A Menu of policy measures and recommendations to address inequality pressures

G20 Framework Working Group's Note to G20 Finance Ministers and Central Bank Governors

July 2024

Executive summary

1. The Brazilian G20 Presidency in 2024, under the theme "Building a just world and a sustainable planet", aims to put the issue of reducing income inequality at the forefront of the international agenda. The G20 Finance Ministers and Central Bank Governors (FMCBGs) in February 2024 expressed support for this priority and agreed to focus on mainstreaming inequality as a key policy concern in a manner consistent with their mandates and authorities. In this context, the G20 Framework Working Group (FWG) has produced this menu of policy measures and recommendations based on members' experiences and analytical inputs from the IOs, which aims to bring together the best evidence on addressing inequality from a macroeconomic perspective.

2. The Note presents four enabling policy areas aimed at facilitating action to combat inequality, alongside four specific policy areas designed to directly confront inequality. It is a set of voluntary and non-binding guidance for members in their efforts to address the challenge of inequality, subject to country-specific circumstances.

3. Enabling policy areas include i) those that promote economic growth and macroeconomic stability, as a sustainable high-growth environment opens up greater employment opportunities and, in turn, possibilities for the implementation of redistributive policies; ii) structural reforms, which promote an environment more conducive to growth; iii) debt management, which can improve the government's fiscal management and open up fiscal space for redistributive policies; and iv) domestic resource mobilization, which improves the government's revenue collection capacity and allows resources to be channeled to policies that can address inequality. Specific actions to directly tackle inequality include i) a range of social protection policies; ii) automatic stabilizers and cash transfer programs; iii) minimum wage and labor market policies; and iv) progressive taxation.

4. While acknowledging that inequality is multidimensional and highly dependent on domestic factors, there is a role for international cooperation in addressing inequality. Multilateral efforts to tackle inequality should focus on framing this cooperation, promoting the exchange of experiences and best practices, supporting equitable and sustainable macroeconomic policies, and identifying areas for joint efforts, like facilitating financial and technology transfer assistance to low- and middle-income countries in their efforts to reduce inequality, and promoting better quality data to allow for granular analysis of distributional impacts. The G20, through the Framework Working Group, can provide an effective multilateral platform to facilitate these efforts. In this context, the present Note provides a good basis to guide the future work of the G20 FWG on the inequality agenda.

1. Introduction

5. Inequality is a multidimensional issue with numerous causes, multiple consequences, and several mutual causations. The far-reaching consequences of high levels of inequality encompass several of today's most pressing issues, such as the viability of transition policies, political radicalization, risk to social cohesion, and the backlash against globalization.

6. In the last decade, the relationship between inequality and macroeconomics has been explored in greater depth in the field of macro-finance, by analyzing how household balance sheets act as a transmission channel for financial crises; as well as through the study of how heterogeneous agents are relevant for understanding business cycles; and in empirical work on economic growth, which explores the relationship between macroeconomic variables (innovation, access to credit, productivity, external imbalances, etc.) and inequality. Besides the traditional long-run perspective of supply-side factors of production (human capital and total factor productivity), these relationships can also be analyzed from a demand-side perspective, through various transmission channels that can have long-run effects, referred to in literature as scarring or hysteresis.[1]

7. Addressing inequality is pivotal for achieving Strong, Sustainable, Balanced, and Inclusive Growth (SSBIG). The distribution of growth, understood as how economic growth affects people heterogeneously across the income distribution, matters for macroeconomic performance and policy. In turn, for growth to be inclusive, it is important that structural inequalities are addressed as well as

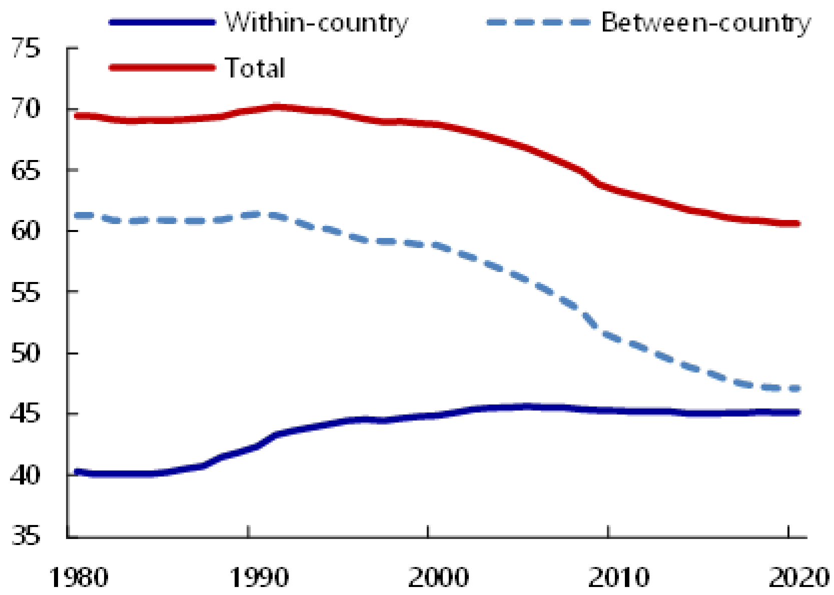
[1] Silva *et al.* (2022).

narrowing the gap between both ends of the income distribution, which could otherwise undermine economic dynamism, social cohesion, and democracy.[2]

1.1 State of Global Inequality

8. For most of the twentieth century, income inequality was on a downward trend in many countries, but political, institutional and economic transformations changed this, leading to a new pattern of rising inequality beginning in the 1980s (within-country inequality in Figure 1), returning to the pre-World War I trend (within-country inequality in Figure 2). The global financial crisis brought attention to these issues, which are becoming a frontier of research in macroeconomics, as evidenced by the development of heterogeneous agents' macroeconomic models.

Figure 1: Global Gini coefficient (+ = more inequality)



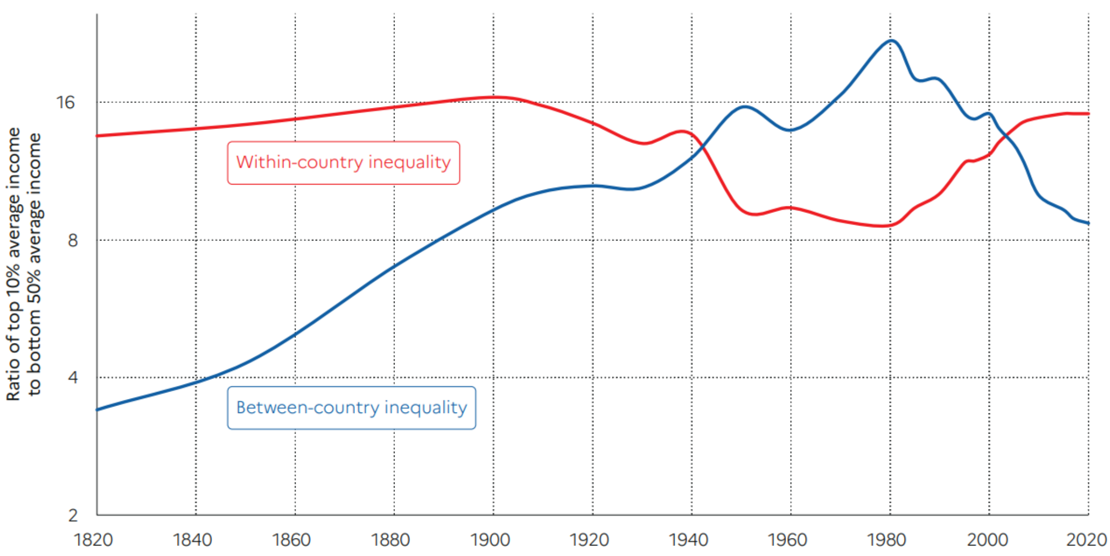
***Source**: IMF Note for FWG-G20 (2024) - G-20 Background Note on The Impact of Growth on Inequality and Social Outcomes – data from Oxford Poverty and Human Development Initiative (2023); World Income Inequality Database; IMF, World Economic Outlook, and IMF staff calculations.*

9. A substantial decline in global income inequality in the 2000s and 2010s was driven by declining inequality between countries due to stronger growth in EMDEs; this process has stalled in recent years (between-country inequality in

[2] OECD (2024).

Figure 1). This situation was exacerbated by the COVID-19 pandemic and wars and escalating conflicts subsequent global food and energy price shocks, and by 2022, inequality between countries increased for the first time in three decades.[3] While fiscal policy was used to mitigate poverty impacts from the COVID-19 crisis, its effectiveness and scale was limited in poorer economies, in particular because of still high relative prices of essential goods such as food and comparatively lower fiscal space.

Figure 2: Global income inequality: Between-country vs Within-country inequality (ratio T10/B50), 1820-2020



Source*: Chancel et al. (2021).*

10. The fight against inequality may become more challenging in the coming years due to subdued growth prospects. Despite the resilience of the global economic outlook, growth expectations for 2024-2025 remain below the historical average for the 2000-2019 period – 2.7 percent GDP growth vs 3.1 percent respectively (this difference is larger for EMDEs with 4.0 percent vs 5.1 percent). [4]

11. High relative prices of essential products, such as food, energy, and housing disproportionately affect the most vulnerable. Supply side measures can help

[3] WID (2023).
[4] World Bank, Global Growth Forecasts.

lessen this strain. Policies directly or indirectly assuring access to these essential products were explored through the 2023 G20 report on the Macroeconomic impacts of food and energy insecurity and their implications for the global economy. Surging inflation in 2022 and 2023 strained household budgets, more so in low-income and emerging market economies. Meanwhile, inflation has fallen significantly from high levels, due to well calibrated monetary policy and the unwinding of supply shocks.

12. Policies can be specifically directed to address inequality or, alternatively, reducing inequality can be a common goal that is woven into multiple policies that countries pursue. In both cases, the policies are influenced by the fiscal capacity of the countries. On a global level, fiscal deficits increased from 3.9 percent of GDP in 2022 to 5.5 percent in 2023 and global debt is projected to increase to close to 100 percent of GDP by 2029[5]. With fiscal policy space becoming highly constrained, countries have been attempting various mixes of policy measures to address the inequality challenge. The appropriate combination of instruments will depend on each country's administrative capacity, public support, the role envisaged for the state, and political economy considerations.

13. While it is noted that there is scope for agreeing on general guidelines for policy action, there is no one-size-fits-all approach, given the multidimensional nature of inequality. The importance of taking into account country specificities in the implementation of these policies is reiterated. Countries have the prerogative to choose and assess the policies that are more effective in addressing inequality within their borders given their specific circumstances.

14. Based on technical analysis received from international organizations and the survey of policies that have been implemented by member countries, a menu of policy options to address inequality pressures has been developed. The menu presents a set of broad measures that countries may consider pursuing to address the inequality challenge subject to country-specific circumstances[6]. The various policies highlighted here are organized into two main groups: the enablers for action to tackle inequality and the actions to tackle inequality themselves. It is also important to note that the effectiveness of these policy measures is subject to varied timeframes; some options, such as cash transfers, have short run impacts, while others, such as development measures, are effective over a longer-run timeframe.

[5] IMF (2024).

[6] The present menu does not include distributive climate policies and just transition policies, which will be the subject of the second FWG G20 note.

2. Menu of policy options

2.1 Enablers of action to tackle inequality.

2.1.1 Economic growth and macroeconomic stability enhancing policies

15. Economic growth not only creates new employment opportunities but also reduces economic tensions, which in turn facilitates the implementation of redistributive policies. By accelerating investment and raising productivity, productive development policies promote higher economic growth and contribute to significant progress in poverty reduction, job creation and narrowing inequality gaps.

16. Productive development policies encompass various strategies such as learning catch-up, research and development, and high-value infrastructure.[7] Well-calibrated incentives and public investment can foster development. Such policies not only create employment opportunities but can also support fair wages and job stability.[8] However, their benefits and costs should be carefully evaluated.

17. To boost productivity and economic opportunities, measures include investing in productive infrastructure to raise demand and create jobs in the short term and enhance productivity in the long term; providing education and health opportunities to raise human capital and offset polarization in skills and incomes; and implementing labor market and structural policies that improve labor market efficiency while increasing inclusion.

18. Strengthening macroeconomic stability through monetary and fiscal policies plays a role in creating an environment for encouraging investment and controlling inflation, thereby supporting economic growth and creating the fiscal space needed to implement redistributive policies. Maintaining low inflation environment can help safeguard the purchasing power of low-income households. Additionally, through fostering macroeconomic and financial stability, both monetary and fiscal policies can contribute to long expansions which tend to benefit groups with less attachment to the labor force, thus leading to lower inequality.

[7] WB (2024).
[8] ECLAC (2024).

2.1.2 Structural reforms

19. Structural reforms can also play a crucial role in tackling inequality by creating a more inclusive and equitable economic environment. If implemented effectively, these reforms can promote inclusive growth and increase opportunities for all. Key areas of structural reform include labor market reforms, product market improvements, financial inclusion, and institutional changes. Many of the actions needed to promote reforms in these areas require concerted and collaborative efforts by policymakers, government agencies, civil society, and the private sector.

20. Labor market reforms are essential to reduce inequality. Initiatives to increase female labor force participation, such as extending childcare, can significantly reduce the gender gap. In addition, promoting youth employment and reducing informality in the labor market ensure that more workers have access to social benefits and labor rights, thereby reducing wage and social protection gaps.

21. Product market reforms that remove anti-competitive barriers have a role to play in promoting economic growth. Increased competition can stimulate innovation and productivity, leading to a more dynamic economy. In addition, by making markets more competitive, these reforms can lower prices and increase access to goods and services.

22. Financial market reforms that promote financial inclusion and financial well-being can help reduce inequality. By increasing access to credit and banking services for vulnerable populations and promoting actions that foster financial literacy, these reforms enable more people to start small businesses and afford education and health care. This can lead to a more equitable distribution of resources and opportunities, promoting long-term economic stability.

23. Improving the quality of education at all levels is critical to equipping individuals with the skills and knowledge needed to make the workforce competitive. This requires investing in teacher training, modernizing curricula to meet contemporary demands, and ensuring adequate resources for educational institutions.[9] Priorities include ensuring equal opportunities through equitable access to quality education right from the start (early childhood education), facilitating the transition of young people from school to work, and upskilling and retraining throughout their working lives. For secondary schools, improving

[9] ECLAC (2024).

teacher quality, increasing enrollment rates and providing additional support to disadvantaged students are of paramount importance.[10] Lifelong learning initiatives, highlighted by both the OECD and the ILO in 2024, play a key role in ensuring ongoing upskilling and reskilling opportunities throughout individuals' working lives. This includes supporting technical and vocational education and training, as well as addressing the digital skills gap by enhancing the quality of Information and Communication Technology (ICT) education.[11]

24. However, the implementation of structural reforms needs to be carefully managed to avoid unintentional negative effects on inequality. The nature, timing and sequencing of reforms, as well as political constraints, are critical in determining their effectiveness in reducing inequality subject to country specific circumstances. Reforms that focus solely on economic efficiency without regard to social equity may disproportionately benefit already privileged groups, thereby exacerbating inequality. Moreover, emerging markets and developing economies with smaller policy buffers may be more adversely affected by the unintended consequences of such reforms, affecting per capita income convergence and internal inequality dynamics.

2.1.3 Debt management

25. While recognizing public debt is an important instrument to finance investment, it remains important to address debt vulnerabilities in low and middle income countries in an effective, comprehensive and systematic manner.

26. Debt management policies are essential tools for safeguarding debt sustainability and the quality of overall policy frameworks, especially in the current global financial landscape. Debt management can mitigate pressures and risks which, if left unchecked, can limit a country’s ability to sustain social policy efforts.

27. High debt burdens also reach households, perpetuating a vulnerable economic situation for certain groups and inequalities. Countries address indebted low-income households (or targeted groups/individuals) with programs aimed at restoring credit conditions, facilitating payment under differentiated terms and reducing the default rates in the country, allowing a household or individual to be reintegrated into the economy and regain access to credit markets.

[10] OECD (2024).
[11] ILO (2024) and OECD (2024).

2.1.4 Domestic resource mobilization

28. Enhancing resource mobilization is a critical challenge, especially in countries where tax revenues are relatively low. In this context, measures to improve revenue mobilization are important to finance social protection and redistributive policies, to build fiscal buffers in many countries so that fiscal consolidation processes do not fall heavily on the most vulnerable populations, and to increase financing space to achieve the Sustainable Development Goals.[12] The move towards more progressive tax systems at the domestic level is recognized as a key measure to increase tax revenues and directly tackle income inequality.[13] Other important options for revenue mobilization measures include effective taxation of income and wealth, especially of ultra-high-net-worth individuals who are most able to evade domestic taxes.[14]

29. The introduction of minimum corporate tax rates, as a common approach, through the swift implementation of the OECD's Two-Pillar Solution is highly important to counter the trend towards low taxation of corporate profits. The decision, for interested jurisdictions, to exchange foreseeably relevant information regarding real estate for tax purposes on a voluntary basis also contributes to enhancing revenue mobilization and countering tax evasion.

30. Low-income countries would benefit from strengthened domestic resource mobilization through modernization and solidification of their tax administrations. These efforts could narrow tax gaps and enhance their tax bases through larger consumption and natural resource taxations systems. Reducing tax expenditures and improving tax compliance, together with investments in the digital transformation of tax administration, could enhance the efficiency of resource mobilization. Existing channels of donor support for enhanced domestic resource mobilization should aim more assertively towards sustainable impact. Facilitating the transition to formality can also secure more stable tax revenues, as the base of taxpayers in the labor market increases. Indeed, funding from private investors and multilateral institutions can also be an important source of resources to promote sustainable development and fairer income distribution.

[12] ECLAC (2024).
[13] Ibid.
[14] ILO (2024) and UNCTAD (2024).

2.2 Actions to tackle inequality

2.2.1 Social protection

31. Expanding or maintaining a high coverage of social benefits is crucial to tackling inequality. To achieve this, it is imperative to ensure that social protection systems are comprehensive, sustainable and resilient, underpinned by sound institutional frameworks. It is important to mainstream a life-cycle and gender approach in the design of these policies, while supporting pension system reforms that prioritize sustainability and solidarity in light of evolving labor market challenges.[15]

32. A critical strategy in this endeavor is to close the social "welfare gap," which increases aggregate demand for quality employment opportunities. [16] This includes implementing policies and programs that strengthen social welfare systems and thereby promote economic stability and growth. To effectively address these issues, it is necessary to strengthen integrated employment services (public employment services and private employment agencies) and unemployment benefits, recognizing that they have the lowest coverage of all social protection branches. In addition, addressing gender inequalities in social protection mechanisms, ensuring equitable financing and promoting transparency in the collection of expenditure and financing data are necessary steps. [17]

33. Finally, expanding access to quality childcare and early education[18], care for the elderly and people with disabilities, adopting housing policies and ensuring modern, efficient and accessible healthcare services complement these efforts.

2.2.2 Automatic stabilizers and cash transfer programs

34. Improving the capacity of economies to respond to crises is imperative. Traditional automatic stabilizers, such as unemployment insurance, work to mitigate the effects of economic fluctuations on both individual and household incomes, thereby preserving purchasing power during periods of low aggregate demand, thereby reducing the severity of recessions.

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[15] ECLAC (2024).
[16] ILO (2024).
[17] Ibid.
[18] OECD (2024).

35. This type of mechanism is all the more important in a world prone to shocks of various natures. Policy makers should consider preparing fiscal frameworks for future crises, including expanding the reach of automatic stabilizers and, where best suited to a country's individual needs, establishing adaptive cash transfer programs to ensure a more resilient response to economic downturns.

36. It is also important to constantly work to improve the flow of information that allows governments to identify vulnerable populations in order to guarantee well-targeted and efficient support. Ensuring a prompt response for economies affected by shocks is essential for safeguarding the most vulnerable segments of society and guaranteeing that fiscal policies prioritize the reduction of inequality.

2.2.3 Minimum (or living) wage and labor market institutions

37. Improving the quality and quantity of jobs is a multifaceted endeavor that aims to address a range of labor market challenges. These include tackling informality and insecurity in the labor market, while promoting opportunities for upward mobility among workers, particularly in the face of structural changes such as ageing populations, climate change, digital advances and artificial intelligence.[19] In addition, promoting gender equality and supporting vulnerable groups are integral aspects of creating a more inclusive and resilient labor market.[20]

38. Strengthening labor market institutions is critical to protecting workers' rights and ensuring fair labor practices.[21] By strengthening these institutions, governments can promote a more equitable and stable labor market environment. Moreover, recognizing the importance of minimum wages as a pre-distributive policy underscores the importance of protecting purchasing power. Maintaining adequate minimum wage levels not only ensures fair compensation for workers, but also sustains consumer spending and protects purchasing power, which is essential for economic recovery and growth.

2.2.3 Progressive Taxation

39. Some members employ progressive taxation, based on the ability-to-pay principle, to enhance the distributive capacity of their tax systems and increase tax revenues. It plays a direct role in reducing income inequality by redistributing

[19] Ibid.
[20] ILO (2024).
[21] Ibid.

the benefits of growth more evenly throughout society.[22] In addition, implementing progressive tax measures is consistent with the Sustainable Development Goals.

40. Progressivity can be attained through various combinations of measures, depending on the characteristics of each country's tax system, for example: i) by reducing tax rates for low-income individuals or exempting them, while raising tax rates for high-income earners; ii) by introducing, when appropriate, windfall taxes alongside increased social transfers; or iii) by adjusting the structure of the tax system, decreasing indirect taxes while augmenting direct ones. Depending on their design, certain taxes can have negative impacts on economic efficiency – countries should bear this in mind when using progressive tax instruments.

3. Conclusion and way forward

41. Inequality is a multidimensional phenomenon with deep social, political and economic implications. Addressing such a complex challenge also requires close cooperation between countries. The G20 has an important role to play in framing this cooperation, promoting the exchange of policy experiences and best practices, supporting equitable and sustainable macroeconomic policies, and identifying areas for joint efforts among G20 member countries. At the same time, inequality is highly dependent on domestic factors, so country-specific policies remain at the center of global discussions on addressing inequality.

42. Four enabling policy areas aimed at facilitating action to combat inequality, alongside four specific policy areas designed to directly confront inequality, have been identified. The enabling policies include i) policies that promote economic growth and macroeconomic stability, since a sustainable high-growth environment opens up greater possibilities for the implementation of redistributive policies; ii) structural reforms, which promote an environment more conducive to growth; iii) debt management, which can mitigate pressures and risks that, if left unchecked, could limit a country's ability to sustain social policy efforts; and iv) domestic resource mobilization, which improves the government's revenue collection capacity and allows resources to be channeled to redistributive policies. Specific actions to directly tackle inequality include i) a range of social protection policies; ii) automatic stabilizers and cash transfer programs; iii) minimum wage and labor market policies; and iv) progressive taxation.

[22] ECLAC (2024).

43. Multilateral efforts to tackle inequality should focus on framing this cooperation, promoting the exchange of experiences and best practices, supporting equitable and sustainable macroeconomic policies, and identifying areas for joint efforts, like facilitating financial and technology transfer assistance to low- and middle-income countries in their efforts to reduce inequality, and promoting better quality data to allow for granular analysis of distributional impacts.

44. Accurate, timely, and transparent data is essential to any meaningful assessment of inequality dynamics. A previous G20 data gap initiative in 2016 recommended the use as appropriate of the G20 Gini Index and Shared Prosperity Premium indicators. There is also an opportunity to advance, as appropriate and at members' own discretion, discussions on alternative approaches to inequality data measurement in the coming years. It is important to consider the multidimensionality of inequality and the contribution of other measurements to provide a broad mapping of inequality. International cooperation on sharing information and expertise at members' own discretion can strengthen data systems in countries that lack a sound information collection structure, while considering countries' specific circumstances.

45. Continued sharing of lessons learnt from implementation of policy actions, and preparing voluntary and non-binding macro-guiding principles for addressing inequality from national perspectives during the coming years is recommended. We encourage the IMF to regularly cover macroeconomic aspects of inequality as part of the SSBIG report. The G20, in close collaboration with the World Bank and subject to members' agreement, can encourage global efforts to strengthen data availability related to inequality accounting for the country-specific circumstances, as well as the multidimensional nature of inequality.

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Country experiences on the relationship between inequality and macroeconomic policy: responses from the G20 members to the Brazilian 2024 PSY.