INTERGOVERNMENTAL GROUP OF TWENTY FOUR
G-24

G-24 Special Workshop on Growth and Reducing Inequality

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SUMMARY REPORT

Session 1: General and Regional Trends and Perspectives

In this session, panelists brought out trends in income inequality, poverty reduction, and labor markets globally and in Asia, Sub-Saharan Africa (SSA), and Latin America and the Caribbean (LAC). The trends are diverse, highlighting the importance of tailoring policy measures to improve inclusion to country circumstances.

Mr. Jomo Sundaram, former UN Assistant Secretary General for Economic Development, stated that global inequality is characterized by rising inequalities within countries in recent decades and decreasing inequalities across countries. Income inequality in countries declined in most of the 20th century, but began to increase from the early eighties in major developed countries and after WWII among developing countries. Strong growth in emerging market and developing countries (EMDCs) has narrowed inequalities across countries.

Nevertheless, global inequality – between world citizens – is higher than inequality within any individual country. Two thirds of world inequality is due to international inequalities. This has been driven by the higher growth in incomes of those within the 3rd and 4th income quintiles, most of whom are in EMDCs, compared to other quintiles over the last 50 years (between 1960 and 2010), as shown by the Milanovic Elephant graph.

Income inequalities are strongly associated with wealth inequalities, with some exceptions. Most countries with the Gini ratios greater than 50 percent and wealth distribution greater than 70 percent are in Sub-Saharan Africa (SSA) and Latin America.

The hypothesis that inequality is necessary for growth does not get much support historically. On the contrary, the evidence has been that higher inequality is associated with lower growth and shorter growth spurts. Greater inequality has also been associated with extreme concentration of political power, which has been used to widen income gaps through rent seeking that slows down growth. Thus addressing inequality matters, and the question is what are the institutions and processes that enable redistribution.

Mr. Jos Verbeek, Manager and Special Representative to the UN and the WTO in Geneva, World Bank, said that growth, trends in inequality and reducing poverty are inextricably linked. There has been a major decline in the number of those in extreme poverty, from 1.8 billion people to 767 million between1990 to 2013, or 35 percent of the world's population to 10.7 percent. Half of the global poor now live in SSA and a third in South Asia. They tend to live in the rural areas, in households with more children, work in agriculture, are young and poorly educated.

Can we end poverty by 2030 with the current trends? The answer is no if income distribution does not improve. Projections show that ending poverty requires reducing inequality at a faster pace. To boost and sustain inclusive growth, the WBG pointed to the need to scale up infrastructure investments and private sector development and invest in people. Building resilience to household income shocks as well improving social protection is also essential. There is a need to improve access to basic services by the poor.

Sukti Dasgupta, Chief of Employment and Labour Market Policies, ILO, and **Kee Beom Kim**, Macroeconomic and Employment Policies Specialist, ILO, presented key trends in labor markets of developing countries. The share of the working poor (percentage of employed living below US$1.90 PPP) has fallen in developing countries of all income groups. Nevertheless, the working poverty rate for women remains higher than men's. In addition, the share of vulnerable employment has remained high and has declined only modestly, which indicates greater challenges in improving the quality of jobs. This indicates that workers may be moving from agriculture to low productivity service subsectors, where informal employment predominates.

There is evidence of a declining employment elasticity of growth, including among G-24 countries between 1985 and 2014. Hourly real wage data has risen in most G-24 countries, but wages adjusted by PPP has fallen in many G-24 countries. This is consistent with the limited shifts in employment to higher productivity sectors, such as manufacturing, in some countries.

On job polarization, in advanced countries and many developing and G-24 countries, the share of low skilled and high skilled workers has risen, while the share of medium skilled workers has fallen. Job polarization has been mostly accompanied by wage polarization (ratio of high skilled to medium skilled wages), but this joint trend is less clear in developing countries.

Mr Juzhong Zhuang, Deputy Chief Economist of the Asian Development Bank (ADB), highlighted that Asia's high growth has led to large reductions in poverty but has also been accompanied with rising income inequality in the past 25 years, with the share of the top income groups increasing. The level of Asia's inequality is lower than in other countries globally but its rise over time is a concern.

The rise in inequality is attributed to: First, technological progress, globalization and deregulation that have led to growth but have favored capital over labor, skilled over unskilled workers, and cities/coastal towns over rural/inland areas. The share of labor income declined while the share of capital income increased. Skill premium has risen: education inequality accounts for 25 to 45 percent of total inequality. Spatial inequality also accounts for a large share of total inequality. Second, social exclusion has also led to unequal access to opportunity. Third, wealth inequality has also risen, which in turn contributes to further income inequality. In China, for example, the wealth Gini coefficient doubled from 1988 to 2012.

The ADB's strategy for inclusive growth has three drivers. The first is ensuring high, efficient and sustained growth in the creation of productive jobs and economic opportunity. Growth paths need to be made more employment friendly, which requires human capital and skills development, and infrastructure investments to reduce spatial inequality. Labor market institutions are to be strengthened, mindful of not imposing excessive costs to business.

The second driver is social inclusion to ensure economic opportunity and social safety nets to protect the poor and mitigate the effects of temporary shocks. Fiscal policy has to promote more income redistribution. Governance reforms are essential to contribute to equalizing opportunities. Finally, in moving toward inclusive growth, there is recognition that inequality is not only driven by differences in individual efforts but in differences in individual circumstances that lead to inequality in opportunity, thus the importance of eliminating obstacles to inequality of opportunity. Within this framework, government measures to reduce inequality require strengthening the various drivers of inclusive growth in ways that respond to country circumstances.

In LAC, **Ms. Raquel Artecona**, ECLAC, showed that the decline in household income inequality during the 2000s has been a notable development, especially in contrast to the increase in income inequality during the 1980s and 1990s. The Gini ratio fell by at least 1 percent per year in 9 out of the 17 countries examined. This decrease in inequality in LAC took place in the context of sustained economic growth and decreasing poverty.

Two factors contributed to this decline. The first is the reduction in hourly wage inequality leading to a better distribution of labor income. On the latter, paid work is the major source -- about ¾ -- of household income, so that improvements in its distribution contribute greatly to reducing inequality. In recent years the supply of skilled labor outpaced its demand leading to a narrowing of college premium and a narrowing in the dispersion of earnings. Demand side factors include a pattern of industrialization that led to a slower increase in skilled labor demand compared to supply and technological change that led firms to become less skill intensive and move some of the skill intensive work off shore.

The second is progressive government transfers. Fiscal policies benefit lower income groups, mainly through cash transfers, more so than public pensions, personal income tax and social security systems. The impact on distribution of fiscal policies was largest in Argentina, Brazil and Uruguay, followed by Chile, Costa Rica, Mexico and Panama, and was less in Colombia and Paraguay. Personal income taxes played a more limited role since this direct tax burden was already low in LAC countries, which relied heavily on indirect tax revenues. The public pension system also led to greater redistribution in countries where it had greater coverage.

There are indicators on other dimensions of inequality. Recent efforts to complement household survey information with information from tax records on income and financial assets show higher levels of inequality, which has implications for the types of policies than will address inequality.

It is also interesting to note that the drop in inequality in LAC was not because workers obtained a higher share of labor income. Only 5 of 13 LAC countries with data showed an increase in wage share of GDP. Women are also overrepresented in the lower three income quintiles.

According to **Mr. Haroon Bhorat**, University of Cape Town, in SSA's extreme poverty has fallen although almost half of its population continues to live below the poverty line, a proportion that is higher than the poverty rates in other developing countries. Growth elasticity of poverty is -.7, which is lower than the rest of the world where such elasticity is about -2. Economic growth is therefore a necessary but not sufficient condition for reducing poverty. How growth reduces inequality also matters.

Mean and median levels of inequality in SSA are high, and much higher than elsewhere in the world, driven largely by 7 economies (mostly in Southern Africa) with very high levels of inequality. Average inequality in SSA has declined since 1999, driven by reduced inequality in the less unequal countries. There is weak relationship between the rates of economic growth and changes in the Gini ratio for many African countries.

SSA faces a major employment challenge: it has a young and growing labor force that requires sustainable employment. Nearly 40 percent of the world's working age population is expected to reside in SSA by 2100, up from 10 percent in 2015. Ten countries will account for nearly 70 percent of the region's population growth.

An additional challenge is improving the productivity of the working poor, which in SSA includes 234 million people, about 2/3 of the total employed and over 8 times the number of unemployed in the region. They are mostly self-employed working in agriculture. SSA also has a high rate of vulnerable employment, between 81percent and 77 percent of those employed.

How Africa shapes its long run growth path depends on how it manages resource led growth, its manufacturing malaise and informality. Resource dependence defines the recent growth trajectory in many African countries. And, the links to labor and investment of resource led growth may be inequality inducing, so that minimizing these requires deliberate policies.

Manufacturing has been slow in taking off in Africa. The transition in many countries has been characterized by a fall in agriculture's share to GDP and an increase in the share of services, but this begs the question of whether this transition will deliver the necessary levels of job creation and broaden opportunities.

The expansion of informality in Africa in the 1990s has been linked to trade liberalization and structural adjustment programs. There is a correlation between high levels of unemployment with greater informality, since the latter tends to be employer of last resort. Raising the productivity of the workers in the informal sector is also an important policy objective.

Participants commented about the potential difficulties that could emerge when increasing agricultural productivity pushes workers to seek, but they fail to find, better jobs in manufacturing/services sectors. They highlighted the need for IFIs and other international organizations to approach goals of poverty and inequality reduction in a more concerted way. They also asked about the social programs that had helped reduce inequality in Latin America, the importance of investment in human capital and the need to account for the size of the informal sector in developing countries.

Session 2A: Trade, technology and labor markets

Ms. Anu Madgavkar, Partner, McKinsey Global Institute, started off the Panel's discussion on the interaction of productivity and work, and its implications on inclusion. Technology is now a dominant factor in investment globally, with amazing progress on automation, artificial intelligence and analytics. Technology has definitely increased efficiency and productivity, and has been good for society and for business.

Many developing countries are in a steeply accelerating phase of digital adoption, and a number of initiatives support inclusive growth. Notable examples are initiatives that are improving the primary health care system that overcomes the shortage of doctors and the delivery of low-cost quality education through digitization. There also are examples of technology providing greater opportunities for workers in the informal sector to find work and improve their job prospects.

On the interaction of technological technology, jobs and work, the impact on workers depends on the capabilities of currently proven technologies. Some activities show high technical automation potential. In developing countries adoption of such technologies may be slow due to lower economic feasibility. Automation impacts both high- and low-wage occupations, as tasks in both of those categories can be routine-intensive enough to be done by machines. Capturing opportunities from well-paying jobs will entail efforts by companies and individuals to improve education choices and skill acquisition and for policy makers to promote measures to raise skills but also rethink incomes and social safety nets. In addition, more and more people also want to work on their own terms, and these "independent" workers are increasingly using digital platforms to access work.

Mr. Marc Bacchetta, Counsellor, Economic Research and Statistics Division, WTO, further noted that obstacles to workers' mobility, caused by skill mismatches, geographic factors, and institutional constraints, are twice as high in developing countries as in developed ones. Appropriate labor market policies to improve retraining opportunities or provide unemployment insurance and redistribution measures will need to be considered.

Notable global trends are the decline in the share of employment in manufacturing and agricultural sectors in developed as well as an increasing number of developing countries, while the share of employment in services continues to grow. Jobs requiring low and high skills have increased in total employment at the expense of middle-skilled occupations. This phenomenon has contributed to polarization in wages and most likely to increased income inequality. The skill premium – defined as the ratio between the wages of skilled and unskilled workers -- has increased in some countries and decreased in others. Furthermore, an important aspect to understand better is how technological innovation affects the labor share of income, which has declined in advanced as well as some developing countries.

It is difficult to disentangle the effects of technological change and trade on employment trends. While some regions and sectors benefit from trade, others could be left worse off, which is a pattern similar to the effects from technological change. Nevertheless, there is empirical evidence that suggests technological change explains up to 75 percent and trade 25 percent of the decline in US manufacturing jobs.

Mr. Joerg Mayer, Senior Economic Affairs Officer, UNCTAD, agreed that what is technically feasible to automate through robots is not necessarily also economically feasible, so that most developing countries now are not overly threatened by robot-based automation. Use of industrial robots now remains low and concentrated in a few developed countries and in relatively well-paying manufacturing sectors. This concentration is bound to widen the divide between the countries that have and have no access to the new technologies and render some paths to industrialization steeper.

This trend raises the question of whether traditional strategies for creating better-paying jobs through more manufacturing still hold sway.

Like the WTO presentation, he referred to the slowdown in global trade, but also noted a less supportive environment for exports from developing countries. The slowdown could be attributed to structural factors, such as the maturing of global value chains – efficiency benefits from ICT innovation have been reaped – and stalling trade liberalization. Another factor was the decline in global demand, and the sharp fall of commodity prices. UNCTAD pointed to the need for measures to boost global demand and steps to strengthen the multilateral trading regime.

Ms. Sabina Dewan of the JustJobs Network emphasized the need to get a better understanding of how technology is transforming work and changing jobs, in place of preconceived notions, in order to capture the opportunities but also manage risks and uncertainty. Ten case studies of the Network illustrate a number of lessons: one is that global labor market mobility is not friction-free. Second is the threat of the erosion of worker rights and lack of social protection of workers in the on-demand economy, but digital spaces may also be the next frontier of collective bargaining. Ms. Dewan posed questions on how data democratization can improve workers' rights in the on-demand economy and how workers can safely organize in digital spaces. She further argued that automation will increasingly impact developing countries: low labor cost will not shield them from job losses associated with automation because firms may still find it profitable to substitute labor for capital where they encounter shortages of workers with the adequate skills.

Mr. Hector Torres, former IMF Executive Director for Argentina, as a discussant, pointed to a central development dilemma confronting policy makers. Countries all want to increase productivity to enhance growth in inclusive ways, making societies fairer and democracies stronger. But innovations that improve productivity free up resources that could be employed elsewhere but the reality is that there is frustration among those who have lost their jobs. Against this background, a crucial question for policy makers is which domestic policies can reconcile technological innovation with jobs and with trade. And, how can the IMF, the WB and other MDBs, the WTO, and the ILO support the implementation of these policies?

In the discussion that followed participants exchanged views on whether digital platforms create new jobs or simply do better in matching existing workers with existing jobs and how countries would generate the resources to be able to develop the skills of workers to adjust to new technologies. There were questions on the extent that new technologies were widening as opposed to shrinking divides within countries and among countries.

Session 2B: Trade, technology and labor markets

Mr. Juzhong Zhuang, ADB, reported a number of recent studies that found the drivers of a declining share of income were technological change, globalization, financialization and changes in labor market institutions and policies, but with differences on the relative impact of each. In Asia, the labor share of income had declined between the early 1990s and mid-2000s, contributing to rising income inequality. In more recent years the picture was more mixed, although it is still true that for most sectors, if China is excluded, the trend continues.

Ms. Marion Jansen, Chief Economist of the International Trade Centre, discussed competitiveness of Small and Medium Enterprises (SMEs) and inclusive growth. Many low-wage workers are employed by SMEs, a fact connected to the lower productivity and bargaining power of SMEs compared to large firms. This gap is significantly larger in developing countries. This suggests that improving the competitiveness and productivity of SMEs is a pre-requisite – although not sufficient condition – for enabling such companies to create better-paying, higher quality-jobs.

Mr. Brian McCaig, Wilfrid Laurier University, discussed evidence from a study of trade, employment and informality in Vietnam that showed that increased exposure to trade, by increasing the demand for workers, had fostered the incorporation of informal workers into the formal economy. Much better data and cross-country research would be needed to ascertain how trade affects the informal sector (also demonstrated by the divergent reports on informality in Africa in Session 1).

Mr. Christian Viegelahn, ILO, shared evidence from a study on jobs created by exporting and importing firms in Africa. Firms that export and import have a larger workforce than non-trading ones, especially in countries with good infrastructure policies. Both exporters and importers employ more women, but the latter only in countries featuring good gender policies. Exporters employ more temporary workers, but good rural policies decrease the prevalence of temporary employment. Exporters pay higher wages, but importers do not.

As a discussant, **Ms. Esther Busser**, International Trade Union Confederation, referred to the need to pay attention to how gains generated by increased productivity would be allocated between workers and capital and the relevance to that end of improving workers' bargaining power and labor market institutions.

Participants asked for clarification on factors that determined bargaining power of SMEs in global value chains, the role of access to finance versus access to technology and other variables in determining the gap between SMEs and larger firms and whether there had been complementary policies that aided the move of workers from informal to formal sector in Vietnam.

Session 3: Financial and Monetary Policies

A few of the presentations in this session discussed **financial globalization, inclusion and inequality**. **Davide Furceri**, Senior Economist of the IMF Research Department, stated that financial globalization has important effects on inequality whereas, compared to trade, its effects on growth and poverty reduction are less positive. In theory, there are four channels through which financial globalization can affect inequality. First, similar to role of technology, when a country opens its capital account, the ensuing reduction in cost of capital makes it highly substitutable for labor, so liberalization would reduce cost of capital and lead to a decline in the labor share. Second, financial globalization can reduce the bargaining power of labor, reducing the labor share of income, bias financial access in favor of the well-off, and increase the probability of crises, which tend to disproportionately hurt the poor.

Opening up the capital account is associated with increased inequality in income distribution as measured by GINI. Opening up of the capital account was also associated with a reduced labor share of income and an increase in the share of income accruing to the top 10 per cent and 1 per cent of the

income distribution. Its impact tends to be larger where financial markets are not well-developed, have less financial depth, and where financial inclusion is more limited. The effects also vary across countries, depending on the size of redistribution policies. And, where crises happen, the impact can be 3 times larger than the baseline.

The research also found support for the hypothesis that at the sector level the effects would tend to be larger for sectors that rely more on external finance and the effect through impact on workers would be larger for sectors where firms are prone to adjust the cost of labor via hiring and firing, rather than wages.

The findings should not be taken as a reason for countries not to undertake capital account liberalization, but they suggest an additional reason for caution and the need to ensure countries have reached a certain threshold of financial and institutional development and that such liberalization is accompanied by pre-distribution and redistribution policies.

Mr. Alex Izurieta, Senior Economic Affairs Officer, UNCTAD, introduced findings from research on financialization and inequality. For the purpose of this research, the proxies used to measure financialization were total banking assets, external assets and liabilities, and assets of top five banks, as a percentage of GDP.

Financialization was found to be associated in a significant way with increased income inequality, measured by the GINI coefficient and the "Palma ratio."[1] It also was associated with reductions in government expenditures as well as increases in rates of indirect taxation. Finally, the research also explored the impact of trade and investment agreements on financialization. They were associated with accelerated financialization, both when considering the time of signature and the time of entry into force of such treaties.

Professor Victor Murinde, African Economic Research Consortium, presented ongoing research he led at the Research Centre in Global Finance at SOAS University of London, on financial inclusion and its links to inequality and poverty reduction in Africa. The research has uncovered a robust association in developing countries between financial inclusion measures with a rise in GDP per capita, reduction in inequality and poverty, and with female participation in the labor force. However, the associations with growth rates and poverty reduction are less strong in the SSA countries. In the case of poverty reduction, supportive factors that seem to contribute alongside financial inclusion were primary school education, openness to international trade, and investment.

He introduced the notion of financial inclusion in the narrow (and traditional) sense, which uses two main indicators: accounts held by households and firms at a financial institution and percentage of individuals or firms that borrowed from a financial institution. In that regard, African countries perform less well than developing countries outside Africa (with the caveat that available data is spotty). Professor Murinde advocated taking a broader view of financial inclusion. This needs to consider assets and liabilities not only for households and businesses, but also for banks and other financial institutions as well as governments. Whether financial institutions are able to access finance

[1] The "Palma ratio" captures changes in the income shares of the top 10 per cent of the population relative to the bottom 40 per cent, as well as income gaps between these two groups.

outside of national boundaries has stronger implications on the narrow measures for households and firms.

Other interventions looked at **monetary policy and inequality**. According to **Mr. Furceri**, IMF, monetary policy has some ambiguous effects on inequality. A study looking at the effects of conventional monetary policy on income inequality in a large sample of advanced and emerging market economies between 1990 and 2013 finds that contractionary monetary policy, other things remaining equal, leads to increased inequality, measured in several ways. Impacts are also asymmetric: the negative effects of contractionary policy on inequality are larger than the positive effects of expansionary policy. The effects, however, vary over time, across business cycles and depending on the types of monetary shocks, and their impacts on different asset prices. The effects also depend on the share of labor income to start with and the concurrent redistribution policies in place. The study also found that, while unexpected contractionary monetary policy shocks increase inequality, changes in policy rates driven by an increase in growth are associated with lower inequality.

Mr. Pierre Monnin, Council for Economic Policies, summarized results from empirical studies on on monetary policy and income inequality for advanced countries (AEs). He pointed to the need to distinguish between conventional monetary policy, such as movements in the interest rate, and unconventional monetary policy, such as quantitative easing and asset purchase programs, because they do not have the same transmission mechanisms and, thus, impacts on inequality. These studies found strong results for conventional monetary policy. Expansive monetary policy decreases inequality, and the impact is economically significant. This would appear to relate to that monetary policy stimulates economic activity and, thus, demand for labor.

For unconventional monetary policies, the results were ambiguous. The bigger impacts seemed to be on returns to capital, thus tending to increase inequality. However, if unconventional monetary policy successfully stimulates the labor market, it would tend to reduce income inequality.

Research also found that both conventional and unconventional expansionary monetary policy led to increased wealth inequality.

Monnin highlighted that the link between inequality and the macroprudential tools for financial stability introduced by Central Banks, runs in both directions: inequality is a potential source of financial instability and there is new evidence that macroprudential policies to tackle financial risk have an impact on inequality. Countercyclical capital buffers and limits to credit growth have been associated with higher inequality – though causality is inconclusive.

Mr. Martin Rapetti, CIPPEC, discussed the link between monetary policy and inequality in developing countries, based on research from Latin America. An important channel was the real exchange rate (RER), a relative price that is key for economic growth and employment. The usual understanding of what macroeconomic policy can do for economic development is that it can provide macroeconomic stability: low inflation, fiscal balance and non-explosive balance of payments. A preferred combination of policies in Latin American countries involved floating exchange rates plus inflation targeting, leading to a tendency to have an asymmetric way of intervening on foreign exchange (forex) market. Central Banks, with the main objective of lowering inflation, tended to intervene to avoid

depreciations, but were way more tolerant with appreciations. As a result, RER tended to have an overvaluation bias.

The problem with this regime is that evidence suggests that there is a positive association between the RER and economic growth: overvaluations are associated with decelerated economic growth and vice versa. This association is also stronger for developing countries so maintaining a stable and competitive RER would tend to favor economic growth.

Rapetti warned that this recommendation regarding RER is controversial in the sense that it involves the management of a relative price that is often considered should be determined by the market.

Finally, a presentation focused on the **role of national development banks (NDBs). Ms. Stephanie Griffith Jones**, Initiative for Policy Dialogue, presented results of a Columbia University project supported by the Brazilian National Development Bank and the Latin American Development Bank, which included several issues papers and seven country case studies.

She argued that NDBs provide patient long term finance necessary for structural transformation, counter-cyclical finance, deepening and improving financial markets for development-friendly instruments, supporting greater inclusion and financing global public goods. NDBs have been broadly successful, and most recently they have gone into new sectors, such as renewable energy and energy efficiency, and new activities. They have also increased their use of new instruments, such as guarantees and equity and their efforts to encourage foreign direct investment and national companies to invest abroad.

But the current size of NDBs is not large enough for the development needs of their countries. Against the backdrop of very low levels of both private and public investment, the leverage NDBs can provide becomes particularly attractive. For NDBs to operate well, the broad context in which they operate matters: good macroeconomic policies and a well-functioning financial sector, a clear development strategy and policy mandates that remain relatively stable in spite of government changes. Some suggested questions for future research are: what are the criteria to define a well—functioning development bank? What is the political economy to ensure NDBs are well governed? What are the most effective instruments for NDBs to channel funds? And, what are the political economy dimensions for generating support for creating NDBs where they do not exist and maintaining their scale where required?

As the first discussant, **Mr. Andrew Cornford**, Geneva Finance Observatory, cautioned against relying on oversimplified indicators for financial globalization as they may ignore the breadth of discrete events involved in opening the capital account, and the magnitude of different liberalization measures that also depends on the historical context in which they were taken. On financial inclusion, he called for further study of the different vehicles to provide financial inclusion. On the NDBs, he suggested that the study should clearly differentiate between them and public banks, national public banks, and private banks.

Ms Yuefen Li, South Centre, clarified that that financial and monetary policies also have cross-border impacts and that their inequality dimensions should be more discussed. Regarding the impact of trade and investment treaties on financialization, she brought attention to the investor-state arbitration

processes as a further reason for concern and why several countries are reviewing their International Investment Agreements. On NDBs, their efforts to prevent private sector free-riding when involving the private sector should also be considered in the analysis.

In his remarks as discussant **Mr. Gerardo Zuniga**, Senior Advisor to the IMF Executive Director, Mexico, agreed with the finding that monetary policies have impacts on inequality but most likely that would not mean that Central Bankers should take into account inequality when they design monetary policy, as other policy instruments (e.g. fiscal) are more suitable to influence inequality. He also cautioned that attempts to manage the exchange rate may enter into conflict with obligations countries have under the IMF Articles of Agreement.

A few issues were raised in the ensuing discussion, including how developing countries should address impacts of policies by developed countries to manage their exchange rates –sometimes coordinated among them; the relevance of considering impacts of inequality in the design of monetary policies and the impact trade and investment treaties have had on inequality in investment-receiving countries.

Session 4: Fiscal Policies

Mr. Davide Furceri, IMF, provided an assessment of fiscal consolidation and inequality in developing countries. He started off by noting that overall, little is known about the economic and distributional impact of fiscal policies on inequality in EMDCs, particularly the impact of fiscal shocks. While fiscal policy is the main tool for governments to affect income distribution, many EMDCs, especially oil exporters, have faced pressures to consolidate. A study of 103 EMDCs from 1990 to 2016 finds that, similar to AEs, contractionary government spending increases inequality in EMDCs. Mr. Furceri emphasized that the impact of fiscal consolidation is quite large: a contraction in a country's government spending by 2 percent increases the measure of inequality by half a standard deviation, which means that effect is long-lasting and significant. A 10 percent increase in government expenditure leads to a decrease of over 1 percent in net inequality, and this effect is more pronounced during economic recessions. In disentangling the effects of fiscal consolidation, the study also finds that effects for government consumption are larger than for public investments, though both have improvements for the poor when expansionary. Mr. Furceri noted that his study currently focuses on distributional effects but a forthcoming IMF paper will also consider multiplier effects of fiscal consolidation. This is especially relevant to determine the effects of cuts in public investments, which have both short-term impact on output and medium-term effects on employment and long-term effects on inequality.

Ms. Rossana Merola, ILO, presented research on the effects of tax-based consolidations (as a result of exogenous tax shocks) on employment, growth and income inequality. The study also sought to establish whether the choice of tax instruments used mattered.

Covering 16 OECD countries, the study finds that tax-based consolidations reduce inequality but at a cost of lower output and employment. The design of tax consolidation matters. Among direct taxes, only personal taxes (PIT) reduce inequality. Indirect taxes, especially the general tax, create incentives for poorer agents to increase labor supply, leading to lower income inequality. Indirect taxes also bring middle-aged women into the labor force resulting in less gender inequality. Ms. Merola pointed out that similar results are obtained for EMDCs but there are certain limitations. First, for direct taxes

(PIT), in EMDCs, influence from key economic groups limit the effectiveness of income taxes in reducing inequality and a high level of informality contributes to the challenge of insufficient tax revenues. Second, for indirect taxes, an increase in tax may result in increased labor participation but in the informal labor market, as workers seek to make up for the decline in their purchasing power

Professor Bruno Martorano, Maastricht University/UNI-MERIT, followed with a presentation on what has worked for fiscal and tax reforms and inequality in Latin America. He presented a study of 18 Latin American countries over the period 1990-2015, which investigated empirically whether the recent changes in taxation observed in the region have contributed to the reduction of inequality recorded in Latin America during the last decade. The study finds that an increase in tax-to-GDP has led to a decrease in inequality, as measured by the GINI index. Additionally, the increasing contribution of direct taxes over indirect taxes promoted the progressivity of the tax system and contributed to the reduction in inequality. Taxation influences the income distribution mainly by reducing the distance between the middle class and the upper class. However, the effect is limited at the top of the income distribution.

Mr. Martorano then presented a case study of the 2007 Uruguayan tax reform, which introduced progressive taxation on labor income and a flat rate on capital income. The new tax lowered inequality by 2 Gini points and had no disincentive effects on labor supply, contradicting the equity and efficiency trade-off theory. He emphasized that promoting equality in LA is still limited by several factors including the inability of governments to mobilize tax revenue to its potential, the relatively high contribution of indirect taxes, and the low contribution of personal income taxes of taxes on property.

Mr. Jeremias N. Paul Jr., Coordinator of Tobacco Control Economics at the WHO, rounded off the session with a presentation on the role of tobacco taxation in addressing health inequalities. Nearly 80 percent of the world's 1.3 billion smokers live in Low and Middle Income Countries (LMICs), with most smokers coming from the lower income segments of the population. Smoking causes around 7 million deaths per year globally, and it is a major risk factor for non-communicable diseases, such as cancer and diabetes, which account for 70 percent of all deaths in the world. The economic costs of smoking amount to 1.8 percent of global GDP, or US 1.4 trillion, with 40 percent incurred in LMICs.

Tobacco taxation is a low-lying fruit to finance the attainment of the SDGs, as by the Addis Ababa Action Agenda. It is a proven win-win formula for increasing government revenues while reducing tobacco consumption. A 10 percent increase in tobacco prices leads to a 5 percent decrease in consumption in LMICs. Due to consumption patterns, tobacco taxes disproportionately benefit lower-income households and higher tobacco taxes generate additional revenue without harming growth and employment.

Mr. Paul presented Philippines as a case study. In the Philippines, additional revenues from increased tobacco tax rates were used to nearly triple the health budget within four years. The initiative, the National Government Allocation for Health Insurance Premiums for the Poor, expanded coverage for 15.4 million families. Increased fiscal space created by higher tobacco taxes helped to attain investment grade status, with credit rating agencies, lessening the cost of borrowing. Lastly, higher taxes and other tobacco control policies helped more than 1 million people quit smoking. Several questions were raised by participants on this session's presentations, for instance, the impact of

cutting government infrastructure spending on inequality and clarification on whether consumers responded to the tax-induced price increases on tobacco by cutting essential spending on nutrition and appropriate policies to deal with this. .

Special Session: A Snapshot of the IMF's Policy and Operational Work on Inequality

Ms. Stefania Fabrizio, Deputy Unit Chief in the IMF's Strategy, Policy and Review Department, delivered a snapshot of the Fund's policy and operational work on inequality. Inequality has become an area of focus for the IMF due to a number of factors: high levels of inequality can be destructive to the level and durability of growth; growth- and stabilization-centric macroeconomic and structural policies have an impact on inequality; and there has been a growing interest on the subject from membership. The IMF's engagement is primarily through analytical work, policy advice and capacity development.

Examples of analytical work carried out by the IMF include: research on what makes growth sustained, how to foster inclusive growth, a global perspective on causes and consequences of income inequality, and lessons and implications of energy subsidy reform, among others. Other relevant issues is covered in the IMF's October 2017 Fiscal Monitor.

On policy advice, the IMF has launched a pilot initiative that has so far completed 24 country inequality case studies, with 16 ongoing. The studies focus on a range of topics and a stock-taking exercise of country-level advice that are discussed in a staff discussion note, "Macro-Structural Policies and Income Inequality in Low-Income Developing Countries." Ms. Fabrizio highlighted the following broad policy lessons from some of these case studies: i) pro-growth polices and reforms can have important distributional trade-offs; (ii) it is critical to understand channels through which trade-offs may arise; and (iii) there is need for well-designed policy packages that reduce or remove potential trade-offs.

On capacity development, the Fund offers workshops and training, technical assistance and toolkits for Fund staff and country authorities. Methodological approaches include a model-based framework for assessing economic and the distributional impact of policies. This framework has been used for G-24 countries such as Brazil, Ethiopia, and Guatemala; in the pipeline are Argentina and Morocco. Additionally, the Fund has a toolkit for incidence analysis of subsidy reform. Ms. Fabrizio further noted that distributional analysis is an integral part of technical assistance on tax and subsidy reforms, and these tools for distributional analysis can be found in the IMF's website, as well as in the Fund's online-courses on energy and subsidy reform.

Participants raised a number of questions. They wanted to know whether the IMF is considering new indicators for inequality; what the Fund is doing in advanced countries vis-à-vis direct taxation on the very rich and its current messaging on this point. A number of questions were raised on the country case study of Bolivia, which experienced a decline of 12 points in its Gini index in 15 years, and the policies that explain this decline, the lessons that can be drawn for other countries, and the role of commodity revenues in this context. Lastly, participants asked the Fund to consider carrying out ex-post assessment of the impact of adjustment programs on inequality.