

Inequality and Fiscal Policy

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Outline of the presentation

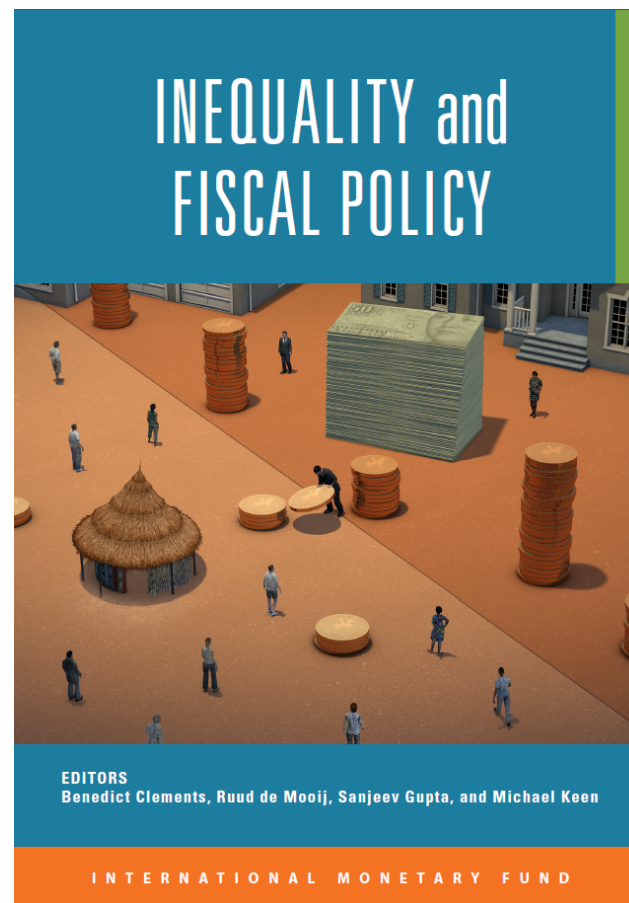


- ❑ **Trends in Inequality and the Redistributive Role of Fiscal Policy**
- ❑ **Lessons for Policy Design:**
 - ❑ Tax Policies
 - ❑ Expenditure Policies
 - ❑ Lessons from Case Studies
 - ❑ Fiscal Consolidation and Income Distribution
- ❑ **Conclusions**

The presentation builds on the findings included in the recent IMF book



- <http://www.imfbookstore.org/ProdDetails.asp?ID=IRFPEA&PG=1&Type=BL>

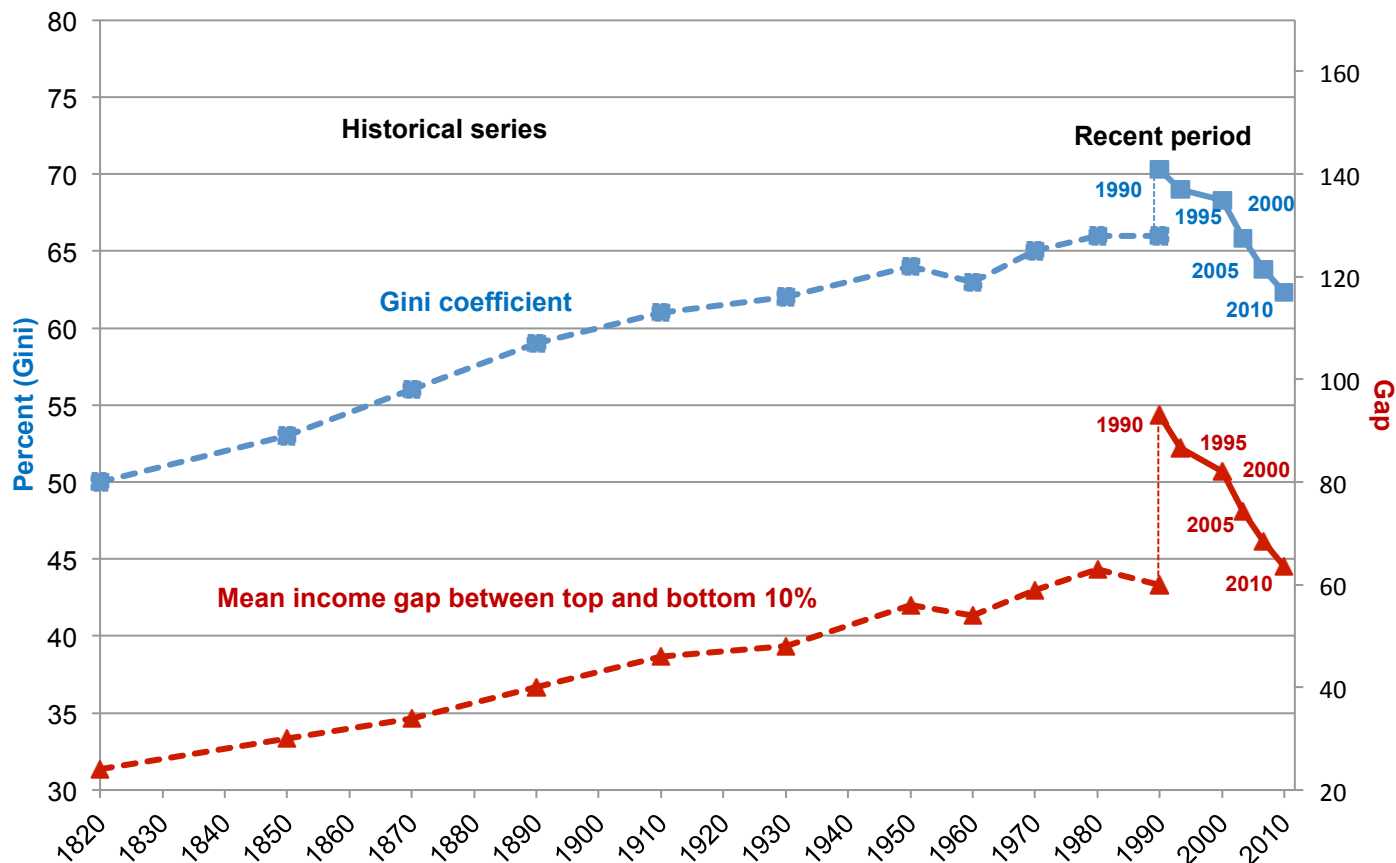


Trends in Inequality and the Redistributive Role of Fiscal Policy

While world income inequality has been going down ...

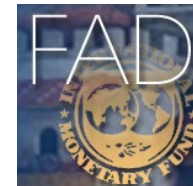


Evolution of World Inequality, 1820-2010



Sources: Bourguignon, *The Globalization of Inequality*. The indexes of PPP that Angus Maddison used for the historical data referenced the year 1990. The data for the recent period use PPP data based on price statistics that were collected in 2005, which sometimes resulted in significant revisions to the parity indexes. This explains much of the discontinuity between the two series in 1990.

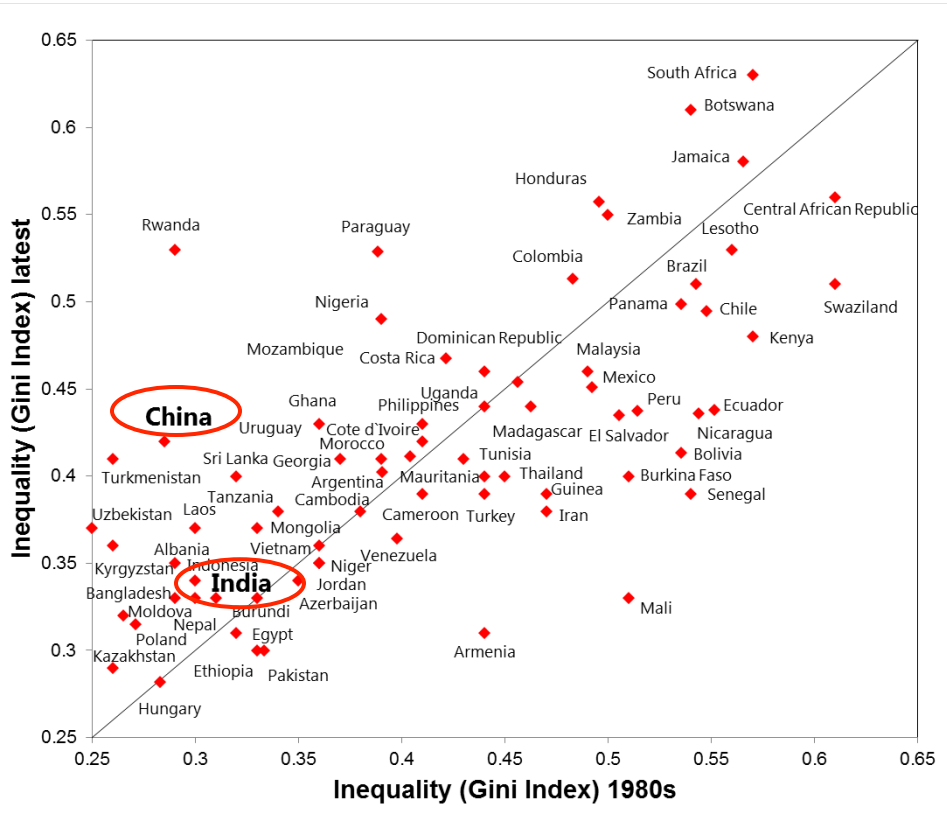
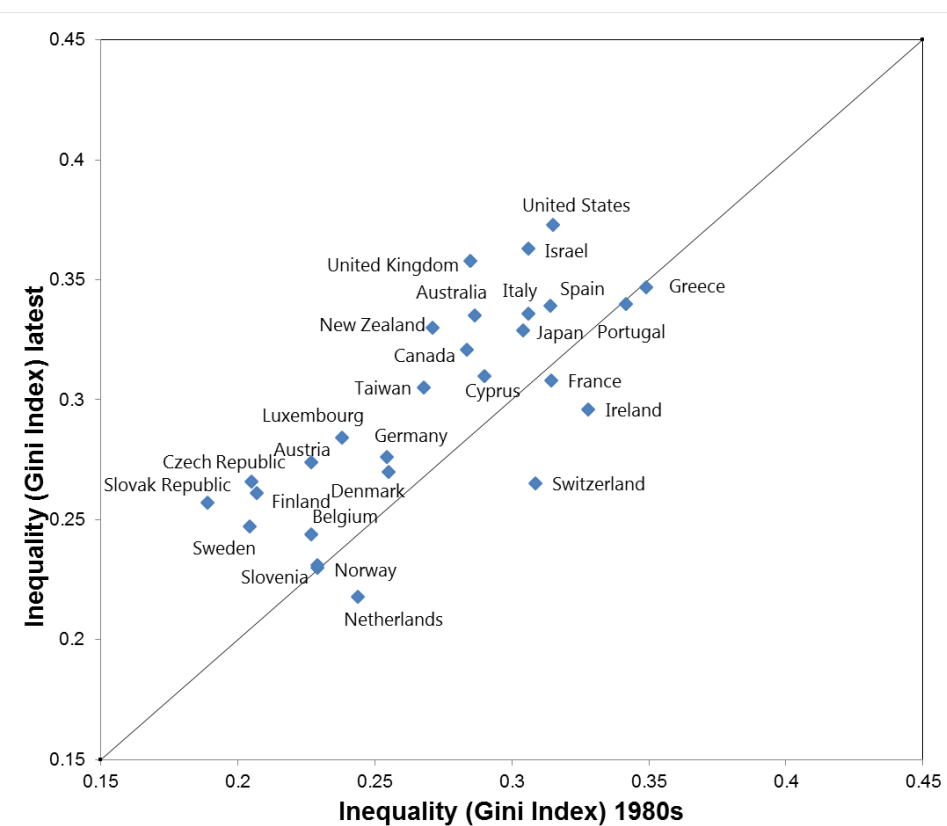
... within countries inequality has been increasing in most advanced economies and in large emerging ones



Income Inequality in the 1980s and 2000s

Advanced Economies

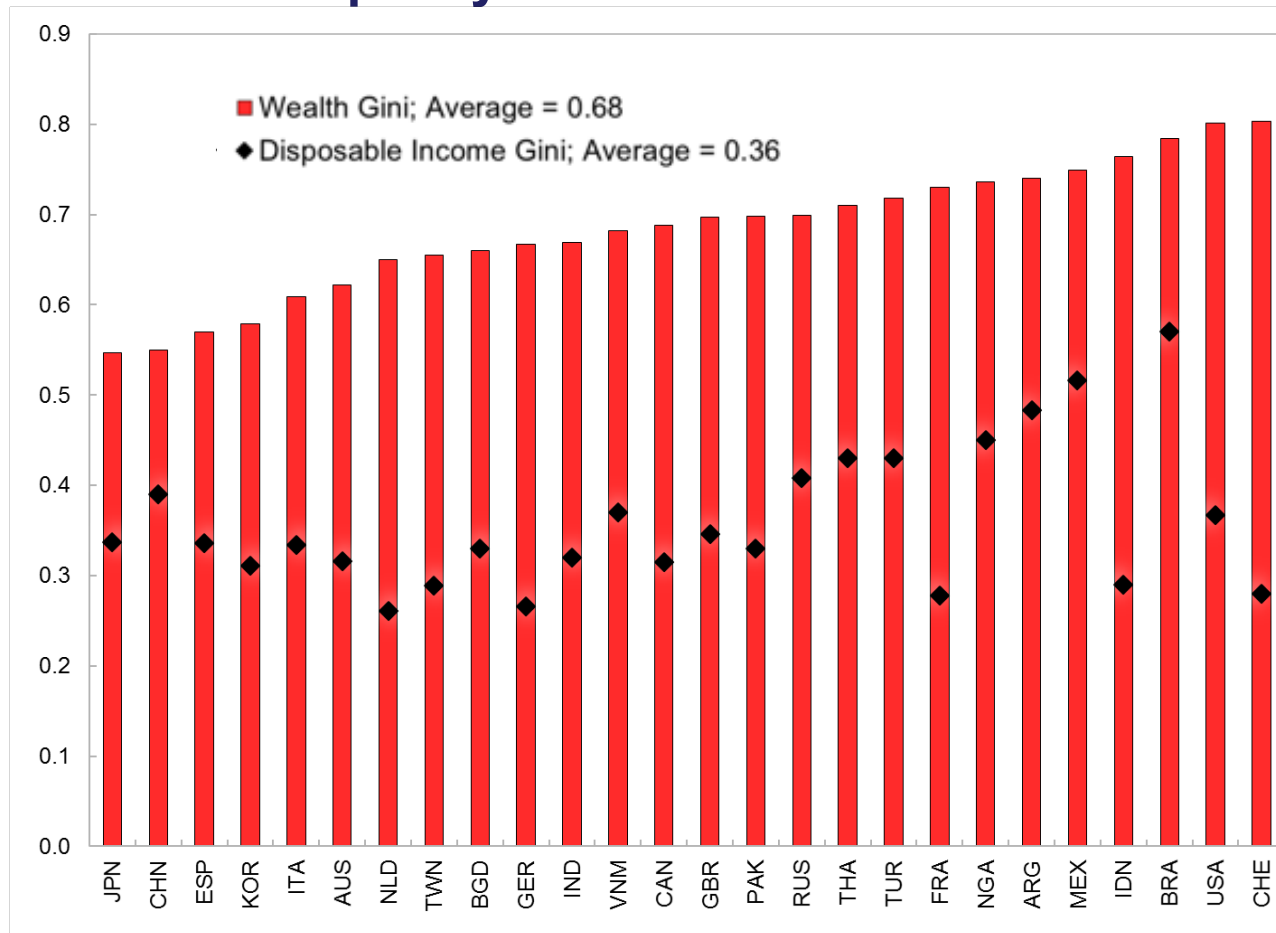
Developing Economies



Wealth inequality is significantly more pronounced than income inequality



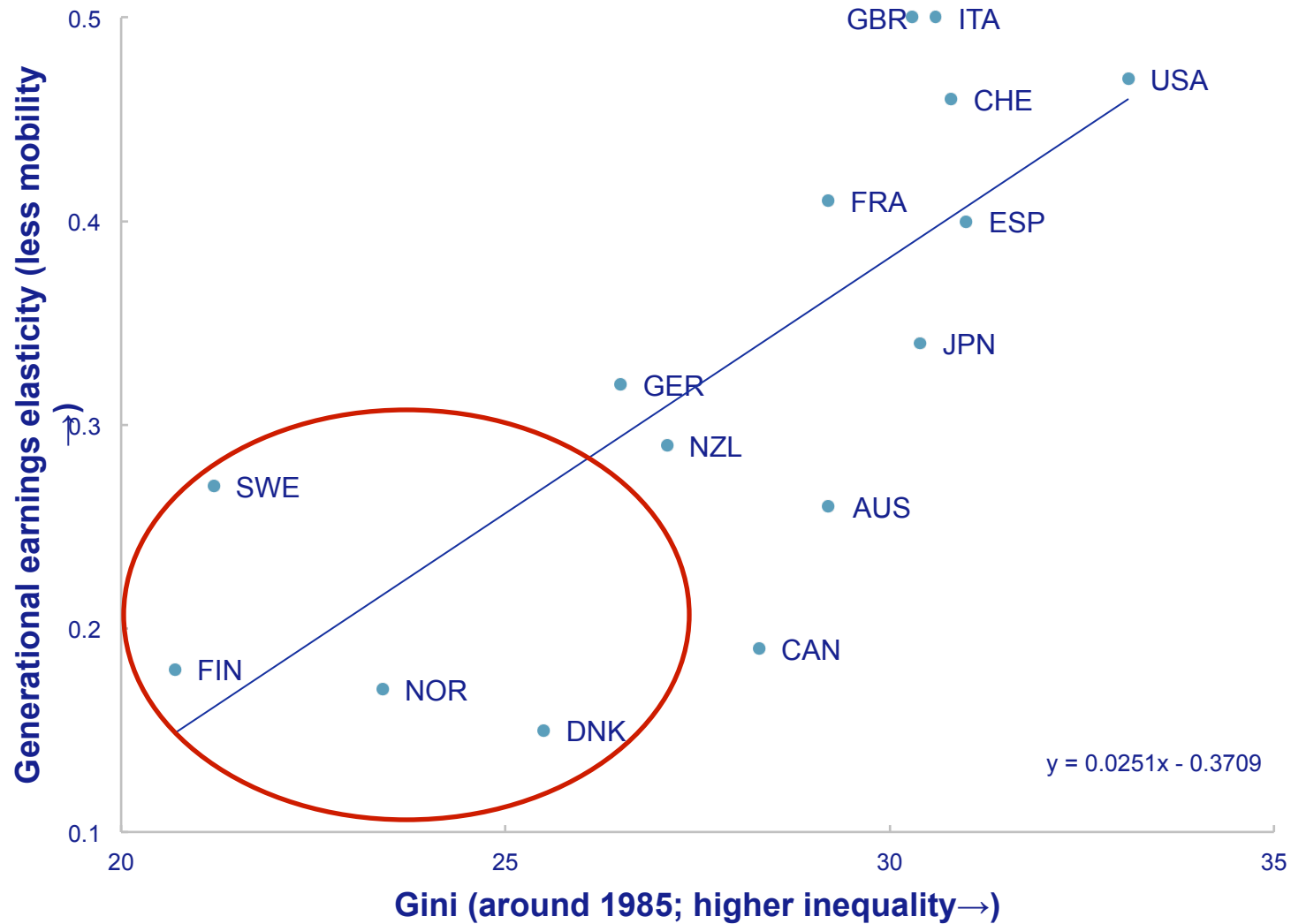
Inequality of Wealth and Income



Sources: Davies and others (2008); Luxembourg Income Study; Organisation for Economic Co-operation and Development; Socio-Economic Database for Latin America and the Caribbean (CEDLAC and the World Bank).

Note: Data labels in the figure use International Organization for Standardization (ISO) country codes.

Inequality and inequality of opportunities tend to be related



Distributive concerns—to a varying degree-- are addressed in IMF advice

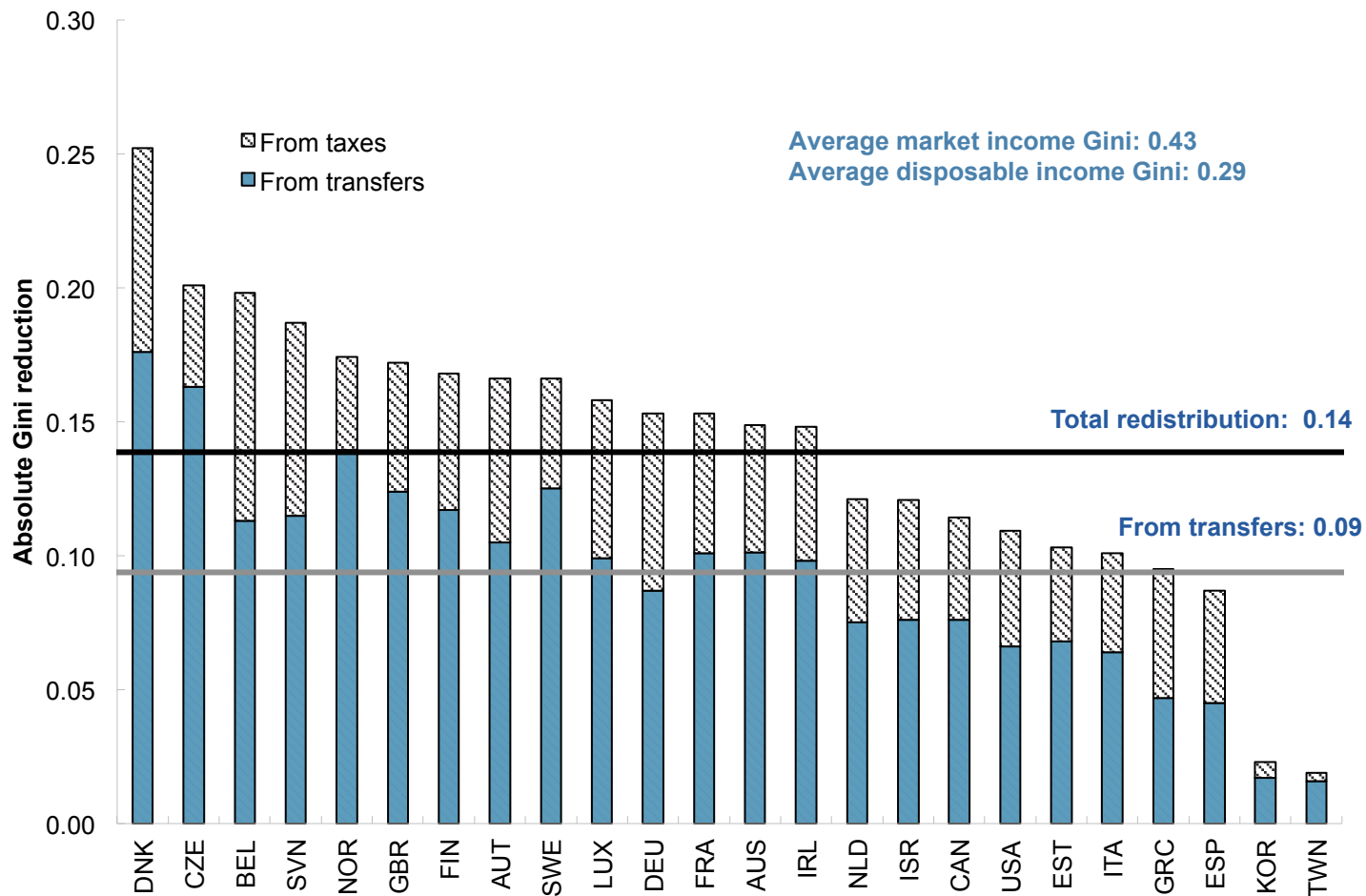


- ❑ Distributive concerns in IMF policy advice:**
 - ❑ Surveillance of economic policies**
 - ❑ Lending**
 - ❑ Capacity building**

- ❑ First began to crop up in IMF-supported programs in the late 1980s and work intensified in the wake of the global financial crisis**

- ❑ Growing recognition that inequality may have social consequences, potentially undermining macroeconomic stability and sustainable growth**

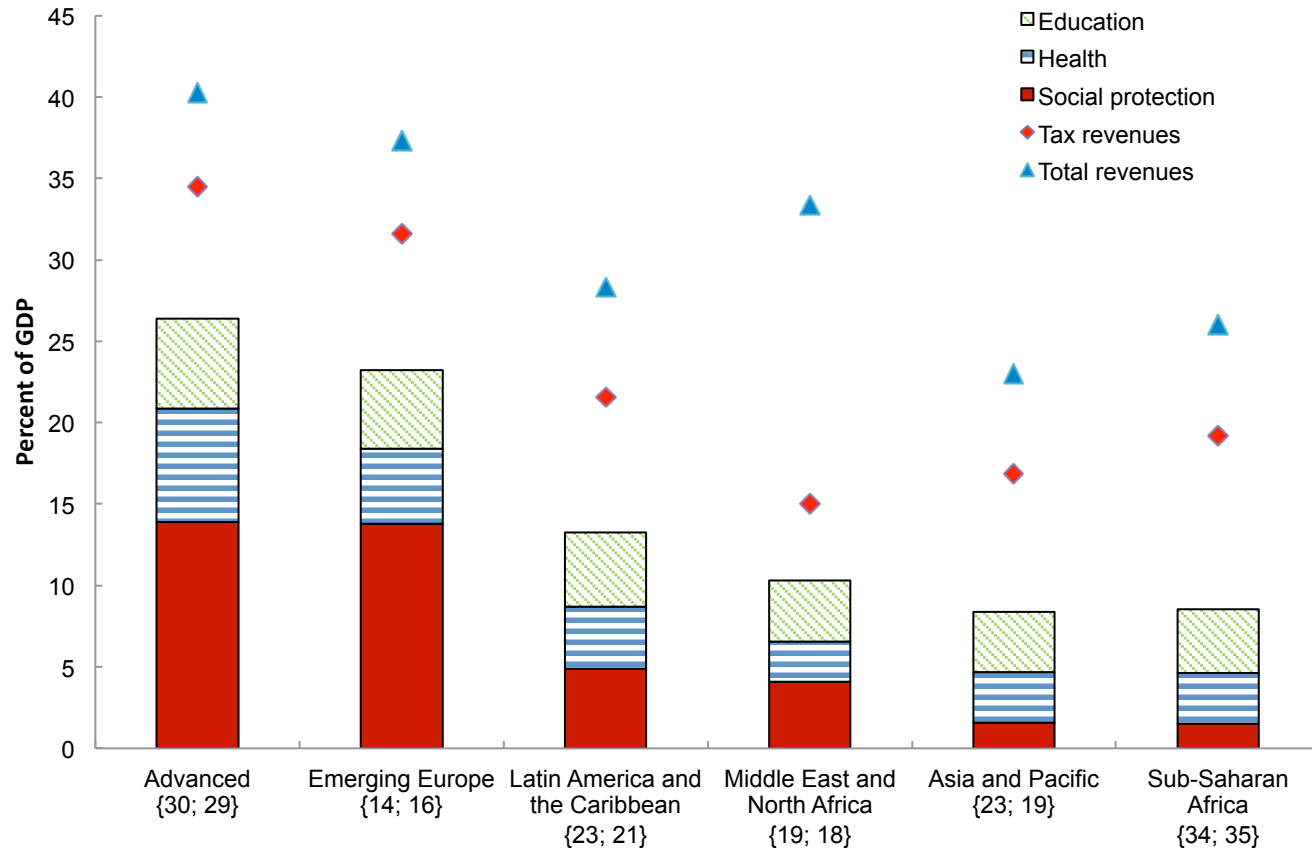
Fiscal redistribution reduced inequality by one third in advanced economies, mostly through spending



The contribution of fiscal policy to reduce inequality is smaller in developing countries



Level and Composition of Tax Revenues and Social Spending , 2010



Source: IMF database.

Note: Numbers in brackets refer to number of countries in the {tax; spending} country samples

Lessons for Policy Design



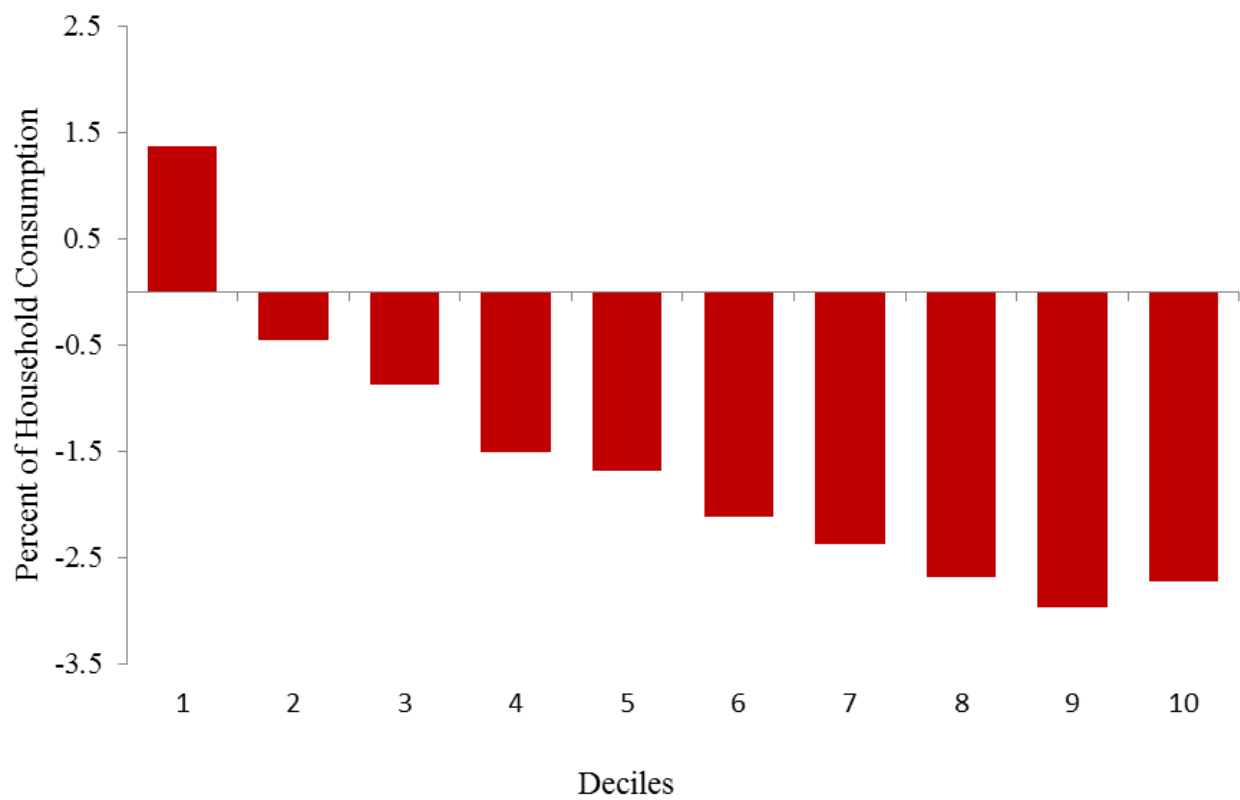
Designing efficient redistributive fiscal policy

- Redistributive fiscal policy should be consistent with macroeconomic objectives**
- Policies need to be carefully designed taking into account also indirect and medium-long term effects**
- Design should take into account administrative capacity**
- The impact of tax and spending policies should be evaluated jointly**

Efficient design requires looking at tax and spending together, as shown also by case studies

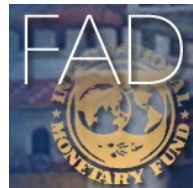
India

Simulated Net Impact by Decile of Combined Tax and Transfer Reforms



Source: IMF staff estimates based on the 2011/12 Indian National Sample Survey and the Employment Unemployment Survey

Tax policy: reform options to achieve more efficient redistribution of taxation



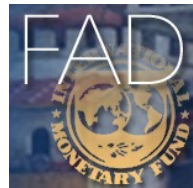
Direct taxes	Advanced	Developing
Implement progressive personal income tax (PIT) rate structures	✓	✓
Relieve low-wage earners from tax or social contributions	✓	
Expand coverage of PIT		✓
More effectively tax multinational corporations	✓	✓
Utilize better opportunities for recurrent property taxation	✓	✓

Tax policy: reform options to achieve more efficient redistribution of taxation



Indirect taxes	Advanced	Developing
Minimize VAT exemptions and special VAT rates	✓	✓
Use specific excises mainly for purposes other than redistribution	✓	✓

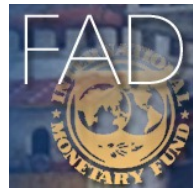
Expenditure policy: reform options to achieve more efficient redistribution of spending



Education	Advanced	Developing
Improve access to education of low-income families	✓	✓

Health	Advanced	Developing
Expand coverage of publicly financed basic health package		✓
Ensure or maintain access of low-income groups to essential health services	✓	✓

Expenditure policy: reform options to achieve more efficient redistribution of spending



Social transfers	Advanced	Developing
Intensify the use of active labor market programs and in-work benefits	✓	
Expand conditional cash transfer (CCT) programs as administrative capacity improves		✓
Increase effective pension retirement age while protecting low-income pensioners	✓	✓
Expand noncontributory means-tested social pensions		✓

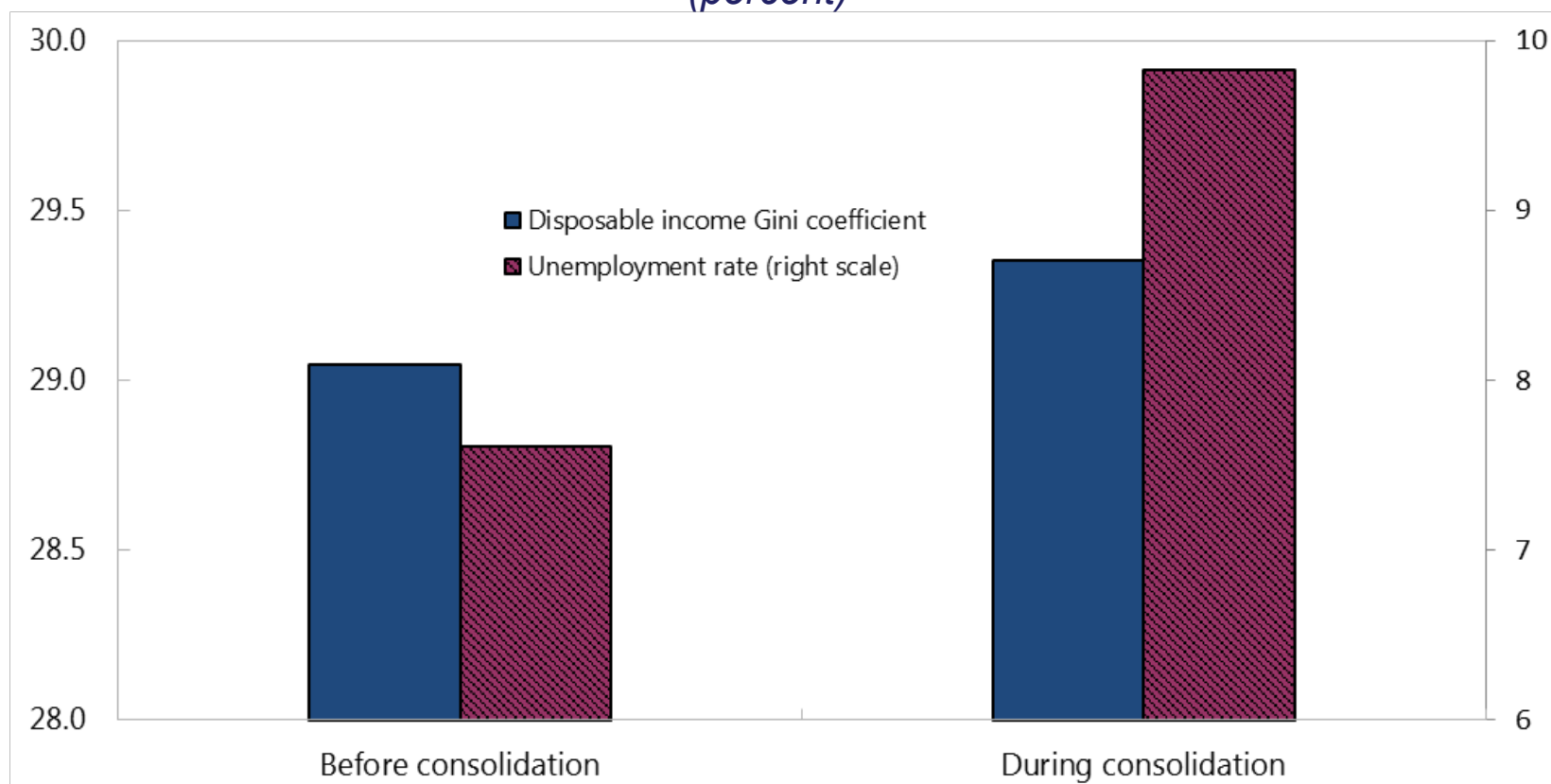


Heterogeneity among countries must be taken into account when designing fiscal policies:

- ❑ income levels and pre-tax & transfers levels of inequality differ significantly among countries**
- ❑ administrative capacity may constrain policy options (for instance for ensuring tax compliance or effective targeting)**
- ❑ institutional design varies among countries and may have an effect on distributional outcomes (for instance decentralization/centralization of certain functions)**

Unemployment Rates and Gini Coefficients During Fiscal Adjustment

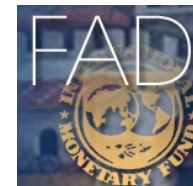
(percent)



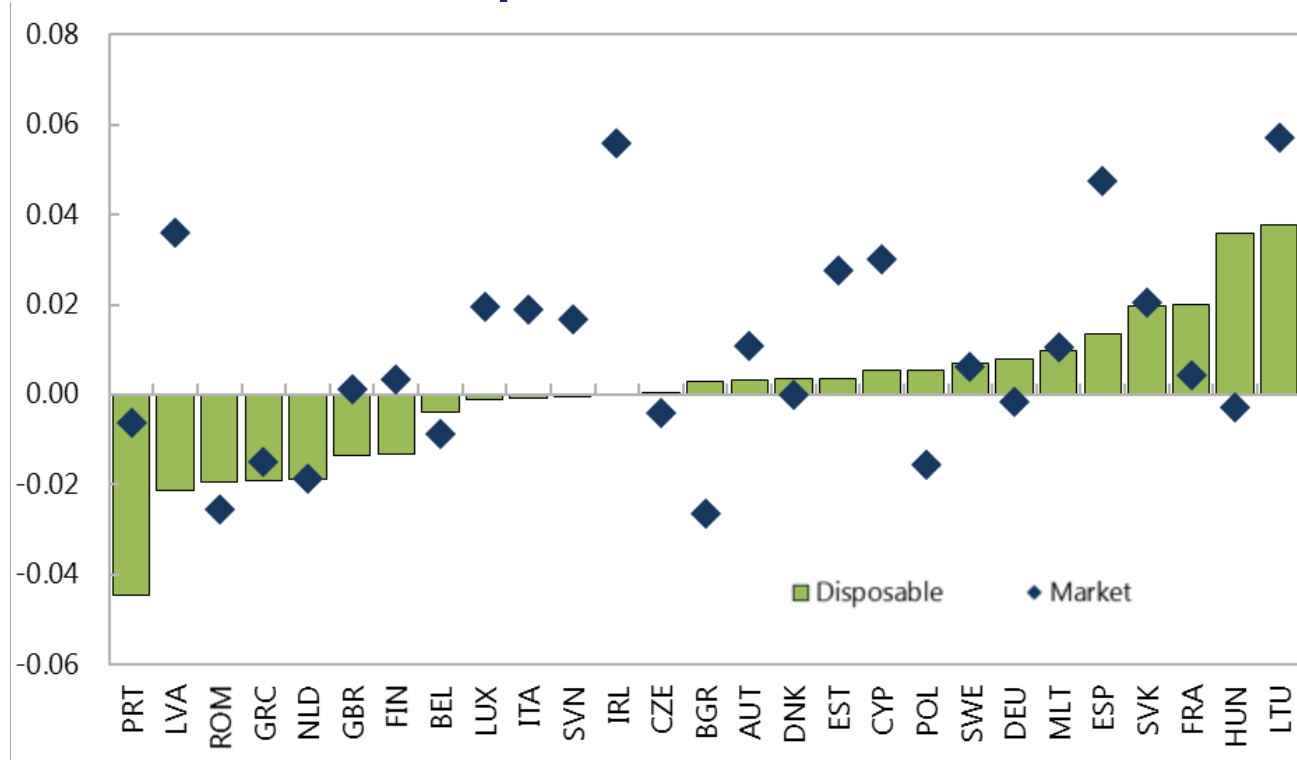
Sources: Solt (2014); Eurostat; and IMF, *World Economic Outlook*.

Note: Fiscal adjustment episodes are defined as in Escolano and others 2014 based on changes in cyclically adjusted primary balances in countries with positive primary gaps. The sample covers 91 episodes across 49 advanced and developing economies between 1945 and 2012.

Fiscal consolidation and redistribution



Changes in Market- and Disposable-Income Gini Coefficients, 2007-13



Source: EUROMOD statistics on Distribution and Decomposition of Disposable Income, accessed at <http://www.iser.essex.ac.uk/euromod/statistics/> using EUROMOD version No. G2.0.

Note: An increase in the Gini coefficient indicates an increase in inequality. The Gini coefficient for market income is estimated based on disposable-income micro data by adding back (in the case of taxes) or deducting (in the case of benefits) each income component, using the EUROMOD microsimulation model. Estimates for market-income Gini in 2007 and 2013 are based on European Union Statistics on Income and Living Conditions 2008 (income reference period: 2007) and European Union Statistics on Income and Living Conditions 2010 (income reference period: 2009), respectively. For the latter, market-income updates from the income reference period to later years are based on a combination of updating factors. For more information on the exact updating factors used for each country, please refer to the Country Reports (<https://www.iser.essex.ac.uk/euromod/resources-for-euromod-users/country-reports>). Changes between years and tax-benefit components are not necessarily statistically significant. Data labels in the figure use International Organization for Standardization (ISO) country codes.

Conclusions

Conclusions

- ❑ Fiscal policy is a powerful and adaptable tool for achieving distributional objectives**
- ❑ Improving both distributional outcomes and efficiency is possible**
- ❑ Considering taxes and spending programs together enhances the effectiveness of fiscal redistribution**