunities for human capital accumulation and career progression. Furthermore, employment in the informal sector can also be detrimental to a worker's subsequent prospects for formal employment, thereby entrapping the low-skilled and contributing to the persistence of income inequality.

While there might be a voluntary upper tier among informal workers, most find themselves in the informal sector involuntarily. Informality affects the less privileged – *e.g.* youth and the low skilled, who, because of their demographics and levels of educational attainments, account for a relatively large share of labour supply in the EEs (OECD, 2010b). Moreover, the informal sector includes many self-employed workers with low levels of physical capital, which is reflected in low productivity and subsistence levels of income.

Importantly, informality means that many workers in the EEs remain outside the scope of labour market and social protection regulations. Only better-off workers, typically in the formal sector, enjoy any protection in the event of dismissal. Even for them, however, the loss of their job is likely to mean a move into worse working conditions, often in the informal sector. Labour reallocation then imposes on workers high welfare costs and inefficient job matching that negatively affects wage earnings and labour productivity.

Education

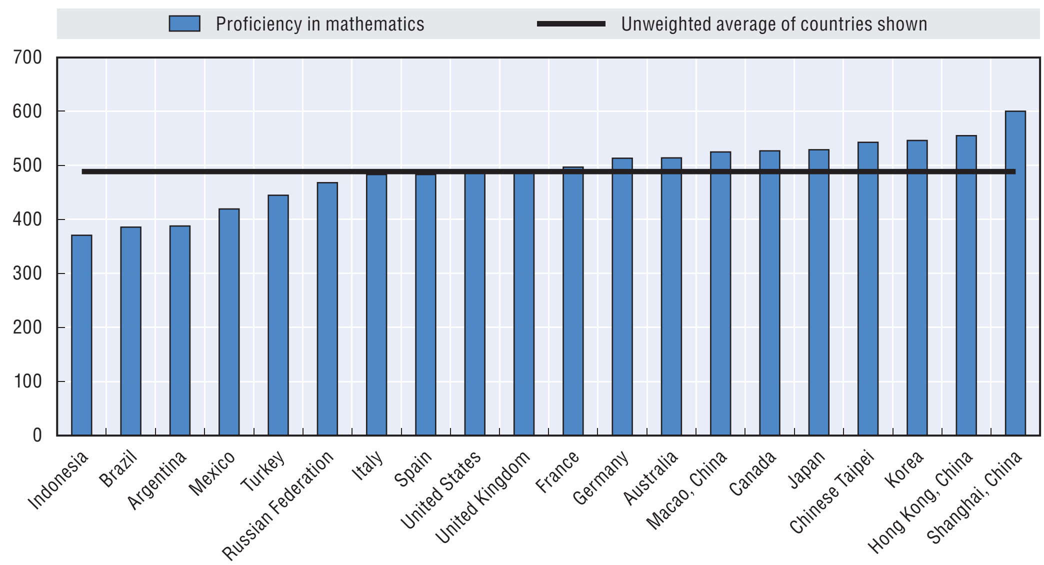
Education is of great intrinsic importance when assessing inequalities of opportunity. Educational institutions that give children from different backgrounds equal opportunities to benefit from quality education are generally associated with improved employment prospects and higher average earnings. Furthermore, education tends to be positively associated with well-being and social outcomes such as health status and willingness to participate and become socially active. By fostering social cohesion, the benefits of greater opportunities for education accrue to society as a whole.

School attainment rates have increased markedly in the EEs. With the exception of India and South Africa, primary attainment rates are today broadly similar to the average seen in the OECD for younger cohorts, although they remain lower for secondary and tertiary enrolments (OECD-ILO, 2011a; OECD, 2010b). Notwithstanding the improvements achieved, enrolment varies markedly, both geographically and between population groups – *i.e.* it is significantly lower in rural areas and is lower for girls than for boys. While in most EEs primary education is generally available in every local community, secondary education may require travelling or moving to larger urban areas, making attendance more difficult for children from disadvantaged households in rural areas, especially for girls still spending time working or helping with household duties. The lack of role models for girls and entrenched social roles still hamper the closing of the gender gap in education in several EEs.

Increasing attendance cannot be an end in itself. Rather, it should be a means to improving learning outcomes and the employability and competences of the workforce. In this regard, indicators included in the OECD Programme for International Student

Assessment (PISA) as to the level of 15-year-olds' cognitive skills in the EEs show considerable variation in cognitive outcomes (Figure 0.6). In Argentina, Brazil and Indonesia, 15-year-olds perform comparatively poorly in mathematics and in PISA's other two cognitive domains, namely reading and science. Such weak outcomes may partly be associated with insufficient investment given that total public spending on education relative to GDP is generally low in the EEs.

Figure 0.6. **PISA scores in mathematics, 2009 (proficiency levels)**



Source: OECD Programme for International Student Assessment (PISA).

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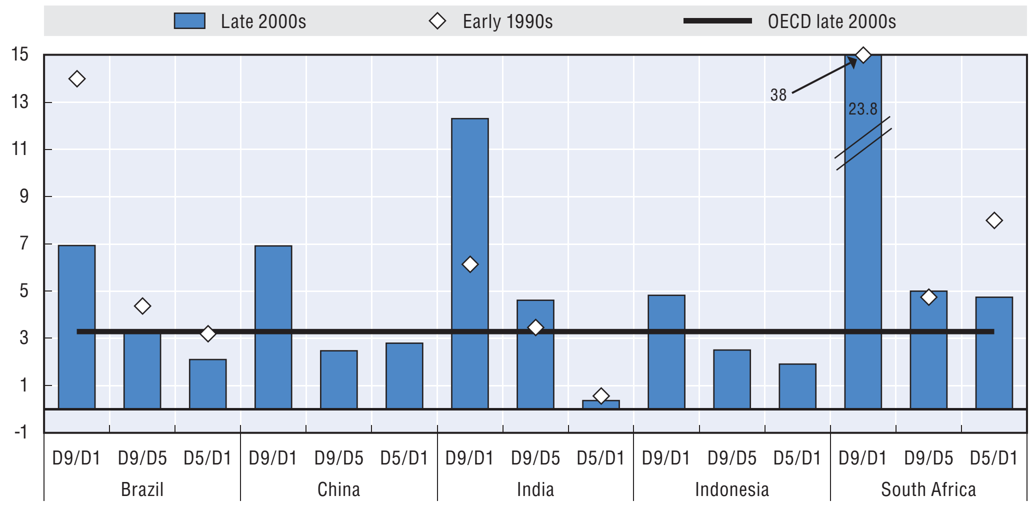
Impacts on earnings

The combination of marked spatial divides, persistently high shares of informal-sector jobs and disparities in access to education accounts for much of the widespread variation in earnings from work in the EEs. In Indonesia, Brazil and China, for example, the earnings in the top decile (conventionally labelled as D9) were by the late 2000s five to six times higher than those in the bottom decile (this latter labelled D1, Figure 0.7). In South Africa the gap was significantly larger, with the earnings in the top decile exceeding those in the bottom by more than twenty times. In India it is twelve times larger.

One country that has experienced a significant increase in earnings inequality over time is India, where the ratio between the top and the bottom deciles of the wage distribution has doubled since the early 1990s. The main driver has been an increase in wage inequality between regular wage earners – *i.e.* contractual employees hired over a period of time. By contrast, inequality in the casual wage sector – workers employed on a day-to-day basis– has remained more stable.

Unlike India, Brazil and South Africa underwent a marked compression of the ratio between the top and bottom deciles (D9/D1) of the earnings distribution, which was almost halved during the period between the early 1990s and late 2000s. The figures for South Africa, however, mask the fact that it had achieved most of the progress shown by the end of the 1990s. Thereafter, top earnings increased at a somewhat faster pace than those at the bottom of the distribution, which points to a partial erosion of earlier progress.

Figure 0.7. **Earnings inequality, decile ratios**[1, 2]



Note: D9/D1: ratio of the wages of the 10% best-paid workers to those of the 10% least-paid workers, calculated as the ratio of the upper bound value of the 9th decile to the upper bound value of the 1st decile. D9/D5 (D5/D1): ratio of the wages of the 10% best-paid workers to those at the median of the earnings distribution. D5/D1: ratio of the wages of the workers at the median of the earnings distribution to those of the 10% least-paid workers. The OECD average refers to the D9/D1 decile ratio of full-time wage workers across 23 OECD countries. Data for the early 1990s generally refer to 1993, while for late 2000s generally refer to 2008.

1. For India, the weekly earnings distribution has been calculated irrespective of how many days in a week workers have actually worked. For China, only mean incomes per decile rather than upper-bound values are available. Nonetheless, comparison of the upper bounds with the mean incomes in other countries (*i.e.*, India and Indonesia) shows that the differences are not significant, while they are also relatively stable across the income distribution. Thus for China means instead of upper bounds have been used.
2. The age group for wage calculations is 15-64 for Brazil and South Africa and 15-59 for India.

Source: OECD-EU Database on emerging economies for Brazil, India and South Africa, and World Bank, World Development Indicators for China and Indonesia. StatLink http://dx.doi.org/10.1787/888932535527

Empirical studies highlight that gender and race discrimination in the labour market are important factors behind the often high levels of earnings inequality in the EEs, although it is important not to ascribe the gender wage gap to discrimination alone. Other concurrent contributory factors include differences in skills and work experience and sector-based composition of the workforce. With these caveats in mind, the evidence for Brazil shows that women's full-time real wages were half those of men in 1993, although the gap has progressively narrowed since then. As a result, Brazilian women earned two-thirds of men's real wages in 2008. Although the gap has fluctuated significantly depending on the year considered in South Africa, women were earning 60% of men's wages in real terms in both years observed (1993 and 2008). Some improvement in the breakdown of wage inequality by race can be observed from the early 1990s. Thus, by 2008 Africans earned on average four times less than whites – measured in real wages – against five times less in 1993 (Leibbrandt *et al.*, 2010).

4. Institutional arrangements shaping redistribution

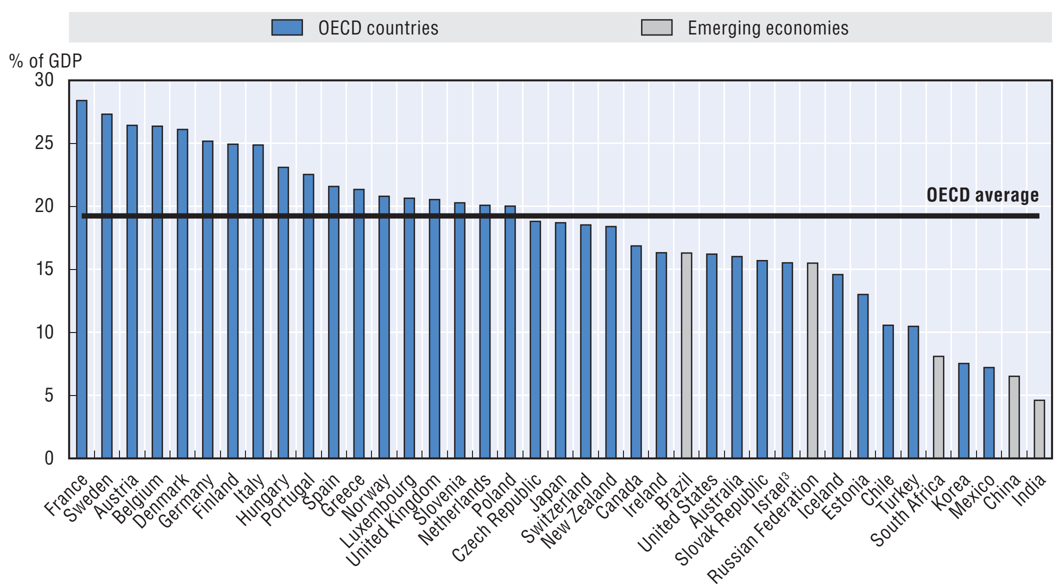
Against the backdrop of important spatial economic gaps, large informality and, sometimes, very uneven access to education services, a comprehensive policy strategy is required to tackle the challenges posed by sizeable inequalities in income and earnings. Such a strategy should involve a mix of reciprocally reinforcing social and labour-market policies alongside education and tax policies. This certainly represents a difficult task in any country, including OECD members. As far as the EEs are concerned, strong economic growth certainly provides a sound base for launching such a comprehensive strategy. On the other hand, the task is more difficult where less structured labour market and social welfare institutions come together with a tax infrastructure whose revenue raising and administrative capacities are relatively limited. Such institutional weaknesses hinder the expansion of public expenditure for social programmes.

How is social protection structured in the EEs?

The coverage and generosity of social protection is generally lower in the EEs than in most OECD countries. Total public social expenditure is well below the OECD average of almost 20% of GDP (Figure 0.8). However, there are significant variations among the EEs. Social spending as a percentage of GDP is highest in Brazil and Russia, where it represents about three quarters of the OECD average. China and India, by contrast, spend three to four times less on social protection than the OECD average.

Figure 0.8. **Public social expenditure in OECD countries and emerging economies**

Total public social expenditure, latest year available[1, 2]



1. Data refer to 2007 for OECD member countries, 2005 for Brazil, 2006-07 for India and South Africa and 2008 for China.
2. Policy areas covered include old-age, survivors, incapacity-related benefits, family, health, active labour market policies, unemployment, housing.
3. Information on data for Israel: *http://dx.doi.org/10.1787/888932315602*.

Source: OECD (2011), *OECD Employment Outlook*.

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Contributory social insurance programmes account for the bulk of public social expenditure in most EEs, particularly in China, India and Indonesia (OECD, 2010a). Even though programmes' coverage varies across countries, it is generally limited, and social expenditure is comparatively low. Most contributory social insurance tends to be in the form of pension schemes, covering workers chiefly in the formal sector and leaving the others unprotected. The share of the workforce contributing to a pension and/or health insurance plan ranges from about 10% India and Indonesia to 50-60% in Brazil and South Africa (OECD, 2011). To a large extent, low coverage reflects a high incidence of informality and self-employment.

Turning to EEs' unemployment compensation schemes, two main instruments are in place to protect workers against the income losses induced by job loss: severance pay (SP) and unemployment insurance (UI). In most EEs, SP is the main form of income support for workers from the formal sector who lose their jobs. Two exceptions are the Russian Federation – where UI and SP, are similar in size – and South Africa, where UI has a higher value than SP. In comparison, the value of unemployment benefits available to workers during the first year of unemployment exceeds that of severance pay in most OECD countries. Moreover, most have universal UI systems in place, while many do not have any mandatory SP programmes. Among OECD members who bear comparison with the EEs, SP for workers unemployed for one year exceeds UI in Chile and Turkey, for example. Mexico, by contrast, has an SP system in place, but no UI.

The value of *de jure* income support available to eligible job losers during the first year of unemployment differs substantially across emerging economies. In Brazil, for example, income support is markedly more generous than the OECD average. This reflects a combination of high SP with moderate levels of UI. In India, income support is substantially below the OECD average, with little or no benefits for the unemployed.

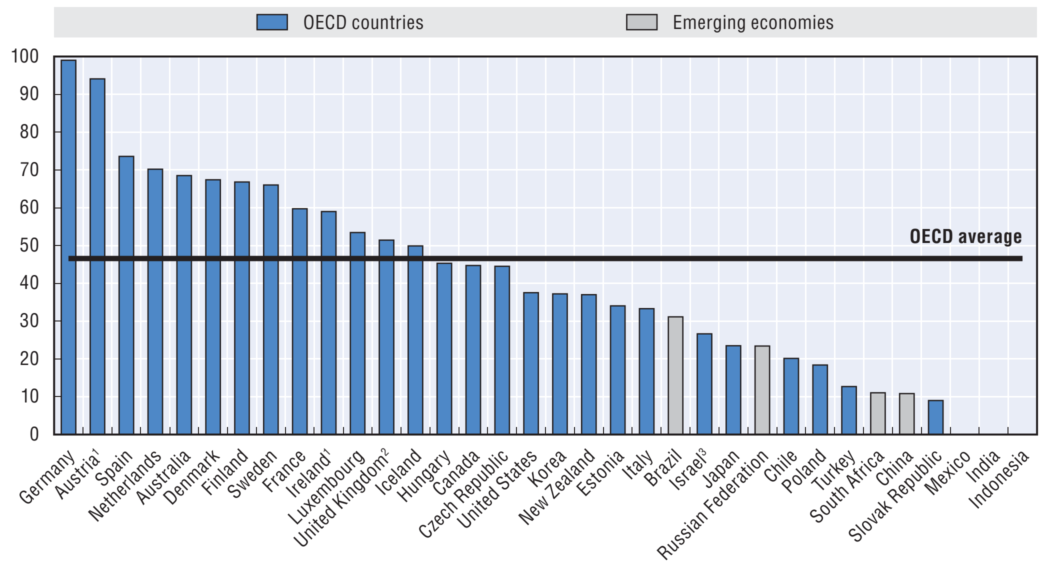
In practice, however, the average level of income support available to job losers in the EEs is much lower than in the OECD because most are not eligible to any form of income support. Workers employed in firms that fail to pay social security contributions are necessarily excluded from UI as they do not meet minimum contribution requirements. Moreover, eligible job losers often do not receive any severance pay, or only part of what they are entitled to, due to widespread "non-performance" – *i.e.*, the inability or refusal of firms to live up to their severance-pay commitments. In Indonesia, for example, only 34% of eligible workers who were separated from their jobs in 2008 actually received severance pay and, of those, a large majority received less than their full entitlement amount (World Bank, 2010).[6] Formal-sector job losers often fail to qualify for UI because of strict eligibility requirements or the short maximum duration of benefits, which results in workers exhausting their benefits before they find a new job (OECD, 2010a). Eligibility conditions are particularly stringent in India where workers should have contributed for at least five years, and Turkey where workers should have contributed during at least 20 of the last 36 months. Minimum contribution requirements of one year in China and Chile could also exclude many job losers from unemployment benefits, once job turnover rates are taken into account (see below for a discussion of the Chilian case). The short maximum duration of UI limits overall coverage in Brazil and Chile, where it does not exceed five months.

Figure 0.9 shows the coverage of unemployment benefits as measured by the ratio of beneficiaries to the number of unemployed. It shows that benefit-recipiency rates are much lower in the EEs than the OECD average. Recipiency is just over 30% in Brazil where it is highest), 25% in the Russian Federation, and some 10% in both China and South Africa. The low level of coverage in the EEs greatly limits the ability of UI systems to prevent unemployment-related poverty and inequality and increases the importance of informal coping mechanisms. It may also impose higher adjustment costs on people who return to work and may represent an inefficient use of resources when individuals are credit-constrained.

Although non-contributory social assistance, aimed chiefly at tackling poverty, remains limited, it has increased over the past decade. The latter dynamic reflects, amongst other things, the expansion of conditional cash-transfer programmes and health-assistance programmes. The conditionality attached to these programmes implies that in

Figure 0.9. **Unemployment benefit recipiency rates in OECD countries and emerging economies**

Percentage of total unemployed, 2007/08



1. Data do not include unemployment assistance which exists in case the unemployed do not meet minimum eligibility conditions for UI or have exhausted the right to UI benefits.
2. Includes Jobseeker's allowance (social insurance and social assistance).
3. Information on data for Israel: *http://dx.doi.org/10.1787/888932315602*.

Source: ILO Social Security Inquiry Database and national sources for Brazil and Mexico; OECD (2011), *OECD Employment Outlook*.

StatLink http://dx.doi.org/10.1787/888932535565

addition to directly tackling poverty, they are also intended to improve school attendance and the health status of mothers and children. Still, both the coverage and incidence of cash transfer programmes vary greatly across emerging economies. They account for 58% of household income for the lowest quintile in South Africa, about 20% in the comparable OECD countries Chile and Mexico and about 15% in Brazil (OECD, 2011a).

In addition to conditional cash-transfer mechanisms, non-contributory social assistance is provided through other mechanisms. Food programmes play an important role in India and Indonesia; means-tested cash transfers to the poor are available in China and Indonesia, while the Russian Federation and South Africa provide means-tested child support (OECD, 2010c). In addition, the EEs spend considerably more on public work programmes (PWPs) than the average among OECD countries, with spending being relatively higher in India and South Africa. By far, the largest programme is the Indian Mahatma Gandhi National Rural Employment Guarantee (ex-Maharashtra Employment Guarantee Scheme/NREGA), which spent about 0.52% of GDP and covered about 10% of the labour force in 2008-9, compared with 0.05% of GDP and 0.6% of the labour force on average in the OECD in 2007. South Africa also spends much more than the OECD average: the coverage of its Expanded Public Works Programme (EPWP) was about 3.5% of the labour force in 2008-9. Chile and Indonesia spend a slightly higher share of GDP on direct job creation programmes than the OECD average. While coverage was low in Chile and Turkey, it reached 5% of the labour force in Indonesia in the early 2000s – significantly higher than in OECD countries as Belgium, France and Ireland, which in 2007 operated direct employment programmes covering between 1.1% and 2.7% of the labour force. In

Argentina, a special large-scale cash-for-work programme (*Jefes y Jefas de Hogar*, launched in 2002 in the aftermath of the economic crisis) has evolved over time to become one of the main factors behind the reduction of inequality in the country.

How are social spending requirements financed?

Measured as a percentage of GDP, the levels of tax revenues in Argentina, Brazil, the Russian Federation and South Africa are broadly similar to those in OECD countries (Table 0.1). In principle, therefore, these countries enjoy the revenues needed to finance public social programmes in support of the less well-off. The share of tax revenues in GDP has risen significantly in China. Although less pronounced, India, Argentina, Brazil and South Africa have also recorded rises in their tax takes.

Table 0.1. **Total tax revenue as a percentage of GDP for major non-OECD economies**

	1995	2000	2007	2008	2009 provisional
Argentina	20.0	21.5	29.1	30.7	31.4
Brazil	26.8	30.0	33.4	33.6	32.6
China[1]	9.8	14.5	20.7	22.0	n.a
India	14.6	14.5	18.9	17.3	15.7
Indonesia[2]	17.0	11.9[5]	12.8[6]	n.a	n.a
Russian Federation[3]	n.a	n.a	36.5	37.0	n.a
South Africa	25.0	26.5	30.8	29.8	27.6
Unweighted average					
OECD Total[4]	**34.4**	**35.5**	**35.4**	**34.8**	**n.a**

n.a. Not available.
1. Figures for mainland China only excluding Hong Kong and Macao.
2. Figures for Central Government only.
3. Revenue and GDP figures obtained from Russian National Accounts.
4. Excludes Estonia because the country was not an OECD member when this annual dataset was compiled.
5. 2001.
6. 2004.

Source: Brys *et al.* (forthcoming).

StatLink http://dx.doi.org/10.1787/888932537427

However, EEs' tax revenues differ significantly from OECD countries' in that consumption taxes are the main source (Table 0.2). Most OECD countries tend to offset the regressive effects of consumption taxes through the progressivity of personal income tax (PIT) and insurance-based and income-related benefits or in-work tax credits. This redistribution through government budgets means that post-tax and benefit incomes are less unequally distributed than gross incomes.

With the exception of South Africa, none of the EEs raises much revenue from the PIT. The latter accounts for between 1% and 3% of GDP, compared with an average of around 9% in the OECD. Such low PIT shares partly reflect thresholds that are high relative to incomes with the result that only the better-off pay the PIT – in India, for example, only the top percentile group until recently. However, low PIT shares are also an outcome of administrative bottlenecks in revenue collection and of tax evasion that stems from high levels of self-employment and sizeable informal sectors, which limit the tax authorities' ability to verify taxpayers' declared income. For example, estimates of the "tax gap" – *i.e.* the difference between actual receipts and what may be expected from incomes and the tax schedule – are often in the order of 50% in Latin America (Jimenez *et al.*, 2010).

Table 0.2. **Tax systems of selected EE countries: a comparative overview**

	Tax/GDP ratio		% of total tax revenus[1]				Top statutory personal income tax rate[2]	Top corporate income tax rate[3] on 1 January	Standard VAT rate
			Personal income tax	Corporate tax	Social security contribution	Consumption taxes			
	2009 (Provisional)	2008	2008	2008	2008	2008	2010	2011	2010
Argentina	31.4	30.7	6.0	11.0	15.0	54.0	35.0		21.0
Brazil	32.6	33.6	n.a.	n.a.	24.0	46.0	27.5	34.0	20[7]
China[4]	n.a.	22.0	5.0	16.0	15.0	51.0	45.0	25.0	17[8]
India	15.7	17.3	12.0	21.0	0.0	58.0	30.0	30.0	10[9]
Russian Federation[5]	n.a.	37.0	10.0	18.0	15.0	51.0	13.0	20[10]	18.0
South Africa	27.6	29.8	29.0	28.0	2.0	34.0	40[11]	28[11]	14.0
OECD average[6]	***n.a.***	***34.8***	***25***	***10***	***25***	***32***	***41.7***	***25.4***	***18.0***

n.a. Not available.

1. Tax categories defined in *OECD Revenue Statistics Interpretative Guide*: personal income taxes = 1 100, corporate taxes = 1 200, social security contributions = 2000, consumption taxes = 5000.
2. These are the top statutory personal income tax rates (combined central and sub-central (measured on either an average or representative basis depending on the country). Where changes in tax rates have occurred during the tax year, the figure represents an annual average (*Source*: *OECD Tax Database*).
3. This column shows the basic combined central and sub-central (statutory) corporate income tax rate given by the adjusted central government rate plus the sub-central rate (*Source*: *OECD Tax Database*).
4. Figures for mainland China only, excluding Hong Kong and Macao.
5. Revenue and GDP figures obtained from Russian Federation National Accounts.
6. Unweighted averages. Excludes Estonia because the country was not an OECD member when this annual dataset was compiled.
7. Federal government levies VAT on industrial products (IPI) on manufactured/imported goods. Rates depend on the type of product.
8. The central government levies VAT at a rate of 17% on supplies of goods and services directly related to production and the delivery of goods. Other services not subject to VAT are subject to business tax at provincial level.
9. The central government levies a central VAT (CENVAT) on the manufacture/production of goods at a standard rate of 10%, as well as a service tax.
10. 2010 data for corporate tax rate.
11. 2008 data for top personal income tax and corporate tax rates.

Source: Brys *et al.* (forthcoming).

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Unlike PIT, the corporate income tax (CIT) generates a greater share of revenues in the EEs than in OECD countries, partly thanks to royalties and profit taxes from operations related to oil and other minerals in countries like Russia and South Africa. Furthermore, the high CIT share reflects the fact that the audited profits of public companies may make it easier to levy such tax. Although raising tax revenues from corporate profits might be expected to be redistributive as businesses tend to be owned by richer people, the incidence of taxation on capital income is not clear-cut. Where taxation leads to lower investment (*e.g.* because MNEs opt to invest elsewhere), the burden may fall in part on labour through lower real wages and employment. At 35% and 34%, respectively, Argentina and Brazil have CIT rates that are exceeded only by the United States in the OECD countries, suggesting that they may be more vulnerable to tax competition and profit shifting.

In only one EE country, Brazil, the share of social security contributions in total revenues is comparable with the average of the OECD countries. In all others the share is significantly smaller, ranging from 2% of total revenues for South Africa to 15% in Argentina, China and the Russian Federation. The Indian social security system is structured in a way that India does not collect any social security contributions that meet the international definition of such contributions.

5. Policy challenges for tackling inequality while creating more and better jobs

The broad challenge of gradually reducing inequality in the EEs over the long-term can be framed in the context of a multipronged approach that addresses four areas:

1. better incentives for more formal employment;
2. targeting social assistance to those in need;
3. spreading the rewards from education; and
4. preparing to finance higher social spending in the future.

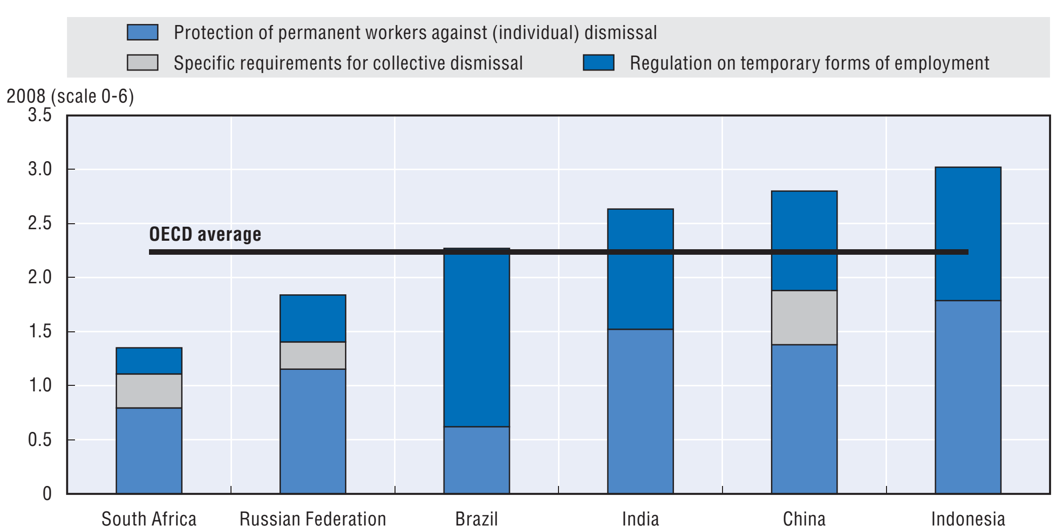
The EEs can alter the distribution of incomes by adjusting their benefits and government transfer systems and improving tax provisions. Such redistributive policies, once appropriately assessed to reflect domestic circumstances and priorities, can be powerful tools for reducing inequality. Indeed, one salient common denominator between the options for policies considered below is that they all help enhance equality, while acting as catalysts for better job creation. This final section reviews the role that key aspects of labour market, social and tax policies play in reducing inequality, focussing on implementation challenges and possible trade-offs.

Better incentives for more formal employment

Employment protection legislation

Excessively strict regulations governing the firing and hiring of workers are usually seen as an important factor in increasing the reluctance of firms to employ workers on a formal basis. At the same time, they exacerbate wage disparities. The overall stringency of employment protection varies widely across the EEs (Figure 0.10). South Africa and Russia have relatively low levels of regulation. By contrast, in Indonesia, China and India, regulation is well in excess of the OECD average. Brazil is positioned between these two extremes, with regulation being broadly in line with the OECD average.

Figure 0.10. **Employment protection legislation**



Note: OECD average is the unweighted average for the 30 countries that were members of the OECD in 2008.

Source: Venn (2009) and OECD Indicators of Employment Protection as accessible from *www.oecd.org/employment/protection*.

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Despite the wide cross-country variation in employment protection in the EEs, their observed costs of individual dismissal are almost universally higher than the OECD average. This is the result of complicated or time-consuming notification requirements and regulations within the formal sector that make it difficult, if not impossible, to lay off workers for economic reasons. Regulation of individual dismissal is particularly strict in India, China and Indonesia. In India and Indonesia, while there are no additional costs or notification requirements for collective dismissals, the effective cost of such dismissals (the sum of costs for individual dismissal and any additional costs for collective dismissal) puts both countries among the top third of OECD countries, while China exceeds all OECD countries on this measure (Venn, 2009). India's employment protection legislation (EPL) makes lay-offs essentially impossible for firms with above 50 and, even more so, 100 employees. Above these thresholds, in fact, EPL plays a strong role in discouraging formalisation of firms and firm expansion (OECD, 2007b).

One way for the EEs to address these issues could be to ease EPL where it is too strict, while assigning a more prominent role to the safety net for employment (see below). By shifting the focus from job security to policies more oriented to supporting job search and improving the employability of workers, this approach could lead to higher job quality by supporting the expansion of formal employment. It could also help to reduce overall wage inequality.

Unemployment compensation schemes

Increasing the coverage of unemployment compensation schemes represents an important challenge for the EEs. Yet, a straight transposition of the UI schemes that prevail in the OECD countries would not be a viable solution for meeting the targets of increased coverage, better work incentives and reduced labour market inequalities. One reason is that public provision of UI tends be more costly in the EEs due to widespread informal work, which reinforces problems of *adverse selection* and *moral hazard*. Conditions of widespread informality mean that workers know more about their own risk of job loss than insurance providers (*adverse selection*) while mandatory requirements in emerging economies are seldom enough to preclude problems of adverse selection when large parts of the labour force operate outside the reach of the rules. Furthermore, it is difficult to control the use of UI when beneficiaries are able to work in the informal sector while claiming benefits (*moral hazard*).

In this context, two countries offer particularly instructive examples for policy purposes. They are Brazil and Chile. Brazil is an interesting case due to its relatively generous unemployment compensation, high coverage by emerging-economy standards and its rich institutional set-up that combines individual severance pay accounts held in the so-called Guarantee Fund for Length of Service (*Fundo de Garantia po Tempo de Servico,* FGTS) with a system of public unemployment insurance (*Seguro Desemprego*). The Chilean case is noteworthy for the hybrid nature of its Individual Unemployment Savings Accounts (IUSAs), which mix unemployment insurance and severance pay. The scheme design combines mandatory individual saving accounts for unemployment (which, like SPs, workers may access after dismissal) with UI to guarantee support for a limited period to unemployed job-losers who have insufficient savings. Any savings left over upon retirement may be converted into a pension or withdrawn in their entirety. Box 0.1 outlines the key institutional features of the two approaches.

Box 0.1. **Unemployment compensation systems in Brazil and Chile**

Brazil

Income support to the unemployed in Brazil is restricted to formal workers who are dismissed without just cause and workers who lost their jobs when their firms closed down. Access to unemployment-related benefits is thus denied to the vast majority of the unemployed, who include previously informal workers, labour-market entrants and individuals who quit voluntarily. The system of unemployment compensation consists of two components:

- The Guarantee Fund for Length of Service (*Fundo de Garantia po Tempo de Servico*, FGTS) combines mandatory savings accounts with a firing penalty upon unfair dismissal. The FGTS – established in 1967 – represents a fund that can be used for special occasions, including dismissal without just cause; the acquisition of a home; and retirement. Withdrawals in the case of unfair dismissal account for about two-thirds of FGTS expenditure (Caixa Economia Federal, 2009). Every Brazilian worker with a formal employment contract governed by the Brazilian Labour Code (*Consolidação das Leis do Trabalho,* CLT) is eligible to FGTS. To constitute this fund, the employer deposits 8% of the worker's monthly earnings into a saving account in the worker's name (2% for fixed-term workers). Moreover, workers with more than three months of tenure are entitled to an indemnity based on the total amount deposited by the employer in their FGTS account. This indemnity, or firing penalty, was initially set at 10% of the amount deposited, but was increased to 40% in 1988. In 2001, the firing penalty was further increased to 50%, although the indemnity to the worker remained unchanged as the additional 10% is to be paid to the government, rather than the employee.
- Universal Unemployment Insurance (*Seguro Desemprego,* SD) was established in 1986 as part of the Cruzado plan for macro-economic stabilisation and has operated in the current institutional structure since 1994. Eligibility is restricted to formal-sector job losers in the private sector with at least six months of contributions in the previous three years. Unemployment benefits are means-tested. The insured workers must have no other resources to support themselves or their family and must not receive other social insurance benefits. The benefits range from 1 to 1.87 times the minimum wage, depending on the level of previous earnings. The maximum duration of benefits is three months for individuals who have had between 6 and 12 months of formal employment in the previous three years; four months for individuals who have had between 12 and 24 months formal employment; and five months for individuals with more than 24 months. Under special conditions, the benefit may be extended for an additional two months. SD is financed by the government through earmarked taxes on businesses. The law that instituted SD also tasked the public employment service (SINE) with helping the unemployed back into work.

Chile

Chile introduced its insurance job-loss compensation scheme in October 2002. The scheme departs from traditional unemployment insurance in that it is based on the combination of a privately managed individual savings accounts (*Régimen de Seguro de Cesantía*) and a publicly financed contingency fund (*Fondo de Cesantía Solidario*) from which workers can draw under certain conditions should their individual funds be insufficient. Workers can access the solidarity fund only once they have depleted their own account. The scheme covers all workers over 18 years of age employed in private sector salaried jobs. Participation is compulsory for those who started a new job after the introduction of the scheme and voluntary for those already in work.

- A fixed percentage of a worker's wage (0.6% for the employee and 1.6% for the employer) is deposited in each worker's individual account. These contributions and their return can be withdrawn according to a predetermined schedule at the end of the employment relationship. The contingency fund is financed by an additional contribution by the employer of 0.8% of the workers' wage and a government subsidy.

Box 0.1. **Unemployment compensation systems in Brazil and Chile** *(cont.)*

- To benefit from the unemployment compensation scheme, the worker must have: *i)* contributed for 12 months (not necessarily continuously) for permanent workers or six months for fixed-term contracts; and *ii)* been unemployed for at least 30 days. If accumulated savings amount to more than two monthly wages (which would require about five years of contribution), the sum is provided to the worker in five incrementally decreasing monthly instalments.
- Workers previously on fixed-term contracts or those with less than 18 months of contributions can withdraw the sum in a single instalment. If the unemployed person has been dismissed for unjust reasons and has accumulated less than two monthly wages, she/he is entitled to a top-up from the contingency fund and will receive five monthly payments decreasing progressively from 50% to 30% of their previous average wage. If workers change jobs, they can either withdraw the accumulated funds or leave them in the account. The same happens with the remaining sum if an unemployed person finds a job within the five-month period.

Recent OECD works identify and address the main challenges of the Brazilian and Chilean social insurance programmes (OECD, 2008c; OECD, 2011a; Hijzen, 2011). They suggest specific policy options, some of which could work well in other EEs. First, unemployment compensation has a greater impact on workers in households that are liquidity-constrained. This suggests that in some EEs there might be a case for reducing inequality by ensuring that unemployment compensation specifically targets those job losers who need it most. First and foremost, the broadening of coverage is important from a growth perspective thanks to the greater capacity of workers to alleviate the impact of job loss on consumption during periods of unemployment. In addition, it is relevant for social fairness, reflecting the possibility for job-losers to receive adequate means as they focus on the search for a suitable job.

Beyond coverage, which remains low in Brazil, targeting also requires unemployment compensation to be sufficiently redistributive among those eligible for income support. At present, the Brazilian FGTS is not redistributive in that it lacks risk-pooling mechanisms. UI is strongly redistributive in most OECD countries, where strong pooling is a key to supporting redistribution from low-risk to high-risk workers. Implementing a more targeted unemployment compensation system in the Brazilian case is likely to require a shift in emphasis, away from FGTS and toward UI. This is where the Chilean hybrid approach could be relevant to Brazil and other EEs. The Chilean IUSA scheme is based on a combination of individual savings accounts managed by a private firm and a solidarity, or contingency, fund from which workers can withdraw money under certain conditions should individual funds be insufficient. Self-insurance provides good incentives for workers to either stay employed or return to work when unemployed, while possibly increasing the incentives to work in the formal sector. This frees up resources that might be withdrawn from the solidarity fund by those with inadequate savings.

The Chilean IUSA model also reveals the importance of fine-tuning conditions for access to benefits. If set in an overly restrictive manner, the capacity of the scheme to encourage workers to move from the informal to the formal sector may be limited. In Chile, more than two years after the introduction of IUSAs, about 80% of salaried workers were affiliated to the IUSAs because they had taken on new jobs. Against the very high rate of job turnover that these numbers suggest, requiring job losers to have paid contributions for 12 months before they can benefit from the unemployment compensation scheme makes for a restrictive condition. Informal workers have little schooling and low incomes, and are more likely to find only precarious jobs at the margins of subsistence. The scheme might therefore be perceived more as a tool to force savings, rather than to encourage the move into the formal sector. These considerations underscore the importance of well balanced benefit entitlement requirements, which should be based on an assessment of the country's job turnover rate.

Furthermore, a high degree of co-ordination between the different components of unemployment compensation could also help achieve an appropriately targeted system. At present, for example, the Brazilian system leaves little scope for co-ordinating the design and implementation of FGTS and SD. More closely integrated programmes reduce administrative costs and in the case of social insurance increase the ability of the government to pool risk, so making social protection more affordable and support reductions in inequality. Moreover, better integration frees up extra resources that could be used to go beyond the alleviation of hardship. For example, they could be directed towards strengthening the complementarities between income support schemes and the mechanisms for assisting beneficiaries in their job search or used to help them overcome social problems (in the same way as the anti-poverty programme *Chile Solidario*).

In order to limit the possible *moral hazard* effects in UI systems, EEs could also consider accompanying investments in UI with greater efforts to strengthen their benefit administration and activation policies. Activation hinges on the principle of "mutual obligation" where, in return for paying benefits and offering re-employment services, the government requires recipients to register with the public employment services (PES), search actively for a new job or participate in active labour market programmes to improve their employability. In the particular case of Brazil, job losers could be required to register with the Brazilian PES (SINE) in order to be able to claim benefits.

Minimum wage policies

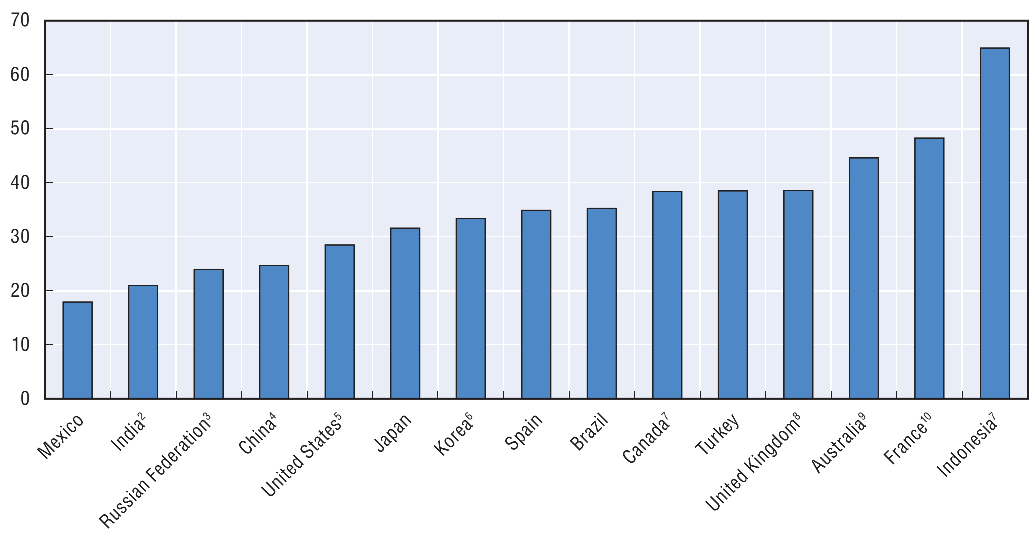
Minimum wages are useful tools for ensuring that fair wages are paid, thus helping to prevent poverty among workers, which includes supporting living standards for the low-skilled – many of whom are youth (OECD-ILO, 2011a). Furthermore, redistributing income to workers at the low end of the pay scale decreases wage dispersion and is likely to boost aggregate demand through a multiplier effect. An advantage of minimum wages from an administrative perspective is that they require little monitoring.

There is evidence from some emerging economies – *e.g.* Argentina, Brazil and Mexico – for the view that minimum wages influence wage determination in both the formal and informal economies, even though, at least in principle, a minimum wage policy can be expected to be less relevant in countries where many workers are in the informal sector. At the same time, minimum wages should be used with caution as anti-poverty instruments since their impact depends upon the distribution of employment across household members. As a result, they are unlikely to work as substitutes for other income support measures to target specific groups.

A balance needs to be struck when setting a minimum wage. If set too low, it may miss its targets. When too high with respect to the average wage, it may discourage the hiring of low-skilled workers or encourage hiring them informally. With these caveats in mind, Figure 0.11 shows the ratio of minimum wages to the average wage for the group of G20 countries that have a statutory minimum wage and for which this share is available. In most EEs, the ratio of the minimum wage to the average wage ranges between 18 and 25%, which places them at the bottom of the list of observed countries. At the opposite end of the spectrum, Indonesia has the highest observed ratio – with a minimum wage that is 65% of the average wage. Nevertheless, Indonesian legislation contains exception clauses that allow companies to opt out of minimum wages if they prove that they cannot afford them. As it turns out, such exceptions are obtained relatively easily (Saget, 2008; OECD-ILO, 2011a). With a minimum to average wage ratio comparable to those of many OECD countries, Brazil falls within the top half of the spectrum.

Figure 0.11. **Minimum wages in G20 countries, 2009**[1]

Percentage of average wages



1. All ratios refer to 2009, except for Brazil (2010), China (2008), and India (2008). These ratios are approximations, as most countries are characterised by national, regional or state exceptions, Nevertheless, such special cases should not affect the ratio too much.
2. Federal rate; state rates exist but should be higher than federal rate; special rates for adolescents (14–18-year-olds) and children (under 14-years-olds) can be set.
3. National rate; regional rates exist.
4. Average of 286 cities.
5. Federal rate, state rates above the federal minimum are allowed. Sub-minima for youth can be applied at the state level but must be above the federal minimum (in 2009, only Illinois had a binding youth sub-minimum). A federal sub-minimum for youth under 20 during the first 90 days of work with a new employer also exists and is equivalent to 65% of the adult wage.
6. Up to 2006, workers under 18 were entitled to 90% of the adult minimum wage (MW) for the first six months of employment. In 2007, the age criteria was abolished on discrimination grounds, and all workers with less than three months of tenure (probation period) are now entitled to 90% of the MW.
7. Average of provincial rates.
8. Sub-Minimum Wage applies to youths under 21. It is around 83% of the adult rate for youth aged 18–20 and around 61% of the adult rate for youth aged 16-17.
9. Youth are subject to a reduced MW to be set out in collective agreements.
10. Youth aged 17 and 18 with less than six months experience receive 90% of the adult MW and youth 16 or younger receive 80% of the adult MW.

Source: OECD Minimum Wages Database for Australia, Canada, Spain, France, Japan, Korea, Mexico, Turkey, United Kingdom and United States; ILO Minimum Wage Database for Brazil and the Russian Federation; OECD (2007) for India; OECD (2010f) for China; and *http://dds.bps.go.id/booklet/boklet_mei_2010.pdf?* for Indonesia.

StatLink *http://dx.doi.org/10.1787/888932535603*

In addition to its low minimum wage ratio by international norms, India allows even lower rates to apply to youth in sectors such as agriculture and tea plantations. Good international practices, however, suggest that there may be stronger grounds for applying lower sub-minimum wages to young workers when the job requires investment in training (OECD-ILO, 2011a). The rationale is that a more differentiated minimum wage setting offers the advantage of encouraging more firms to invest in hiring and training young workers, while enabling them to share the related cost burden with the young workers. OECD countries following this practice include Germany and the United Kingdom, where salaries and training allowances are initially set at relatively low levels to account for the lower labour productivity expected during the training period.

Among the EEs, sub-minimum wage practices could be particularly appealing to Brazil, a country with comparatively high social security contributions, which act as an incentive for informal employment and the under-declaration of earnings. Until recently, the observed overall effects of the minimum wage in Brazil have been positive. It has, for example, supported the increase in earnings at the bottom of the distribution, which has helped to compress the wage distribution. Nonetheless, there is also strong evidence that these positive effects are fading (OECD, 2010a). Social partners have an important role in determining a desirable level for the sub-minimum wage. When it is predicated on training provision, regular monitoring to avoid abuses should be enforced.

Targeting social assistance to those most in need

Cash transfers

Cash transfer programmes provide income support to a population's most vulnerable groups in the form of income-tested benefits. Although most EEs' cash transfer schemes are permanent, there are also examples of one-off or temporary transfers to mitigate the effects of a specific shock. Conditional cash transfers (CCTs) appear to have been particularly effective, both in reducing inequality and in meeting other long-term development objectives, such as raising school enrolment rates and improving educational and health outcomes. The effectiveness of CCTs stems from the fact that they are typically means-tested and contingent upon certain behaviours (*e.g.*, the use of specific health and education services for children). Box 0.2 discusses three particular cash transfer programmes, the Brazilian *Bolsa Família*, the Chinese *Dibao* and the South African *Child Support Grant*.

One example of such positive results has to do with the gender dimension of CCTs. First, the programmes themselves are often focussed principally on women, whose role in the allocation of household resources is enhanced by the fact that the monetary transfer is made to them.[7] Second, CCTs enhance the scope for "double dividends" – they reduce the costs of education so boosting children's school enrolments and freeing up mothers' time to work and earn salaries. Such dual gains can be particularly beneficial to households at the bottom of the income distribution and with young children. Finally, CCT programmes' gender equality gains may stem from the fact that the beneficiaries of higher enrolments include girls, so helping to raise their generally low school attendance and reduce their higher drop-out and repetition rates. It goes without saying, however, that these benefits remain contingent upon the availability and quality of health and education infrastructure. This is a critical factor especially in regions and urban ghettos where the poor are concentrated. Even so, CCT programmes have been instrumental in reducing poverty in most EEs (OECD, 2010c). All programmes have also been found to reduce inequality.[8]

Means-testing is very important for proper targeting. It needs to be appropriately designed, keeping the right balance between adequate protection and incentives to

Box 0.2. **Examples of cash transfers programmes: *Bolsa Família*, *Dibao* and *Child Support Grant***

Dibao (China)

Started as a pilot programme in Shanghai in 1993, the *Dibao* programme was implemented in all Chinese cities in 1997, and progressively extended to the whole country through 2007. The aim was to provide assistance to workers laid off by state-owned enterprises in their restructuring process and avoid social unrest related to rapid economic transformation (Chen and Barriento, 2006). The amount of the benefit equals the household's size multiplied by the gap between per capita household income and a locally determined minimum living standard. The *Dibao* is financed by central government and the municipalities, whose share varies according to their financial capacity (in the wealthy coastal region, municipalities pay most of the expenditure, while poor municipalities, like those in the west of the country, bear almost none; Solinger, 2008).

Although the very rapid increase in coverage is a significant achievement, a majority of poor households are still not covered. Rural migrants are explicitly excluded, due to the urban registration system (*hukou*). Fiscal constraints tend to lower the threshold for the determination of local poverty lines by local governments, implying that entitlements do not properly reflect the extent of the poverty gap. Another upshot is that the benefit often fails to cover the basic needs of the poor. Intrusive methods used to determine eligibility and administer the benefit might also discourage people from applying (Cai *et al.*, 2010). Individual applicants' relatives and neighbours, for example, are questioned. The results of the scrutiny are publicly posted in a common community space, in order to solicit the views not just of immediate neighbours but of everyone acquainted with the applicant family's true state of eligibility, and in a position to see their daily comings and goings (Solinger, 2008). Some aspects of the *Dibao* programme may also be seen as preventing recipients from exiting poverty. In some cities, households which have a computer or a car, use a cell phone, and enrol their children in special educational establishments are not eligible (Solinger, 2008). Furthermore, the benefit is calculated in such a way that it is reduced if there is any increase in income, which, in effect, implies a 100% marginal tax on labour income.

Bolsa Familía (Brazil)

Brazil introduced *Bolsa Família* in 2003 by bringing together four existing federal schemes to boost school attendance, improve maternal nutrition, fight child labour and provide a cooking gas subsidy. The programme targets two groups on the basis of self-declared income: the very poor and the poor. Both groups are eligible for monthly payments for each child below the age of 15 up to a maximum of five children. The very poor also receive a flat payment regardless of household composition. The payment of the benefit is conditional on children enrolling in school, health visit requirements and pregnant women undergoing medical check-ups. Such conditions are actually intended to encourage beneficiaries to take up their rights to free education and health-care, and non-compliance is seen as evidence of some kind of obstacle to accessing the service, rather than unwillingness to comply (Fizbein and Schady, 2009). Consequently, benefit is temporarily suspended only after three warning notices and the possible visit of a social worker.

Overall, the programme is generally considered to have successfully increased consumption, reduced poverty and raised poor children's attendance at school (see below). However, the selection method has often been criticised on the grounds that it can lead to selection distortions such as patronage and leakage. Hall (2008) reports cases of clientelism and manipulation to electoral ends. It also leads to high inclusion errors compared, for example, with the Mexican CCT programme.

Box 0.2. **Examples of cash transfers programmes: *Bolsa Família*, *Dibao* and *Child Support Grant*** *(cont.)*

Evidence also suggests that *Bolsa Família* affects the allocation of expenditure to food, educational materials, and children's clothing (Soares *et al.*, 2007). Although the programme has been successful in raising enrolment rates, more children are falling behind at school. Nor has there been a significant impact on the vaccination of children. Such evidence points to the importance of tackling supply constraints in the provision of public services. The capacity of *Bolsa Família* to fulfil its objectives is limited by the country's ability to meet the demand for social policies. The lack of investment in the quality of education available to disadvantaged children (Soares *et al.*, 2007), and the lack of access to a set of public services (Paes Souza and Pacheco Santos, 2009) reduce the capacity of the programme to break the inter-generational transmission of poverty.

Child Support Grant (CSG, South Africa)

The *Child Support Grant* (CSG), created in 1998, was initially based on a household income means-test and came with various requirements attached. These included the requirement to produce documents and demonstrate efforts to secure income from other sources. The resulting low take-up prompted the government to review eligibility conditions and related requirements. The CSG's approach was therefore changed by switching the payment of the benefit in favour of the care-giver instead of the child. Women, who account for the majority of primary care-givers, were granted some freedom in the way they used and allocated funds. In addition, while the means-test initially applied to the household income, the government restrained the reference income to that of the care giver and his/her spouse only. In 2008, further amendments set the income threshold for qualifying for the CSG at ten times its value. Moreover, the threshold test was doubled for married couples with two earners, making it more generous and therefore more likely for poor households to qualify. Furthermore, the benefit level was substantially increased from ZAR 100 in 1998 to ZAR 250 in 2010/11, corresponding to 2% of average wages.

CSG take-up has increased dramatically in the decade to 2010. By that year, it was paid monthly to the care-givers of 10.4 million children, who accounted for about 68% of all social security recipients (OECD-ILO, 2011f). A substantial increase was also observed in recipiency rates among the mothers of newborn children who began increasingly to apply for the CSG as the programme gained momentum and the poorest households found out about it. The increase in coverage reflects to a large extent greater confidence in the system.

However, the bulk of the increase is the result of the gradual extension in age eligibility introduced over the years. The CSG was initially available only to children until their seventh birthday. It was gradually raised in three phases to take in higher age groups. From April 2005, the age threshold was set at 14 (*i.e.* children had to be under 14 years old to receive the grant). Between June 2005 and July 2006, over 1.5 million new children received the grant, after which take-up slowed again. In 2008, eligibility conditions were once more amended with the aim of phasing in coverage of all children to the age of 18 in three stages by 2012. It is estimated that this raising of the age ceiling will further increase the number of beneficiary children by about 2.4 million by 2013. There have been recent discussions on making reception of the CSG conditional on school enrolment and attendance.

participate in the labour market. The risk to avoid is creating dependency among the low-skilled, which may ultimately lessen incentives to work. Possible solutions to this difficult trade-off include establishing different thresholds for entry into and exit out of social assistance programmes and the gradual withdrawal of benefits (OECD, 2011a). Importantly, the inequality-reducing effect of programmes, such as *Bolsa Familia,* is attributed mainly to service contacts and attainments, rather than the amount of the associated cash transfer (OECD, 2010a). Overall, the available evidence points to CCTs exerting negligible adverse effects on the supply of labour.

Whether or not they are subject to conditionality, all cash transfer programmes should be properly targeted on benefiting the poor to ensure effective implementation that ultimately supports inequality reductions. In practice, however, the task of appropriately identifying the population in need may be difficult to fulfil. Russia is an example of a country where there remains significant scope for improving the targeting of housing and child allowances (OECD, forthcoming). While, in principle, allowances are income-tested, a relatively large share accrues in practice to the middle income segment.

In addition, there are often trade-offs between reducing under-coverage, or exclusion errors, and improving efficiency. A case in point is South Africa, where about 55% of the households in the bottom quintile receive the Child Support Grant compared to less than 10% in the top quintile (OECD, 2010a). *Prima facie* these outcomes suggest that targeting mechanisms are working and that its mechanisms are indeed well designed (Box 0.2). Yet these upsides mask the fact that the system is still unable to reach out to 2.9 million children who remain uncovered even though they are in need. Full effective implementation of cash transfer systems requires the backing of a comprehensive administrative structure, combining measurement information and institutional capacity.

Putting in place such a structure involves administrative costs (UNRISD, 2007). Some countries such as Indonesia rely on proxy means-tests that use household characteristics while South Africa and Brazil use income declarations, which may be less effective as they are more prone to errors or under-declaration. Adequate monitoring and the enforcement of sanctions in the event of non-compliance need to be in place for targeting requirements to work. Although the frequency of conditionality monitoring varies across countries, there is also evidence suggesting that mild verifications may be enough to induce participants to comply (Grosh *et al.*, 2008).

Public Work Programmes (PWPs)

Compared with cash transfer schemes, public work programmes (PWPs) can be more easily introduced to provide income support to the newly unemployed workers not covered by unemployment compensation schemes. Their main objectives are twofold, namely to provide a safety net to poor segments of the population through labour-intensive public works, and to contribute to local development through investment in infrastructure. These twin objectives differentiate them from the PWPs generally used in advanced economies. First, they are used more as social policy tools to afford temporary income support to disadvantaged groups than as active labour market measures to improve participants' employability. Second, the projects undertaken not only create employment but benefit local communities, *e.g.* through road construction and maintenance, drainage projects, public building maintenance (Grosh *et al.*, 2008).The EEs have often launched or scaled up their PWPs to tackle unemployment and poverty – particularly among the most disadvantaged groups (*e.g.* women, youth and the disabled) – during economic crises. Box 0.3 considers two PWPs, India's National Rural Employment Guarantee Scheme and South Africa's Expanded Public Works Programme.

Again, design and institutional setup are important factors. Setting PWP wages at relatively low levels (*e.g.* the minimum wage, as in India) ensures participant's self-selection. Under certain circumstances – *e.g.* in the event of a cyclical economic downturn –

Box 0.3. **Two examples of public work programmes, India and South Africa**

India

The National Rural Employment Guarantee Scheme (NREGA) is India's largest public works' scheme and possibly one of the largest in the world in terms of coverage (10% of the labour force in 2008-09). It was initially established in 1978 in the state of Maharashtra and was gradually extended so that by 2009 it covered the entire country. The scheme aims to guarantee to all rural households up to 100 days of unskilled manual wage employment per year (mainly in water conservation, land development and drought proofing) at the minimum wage for agricultural workers in the state. If claimants are offered no work in the 15 days after their application, they are entitled to receive an unemployment benefit of between 30 and 50% the minimum wage. Although the scheme was scaled-up in 2009, this could have been for electoral reasons, rather than because of the global economic downturn.

Although the NREGA can play an important role in reducing short-term poverty and smooth employment and income throughout the year for rural labourers, its enormous potential has not yet been fully exploited (Chhibber *et al.*, 2009). It remains little used, particularly in poorer states, possibly because of its funding design. Fund allocation is not pre-determined according to state income levels, but based on the Annual Work Plan and Budget Proposal that each state submits to the Ministry of Rural Development. As a result, low-income states with higher numbers of households below the poverty line, and lower than average capacities to plan, manage and forecast labour demand, tend, on average, to receive less resources (Chakraborty, 2007). In addition, weak implementation capacity at local level limits the benefits that poor rural communities derive from the scheme. The average duration of jobs is only 50 days, possibly because rural labourers tend to participate in the scheme only in the lean season and at times of drought.

South Africa

The South African Expanded Public Works Programme (EPWP) was launched in 2004 to revamp the National Public Works Programme (NPWP) and the Community Based Public Works Programme (CBPWP). It is the third-biggest infrastructure spending programme in the world and a key component of South Africa's social protection strategy. The programme provides short-term work to the unemployed and to marginalised groups, mainly the unskilled, poor and young people, in four sectors (infrastructure, economic, environment and social sectors, with infrastructure being the most important). The scheme aims to not only provide the poor and unemployed with temporary work, but also strengthen their skills through training and by offering them "exit strategies" at the end of their participation in the programme.

However, the EPWP has been criticised for its limited capacity to pursue both objectives at the same time (Hemson, 2007). As a result, the second phase of the scheme announced in April 2009, places more emphasis on generating employment than on training in order to maximise the benefits of immediate job creation. The quality of jobs offered by the EPWP is low both in terms of job duration and wages. As in the Indian scheme, average job duration is shorter than initially stipulated, especially in areas with high unemployment rates because of pressure to rotate jobs (Lieuw-Kie-Song, 2009) and wages are low (Hemson, 2008). In addition, low actual spending, and weak implementation capacity further limit the effectiveness of the scheme. The second phase of the programme aims to address these shortcomings by improving co-ordination across governmental bodies and providing incentives to promote programme expansion and lengthen job duration.

this self-selection is important because it speeds up implementation at relatively low costs. In effect, PWPs can be rapidly scaled-up in times of crisis to provide income support to newly unemployed workers not covered by unemployment compensation schemes. They may thus offer several advantages over cash transfer schemes when it comes to the need to counter the impact of adverse cyclical developments. On the other hand, their effectiveness in reducing inequality and endemic poverty over the long-term is more debatable. Furthermore, they also become prone to misuses over time (OECD, 2010a).

One important way to increase the effectiveness of PWPs is by including some training. Improving beneficiaries' skills, would enhance their job opportunities and lessen repeated use of PWPs by the same individuals. Interesting examples in this direction are the *Jefes y Jefas de Hogar* programme in Argentina and EPWP in South Africa.[9] The Argentinean scheme gives participants the option of either working or attending training courses or educational classes in exchange for benefits. The South African EPWP's training provision includes the possibility of acquiring national qualifications, with a view to preparing for possible longer-term employment. So far, however, the percentage of participants who opt for or are offered training has been low, which has limited the added value on the labour market in terms of newly acquired skills (Box 0.3).

Interactions with regional inequality

One important aspect of social policy is that its effects may help to reduce regional inequalities. Many targeted cash transfers can contribute to reducing regional disparities for the very reason that they are allocated to the poor and, as such, are distributed primarily in regions which have the largest shares (and even highest absolute numbers) of poor individuals and households. Work by Silveira-Neto and Azzoni (2008) shows that in Brazil cash transfers (*Bolsa Familia*), together with the appreciation of the minimum wage, account for approximately 40% of the observed reduction in regional income inequality in the country since 1995. PWPs such as India's NREGA have sometimes been focussed on lagging states, as tools to help redress regional inequalities. While the realms of social and regional policies differ, the former may support the latter.

Spreading the rewards from education

Another important policy challenge is to invest in policies that promote the up-skilling of the workforce. Higher educational attainments *per se* do not necessarily contribute to lower inequality because the related increased returns to education can accrue mainly to the highly-skilled workers. However, where attainments have been shared more widely, so contributing to the upgrading of the workforce's skills as a whole, they have also been associated with higher rates of employment and higher average earnings. In regional areas where access to education is hindered by the need to travel long distances, a focus on the elimination of possible shortcomings in the transport infrastructure and/or services becomes an important requirement if conditions of access to education are to be improved. Over time, the elimination of such bottlenecks will widen the scope for greater use of conditional cash transfers.

Argentina and Brazil are interesting examples of countries that have been successful over the past two decades in promoting equal access to education, while broadening the distribution of school attainment (Lopez-Calva and Lustig, 2010). In both countries, the expansion of basic education – supported by non-school family policies to improve early-childhood health and nutrition programmes, and progress in the service infrastructure – has contributed to narrowing the earnings gap between skilled and low-skilled workers. Such educational initiatives may have played a role in supporting reductions in labour income inequality that the two countries have achieved in the recent past. Investments in education in India and Indonesia have likewise increased access to education, even though progress so far in reducing income gaps has been less tangible, particularly among the most disadvantaged.

Recent OECD work suggests that wider access to vocational pathways in secondary education can help youth, disaffected with academic education, stay engaged with education (Quintini and Manfredi, 2009). More vocational education could be a particularly interesting option for the EEs to consider, insofar as it could not only improve nationwide graduation rates, it could also play a considerable role in smoothing paths of transition from school to work. Interestingly, the available evidence suggests that when class-based vocational training is combined with work-based apprenticeships, the transition from school to work becomes smoother even for those young people not subsequently retained by the firm providing the training. Youths can leave the programme with skills that are immediately usable at work with little or no need for further training. Such dual forms of vocational training could be appealing to emerging economies where only low percentages of students are generally involved in vocational education. For instance, no more than 10% or upper secondary students attend vocational courses in Brazil, India and Mexico (OECD-ILO, 2011a). The National Policy on Skill Development in India is an interesting example in this respect: it encompasses the creation of a private-public partnership to strengthen industry engagement in skills development and promotes greater employer involvement in the country's Industrial Training Institutes. This policy initiative is helping to reduce skills mismatches and has visibly increased graduates' placement rates (OECD-ILO, 2011e).

Preparing to finance higher social spending in the future

The development of a comprehensive social protection system could put upward pressure on government spending. This suggests that one key challenge for the EEs is to meet the long-term need for greater additional revenue to finance social protection expenditure while sustaining growth. The question is how to do so in a way that promotes redistribution and does not hinder growth.

Faced with high levels of informality, one important priority would be to widen the coverage of the formal sector in order to enhance the distributive capacity of the tax system. This would require special emphasis on improving revenue-collection procedures through measures to underpin the capacity of the tax administration to enforce compliance.[10] There would also have to be initiatives to address tax simplification to encourage taxpayers' voluntary compliance with their obligations. Tax simplification is reported to have helped the significant expansion of formal jobs recorded in Brazil since the early 2000s (OECD-ILO, 2011d). Focus on the fight against corruption would also help improve tax collection. Over time, the pay-offs from these efforts would be visible both in terms of improved horizontal equality – individuals with the same gross income paying the same amount of tax – and vertical equality – as better-off individuals who are typically better able to evade taxation have to pay their fair share in taxes.

Broadening tax bases could also contribute to meeting efficiency, growth and distribution objectives. Broader tax bases would have to be supported by careful re-assessments of tax relief systems. Tax relief and exemptions often exist because of the influence of the rich and powerful on the drafting of tax codes. Greater transparency, particularly as to the amounts of revenue forgone and the beneficiaries, is often a good first step in eliminating tax relief arrangements.

A broad base and low PIT rate approach represent a good starting point for a tax policy aimed at keeping distortions to a minimum. A low tax burden also has positive effects on economic growth as it enhances entrepreneurship and incentivises foreign direct investment and education.

Looking to the future, however, greater redistribution in EEs requires a change in the structure of the tax system. Special attention should be given to striking a better balance between tax revenues through PIT and property taxation, on the one hand, and consumption taxes, on the other. Indeed, achieving such balance is a long-standing feature of the broad effort by emerging and developing economies to promote income equality. A shift in the tax structure from consumption to income taxes would increase the redistributive potential of the tax system by making the tax regime more progressive. Tackling inequality and relative poverty would be made easier.

Implementing such an approach, however, is not straightforward. In principle, where countries are growing fast, they may have the scope to raise additional revenues from PIT and make the tax regime more progressive by keeping thresholds unchanged, thus letting the "fiscal drag" kick-in. In practice, this option may not be the best one to pursue, at least until there are strong signs that the size of the informal sector has begun to shrink. Meanwhile, the EEs differ in their attitudes towards the use of the "fiscal drag". On the back of fast growth and an under-indexed tax schedule, the Chinese population subject to income tax increased from less than 0.1% in 1986 to about 20% in 2008 (Piketty and Qian, 2009). While the mechanical effect of the "fiscal drag" may have contributed to this result, China's latest reform has chosen to offset the impact of the "fiscal drag" through large increases in personal allowances. By comparison, India has made much less use of the "fiscal drag" over time. Reflecting the constant adaptation of exemption levels and income brackets in India, the share of population paying income tax has remained stable at the low level of around 2-3%.

All in all, under current conditions of widespread informality and tax evasion, the role of taxes in income redistribution remains limited. Changing this situation is likely to take time, unless countries rapidly put in place ways and means to expand the tax base and reform the tax administration. Until then, reducing inequality is better addressed through well-targeted social welfare programmes and the recourse to mechanisms of in-work benefits. In-work benefits may take the form of tax credits, wage-related transfers, or lump-sum payments. Where there are significant earnings or income disparities at the bottom of the distribution, they have been shown to reduce inequality and increase employment in OECD countries if they provide regular payments to low-income workers (Immervoll and Pearson, 2009). As such, they could be an attractive additional policy option in emerging economies.

Notes

1. Extreme poverty is conventionally measured by the share in the total population of those living on less than USD 1.25 or USD 2 per day (in purchasing power parities).
2. Important factors limiting the comparability of Gini indices based on consumption survey data include differences in definitions of consumption; variation in the number of consumption items that are separately distinguished in surveys; whether survey participants record their consumption or are asked to recall their consumption in an interview; changes in the length of the recall period during which survey participants are asked to report their consumption; different methods used to impute housing, durables, and home production, which alters the incidence of in-kind consumption; and underreporting for some items. Income inequality data can also vary depending on whether the income is pre- or post-tax; whether and how in-kind income, imputed rents, and home production are included; and whether all income – including remittances, other

transfers, and property income – or only wage earnings are captured. World Bank (2006) and IMF (2007) provide detailed overviews of methodological issues.

3. It should be noted, however, that the comparison between points in time may hide the presence of infra-period variations. In Argentina, for example, the period between the early 1990s and the end-2000s was characterised by a sharp increase in inequality until the early 2000s and a decline thereafter. In effect, the period comprises two contrasting economic policy approaches. Following several years of limited social protection in the 1990s, social policies became more redistributive during the 2000s, which helped to moderate the income gap between unskilled and skilled workers. See Gasparini and Cruces (2010) for an in-depth discussion.

4. Middle-class issues have been the focus of a recent OECD report discussing the critical role that the middle class plays in improving social cohesiveness and fostering economic progress in developing and emerging economies (OECD, 2011b).

5. The analysis of income at the very top of the distribution has a counterpart in recent studies. For example, Banerjee and Piketty (2005) report that in India the income share of the top 1% of the distribution reached 9-10% in the late 1990s, with the income for the narrower top 0.1% group also increasing. Although comparable data on top incomes remain scarce, it appears that, after falling markedly over time, the share of the richest 1% in Indonesia was lower than in Argentina and in India (Leigh and van der Eng, 2009). Shares of the top 1% are high in South Africa too, accounting for almost one fifth of taxable incomes in 2005 when dividend incomes are included (Alvaredo and Atkinson, 2010). Leibbrandt *et al.* (2010) found that the top decile of the income distribution in South Africa accounted for 58% of total income in 2008 compared with 54% in 1993.

6. In addition, judicial procedures related to disputes over reasons for dismissal tend to be time-consuming and costly in many emerging economies, resulting in financial insecurity for firms and inadequate compensation for dismissed workers (Venn, 2009).

7. CCT benefits in Brazil and Indonesia are all paid to the mother since women tend to spend a higher share of benefits on children and household-related expenditure than men.

8. Soares *et al.* (2007) show that about 21% of the fall in income inequality measured by the Gini coefficient between 1995 and 2005 in Brazil and Mexico can be associated with *Bolsa Família* and *Oportunidades*, respectively. Similar positive effects on inequality for the two programmes are found by Fiszbein *et al.* (2009) and Barros *et al.* (2006) for Brazil only. In contrast, the impact of *Chile Solidario* on inequality was smaller, most likely because of the low benefit paid to participants (Soares et al., 2007) and the fact that the cash transfer is seen as a way to motivate people to make greater use of social workers' services, rather than supporting their income.

9. As part of the responses to the recent economic downturn, Mexico's public employment services offer funds for training grants that particularly target youth.

10. Partly related, both Argentina and Brazil have strengthened labour inspections over the recent past, either through increasing the number of inspectors (Argentina, see OECD-ILO, 2011c) or by improving the incentive structure and adopting better inspection methods for meeting targets (Brazil, see OECD-ILO, 2011d). Brazil has introduced a bonus system that ties a percentage of inspectors' salaries to performance.

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ANNEX 0.A1

Main Features of Social Protection Systems in EEs

Social protection systems can be described using three main dimensions: *i)* the relative importance of social insurance *versus* general public expenditure and/or social assistance; *ii)* the overall coverage of the schemes; and *iii)* the unification/fragmentation of the schemes.

Argentina's social insurance scheme is financed by social contributions, which covers old-age pensions, survivors and disability and health care for all private and public sector employees and self-employed workers. Contributory family allowances are paid to children of formal salaried workers and unemployment insurance can only be paid to formal workers who have contributed for six months. In the wake of the 2001 national economic crisis, Argentina extended social security benefits and non-contributory old-age pensions as well as transfer programmes for the unemployed. Transfer programmes include community work schemes and vocational training. Another important programme is the universal child allowance for school-age children who attend school and register for health-care services. It covers over 46% of the poor population of the targeted group (ECLAC, 2010). According to ILO (2010), 75% of children and adolescents are supported by family allowances and 89% of adults older than 65 receive retirement benefits or a pension. Last, at least 350,000 persons of working age are covered by programmes related to unemployment, problems of labour market entry and job loss risk.

Brazil has a comprehensive social insurance scheme financed by social contributions, which covers old-age pensions, maternity, disability, and work-accident benefits for all private sector employees and the self-employed, and their dependents. There is also an unemployment insurance scheme. Most public servants are covered by their own social security schemes. According to PNAD data, 52% of the workers were affiliated to social security in 2007. Public health care is provided on a universal basis and financed out of general taxation. Social protection also includes a (rather generous) non-contributory basic old-age pension, as well as a conditional cash transfer scheme for the poorest (*Bolsa Família*).

China has various social insurance schemes for medical care, pension, unemployment, etc. Most schemes are administered at a decentralised level (*e.g.*, county, municipality) and contribution rates often vary across provinces or even within the same province, thus limiting the scope for risk-pooling. Until recently, social insurance schemes covered only urban areas, but efforts have been made to widen coverage in rural areas under different types of schemes, which are largely subsidised. According to Zhu (2009), coverage rates in 2008 were 55% for the urban basic pension and 85% for urban and rural medical care. A means-tested minimum subsistence benefit (*Dibao*) is also provided in urban and rural areas.

India has a very fragmented social protection system. A number of social insurance schemes exist, all of very limited coverage. The main one provides health insurance and maternity benefits to highly-skilled employees (earning wages above a certain ceiling) in large and medium-sized businesses (it covered 8.7 million workers in 2006 compared with about 400 million employed persons in 2004). A number of contributory schemes are also run by the state governments (often with funding from the central government) for workers in small enterprises. However, their coverage is limited to certain areas and population groups (Mazundar, 2010). The most important non-contributory safety nets for poor households are the national rural public employment programme and the product subsidies on rice and fuel. A large number of cash transfer programmes for poor households are also available, but most of them are of very limited coverage.

Indonesia only recently established social insurance schemes based on social contributions. They offer (low) old-age pensions, life and health insurance, and job-related disability and illness compensation. Participation in health insurance is optional if the enterprise has alternative arrangements. The scheme covers only workers (and their families) employed in firms with more than ten employees or a payroll of more than one million rupiah (OECD, 2008a). In 2008, about 8% of the workers were registered with the scheme (*Jakarta Post*, 19/08/2009). Informal workers can register on a voluntary basis, but contribution rates are high, and very few actually do contribute. Several safety nets targeted at the poor have been in place since the 1997 Asian crisis. Some have relatively high coverage, notably a food security programme providing subsidised rice and a cash transfer programme.

The Russian Federation has a number of social insurance schemes (pension, health, disability, etc.) covering employees and the self-employed, and financed out of a unified social contribution. Health insurance accounts for a minor share of public health expenditure. Data on the coverage of the social security system are not available. It was high at the beginning of the transition period, but is likely to have fallen, due to the growth of employment in the unincorporated sector – less likely to be declared to social security – and the rise in non-standard forms of employment (workers with civil or verbal contracts). Social assistance includes some income-tested programmes for low-income families (child allowances and housing subsidies), food subsidies for children in full-time education and financial support for children in kindergartens. In addition, Russia inherited the so-called "privileges" system inherited from the Soviet era: it comprises benefits (often in-kind) for specific categories of citizens, who include the disabled, special-merit categories (veterans) and a large group of workers and retirees with long employment records.

South Africa: the only social insurance scheme is for unemployment. The pension system is a fully-funded scheme managed by private pension funds. According to a labour force survey, about 75% of the workers were covered by a pension scheme or the unemployment insurance scheme in 2007. Public health expenditure is financed out of general taxation. Social assistance is fairly well developed, notably through a (relatively generous) basic old-age pension and means-tested child allowances and disability grants (covering respectively 5%, 10.5% and 3% of the population in 2008, according to National Income Dynamics Study). Public works programmes are also available for the unemployed.