Workshop "Inequality and Structural Reforms: Lessons from Policy"
Monday 19 June 2017
Summary of discussions

On 19 June 2017 the Directorate General of Economic and Financial Affairs (DG ECFIN) of the European Commission organised a half day workshop entitled "Inequality and Structural Reforms: Lessons from Policy". The workshop brought together economists and policy experts with the aim of improving the understanding of how labour/product market and tax policies can be better designed to enhance equality while fostering growth.

Kerstin Jorna, the Deputy Director General of DG ECFIN, introduced the workshop by explaining the political relevance of inequality. She highlighted the importance of having a deeper and fairer Economic and Monetary Union, which is one of the ten political priorities of the Juncker Commission.

Session I – Inequality and structural reforms

In the first session, chaired by *Manfred Bergman* of DG ECFIN, the speakers presented recent empirical results deriving from general equilibrium modelling, panel data estimation and micro simulations. The impact of structural reforms on inequality depends on the type of reform considered as well as on the country and time dimensions. Different points of view were highlighted and avenues for future research put forward.

Alain de Serres (OECD) presented evidence of the income distribution effects of different product and labour market reforms based on various econometric techniques. It was shown that the impact of pro-competition product market reforms, technological progress and trade are difficult to disentangle and that there is little evidence of adverse employment effects of competition. For labour market reforms, however, the income distribution effects are more clear-cut, especially at the bottom of the distribution. It was for instance shown that, in general, labour market regulation policies (e.g. easing employment protection law or lowering income wages) induce offsetting effects between wage dispersion and employment. Also labour market institution policies (e.g. lowering union density or lowering the legal extension of collective bargaining) are generally favourable to employment as well as to income distribution.

Jan in 't Veld (European Commission – DG ECFIN) presented the effects of structural reforms on the functional distribution of income in the EU. The study aims to assess the EU-wide distributional impact of jointly implemented structural reforms using QUEST, DG ECFIN's dynamic stochastic general equilibrium model. The assessment is done by simulating the introduction in each Member State of potential structural reforms, which are comparable in terms of 'degree of ambition'. This is done by closing half the gap with best performers for different structural indicators. The main finding of the model is that generally there can be a trade-off between increasing the employment of a group (e.g. low-skilled) versus increasing the income of the average group member relative to income per capita. Furthermore, for labour market reforms there is a trade-off between growth and equity, while for product markets reforms and human capital investment growth and equity complement each other. Labour market reforms combined with existing product market rigidities may therefore be suboptimal and would require simultaneous product market reforms.

Bert Brys (OECD) focussed his presentation on taxation of savings and on the relationship between taxation and skills. In the first part, he showed that taxation of savings is broadly progressive, although savings are usually taxed at a lower tax rate than labour income. Tax expenditures for pensions, though, are often regressive and should be capped if inclusive growth wants to be favoured. He also explained how the automatic exchange of information provided the opportunity to reform capital income taxation of individuals. In the second part he analysed the impact of taxes on skills investments, showing how tax and spending policy impacts individuals' decisions to invest in skills. He highlighted that while progressivity taxes away the returns to skill investments, investment in skills pay a healthy return to the individual on average, but not for students who earn a small return in the labour market. The effect of tuition fees is small on incentives to invest in skills and tax support for skills is generally modest whereas the policies to reduce credit constraints and reduce market failures potentially are the most effective (e.g. training funds/accounts, and income-contingent loans).

Salvador Barrios (European Commission – JRC IPTS) presented how the impact of tax reforms on the income distribution could be measured using EUROMOD, the microsimulation tax and social benefit model of the European Commission developed by University of Essex. He highlighted how EUROMOD combined with QUEST could measure the behavioural and macroeconomic feedback effects of a tax or benefit reform. EUROMOD-based simulations of recent tax reforms in the EU (since 2009) show that they have, in general, a (mildly) progressive effect. Moreover, a more progressive tax system tends to be associated with better automatic stabilisation. The specific experiences of Italy (introduction of a refundable in-work tax credit for low income earners) and Poland (the proposal of increase the income exempt from personal income) were discussed.

The first session was concluded by a discussion addressing both technical questions and policy questions. The sequencing of implementing different policy reforms and the possible policy recommendations to be drawn from ex-post analyses were discussed.

Session II – Redistributive structural reforms: policy evidences from Member States

In the second session, chaired by *Mary Veronica Tovšak Pleterski* of DG ECFIN, Latvia, Portugal and Ireland presented their country-experience with structural reforms. The representatives of these three Member States shared their views as well as the lesson learnt.

Ieva Jaunzeme (Head of the administration at the Ministry of Economics of Latvia) gave a presentation on the proposed reform of a Minimum Income Scheme. Firstly, she introduced the Latvian social security system which, at the moment, includes a state social insurance, a state social benefit and a municipal social assistance. Since these tools are not sufficiently targeted to the ones in need, Latvia ranks very high in terms of income inequality. On the basis of several recent studies, Latvia is preparing a reform of its Minimum Income Scheme, which ultimate goal is to establish a solidarity-based poverty and income inequality reduction system. The next step is to set the minimum income in a way that is methodologically substantiated (e,g. tied to socio-economic indicator) and socio-economically adequate to be used as a reference point for all the above mentioned social security systems in Latvia. The minimum income level is also meant to be used within the tax system to reduce the tax wedge on low-wage earners. The latter are subject to the poverty trap and social assistance recipients are not motivated to accept low paid jobs.

Pedro Da Silva Martins (Queen Mary University of London) presented different labour market reforms in Portugal in the period 2011-13 and focussed on one in particular, the collective bargaining reform. This latter consisted in the suspension of the government-issued extensions of collective agreements that, generally, widen the collective agreements beyond their signatory parties to all firms and workers in the same sector. The study was conducted with a counterfactual evaluation approach, exploiting a natural experiment on collective bargaining in Portugal, and with a regression discontinuity design. He showed that the extension had two different effects, the first being a negative impact on employment growth, especially for the non-affiliated firms, whereas the second being a beneficial impact on low wages along with a greater wage compression.

Pat Casey (Ministry of Economics of Ireland) presented some structural reforms implemented in Ireland between 2008 and 2016. He firstly presented the performance of the Irish economy as subdivided in two phases. The first phase (2008-14) was characterised by a substantial fiscal consolidation exercise, including an EU/IMF programme of financial support along with substantial reforms. During the second phase, post 2014, policy actions focused on improving the resilience of the economy. He also stressed the relevance that inequality has in the Irish policy guidelines. He then focussed on labour market structural reforms and in particular on four tools considered crucial: the 'Action Plan for Jobs', the 'JobBridge' initiative, the 'Pathways to Work' and the 'National Skill' strategy. Thanks to the studies on 'black spots' (i.e. the areas with at least 200 people in the labour force where the unemployment rate is 27% or higher) policies are already and will be better targeted. Among the lesson learnt, he insisted that there is no 'one size fits all' for having successful structural reforms. There are, however, some common elements: the necessity of a broad and a continuous political support, the capacity of not missing the good opportunities to put in place the necessary reforms and the ability to adapt the policy as the circumstances changes.

The second session was concluded with some clarifications on the reforms described and on what could have been changed on the basis of the actual experiences. The three speakers concluded with some advice to policy makers: "blend, evaluate, establish dialogue and support ownership" (Da Silva Martins), "inequality matters" (Jaunzeme), "be clear on the long term goals and be flexible in adapting to changes" (Casey).