

## **Fiscal Policy and Income Inequality**

**Sanjeev Gupta**  
**Deputy Director**  
**Fiscal Affairs Department, IMF**

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### ***Structure of the presentation***

- Trends in inequality**
  - Including inequality of income and wealth
- Redistributive role of fiscal policy**
- Design of efficient redistributive fiscal policy**
  - Basic principles for designing fiscal redistribution
  - Design of spending measures (cash and in-kind transfers)
  - Design of tax measures (direct and indirect taxes)

# I. Trends in Inequality

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*Inequality has been increasing in most economies*

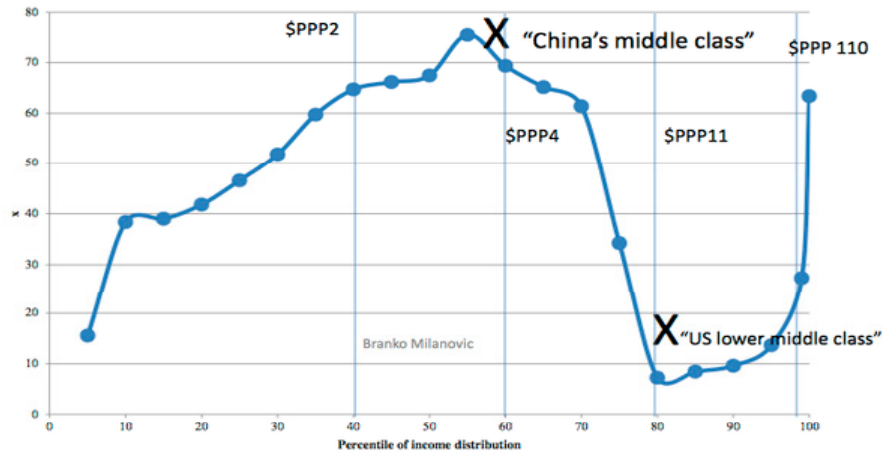


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# Global Inequality and Income Growth

### Real income growth at various percentiles of global income distribution, 1988-2008 (in 2005 PPPs)

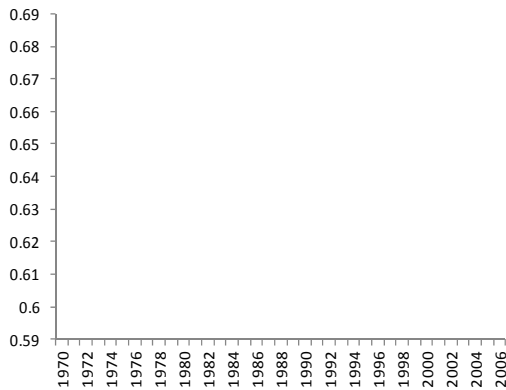


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# Inequality Between Countries Down, Inequality Within Countries Up

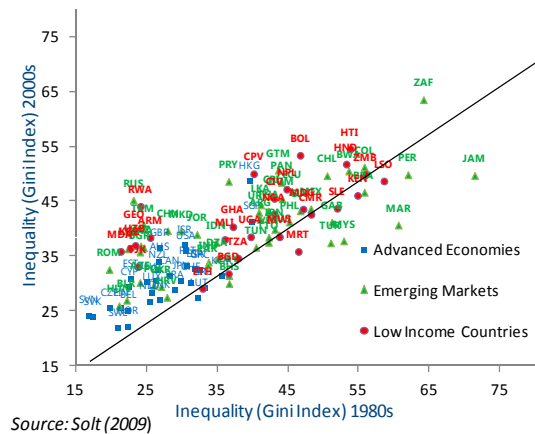


### World Gini Coefficient, 1970 - 2006



<sup>2</sup>World inequality is defined by the Gini Index, assuming the world is one country. Source: Sala-i-Martin (2006).

### Income Inequality in the 1980s and 2000s

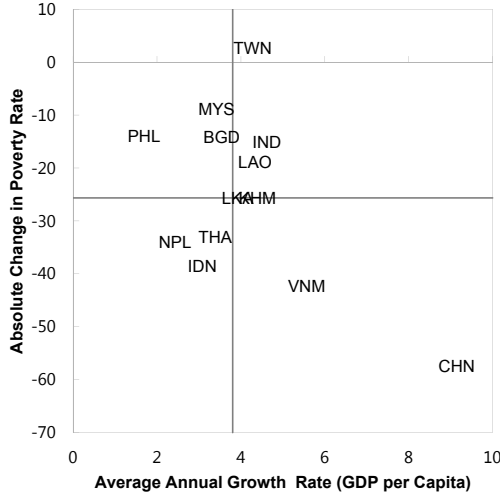


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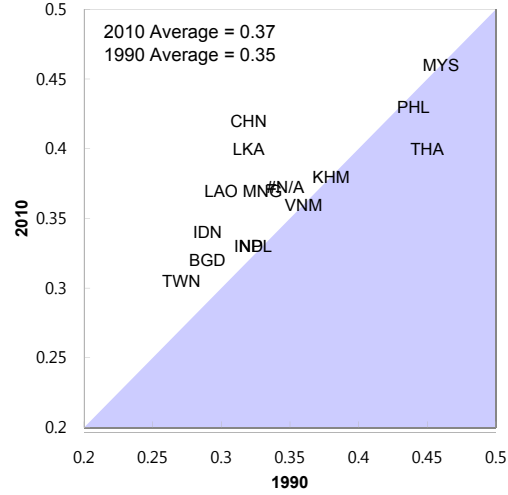
# In Asia, although poverty has decreased substantially, inequality has increased



Poverty (\$2/day) and Growth 1990-2010



Gini Coefficient

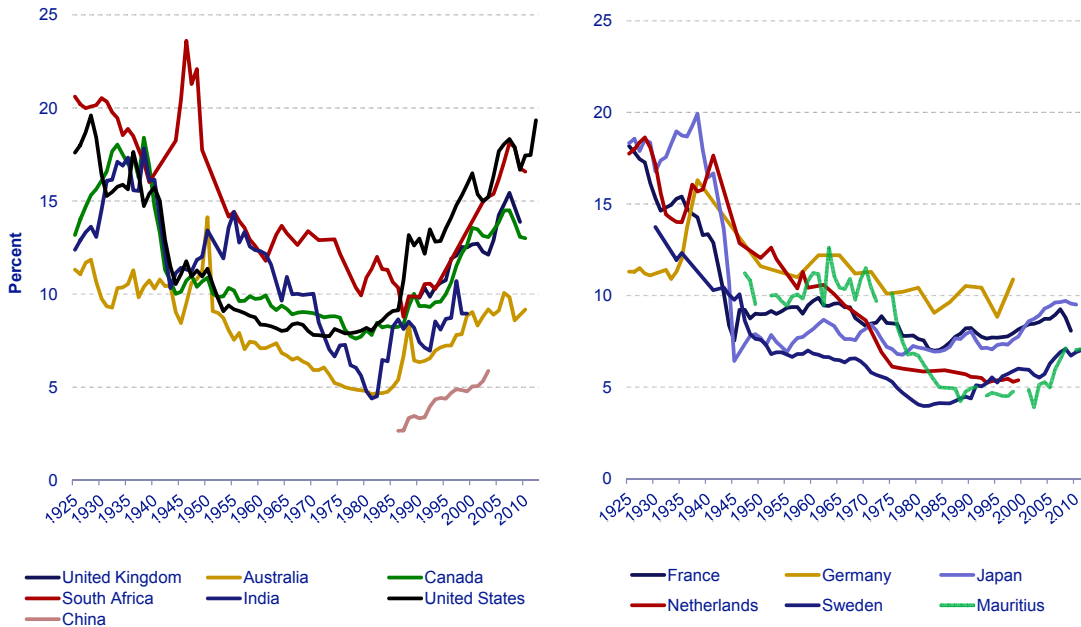


Countries included: BGD=Bangladesh; BTN=Bhutan; KHM=Cambodia; CHN=China; FJI=Fiji; IND=India; IDN=Indonesia; KIR=Kiribati; KOR=Korea, Republic of; LAO=Laos; MYS=Malaysia; MDV=Maldives; MHL=Marshall Islands; MNG=Mongolia; MMR=Myanmar; NPL=Nepal; PNG=Papua New Guinea; PHL=Philippines; WSM=Samoa; SLB=Solomen Islands; LKA=Sri Lanka; THA=Thailand; TON=Tonga; VUT=Vanuatu; VNM=Vietnam; PAK=Pakistan.

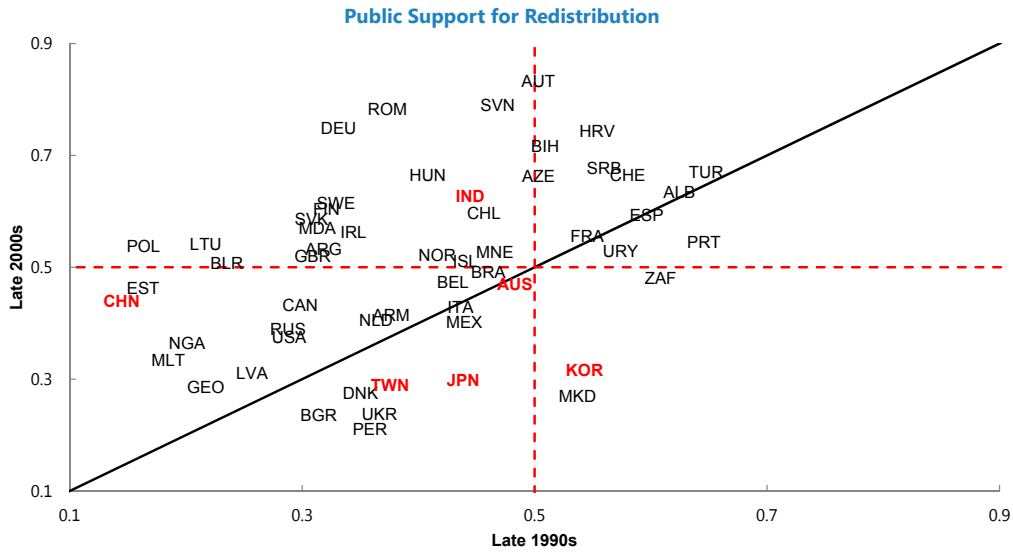
# More recently, the focus has been on the rising income share of top income earners



Gross Income Share of Top One-Percent in Selected Advanced and Developing Economies, 1925–2012

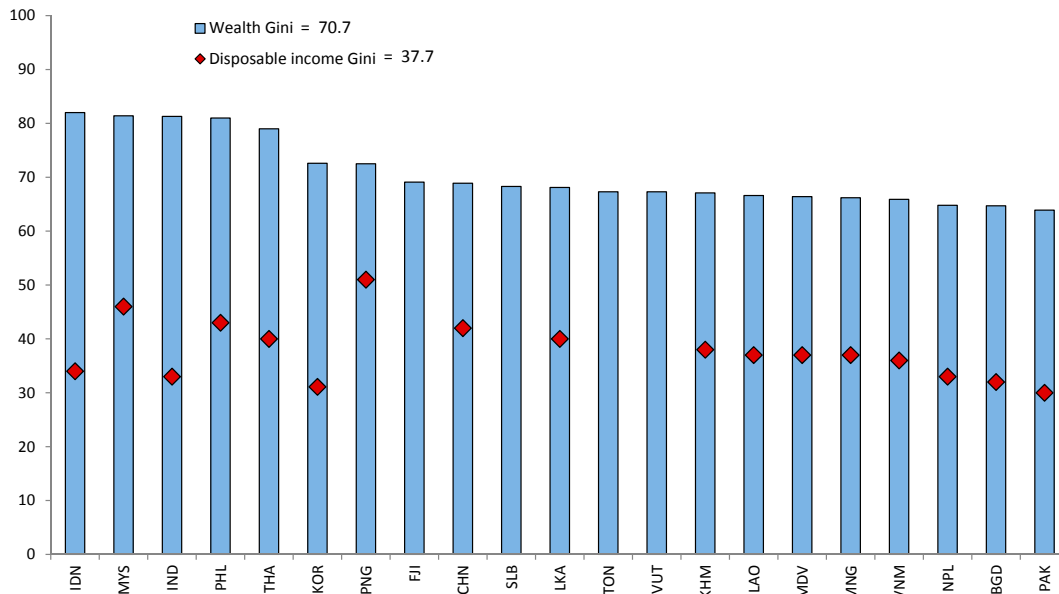


# Public support for redistribution has been rising



Source: Integrated Values Survey 1981-2008

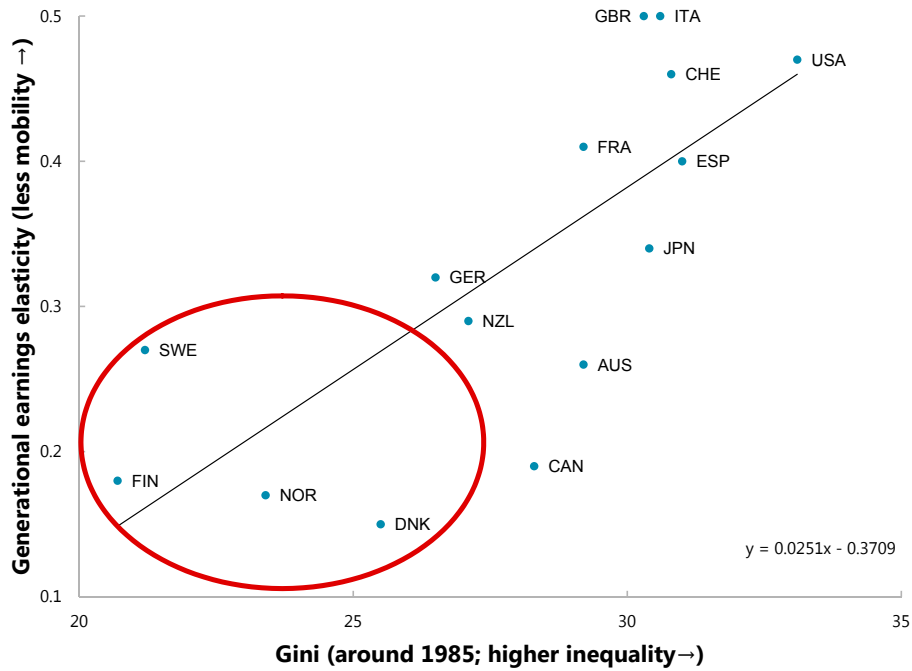
# Wealth is even more unequally distributed



Source: Disposable income Gini is taken from OECD; Luxembourg Income Study Database; Socio-Economic Database for Latin America and the Caribbean (SEDLAC); World Bank; Eurostat. Wealth Gini data comes from Credit Suisse Global Wealth Databook (2012).

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## *Intergenerational income mobility is higher in countries with low income inequality*



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## **II. Redistributive Role of Fiscal Policy**

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## Redistributive fiscal policy reduces inequality by one third in advanced economies, mostly through spending

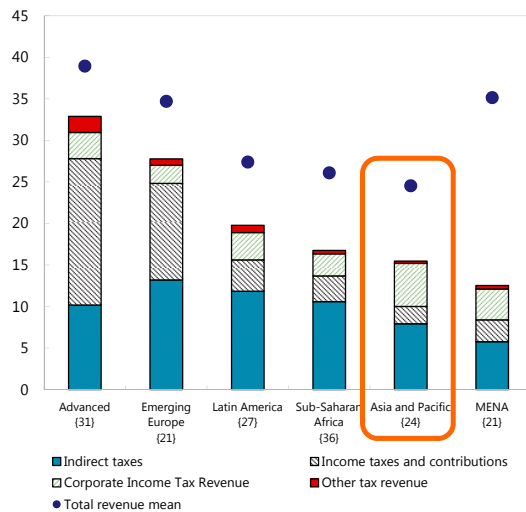
Countries included: AUS=Australia; AUT=Austria; BEL=Belgium; CAN=Canada; CZE=Czech Republic; DEU=Germany; DNK=Denmark; ESP=Spain; EST=Estonia; FIN=Finland; FRA=France; GBR=United Kingdom; GRC=Greece; ISR=Israel; IRL=Ireland; ITA=Italy; KOR=Korea; LUX=Luxembourg; NLD=Netherlands; SVN=Slovenia; SWE=Sweden; TWN=Taiwan Province of China; USA=United States.

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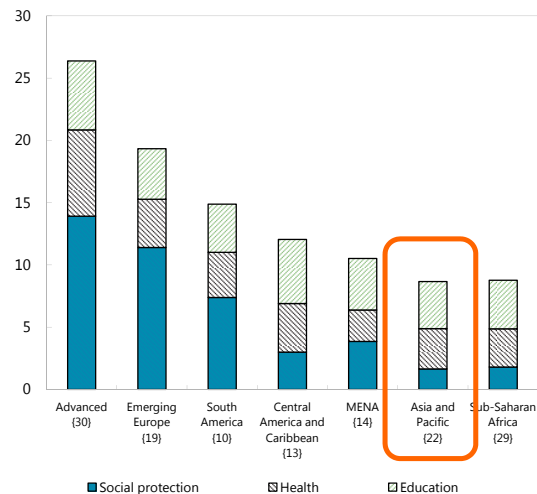


## Fiscal redistribution also low reflecting low revenues and social spending

Composition of revenues, 2010  
(Percent GDP)



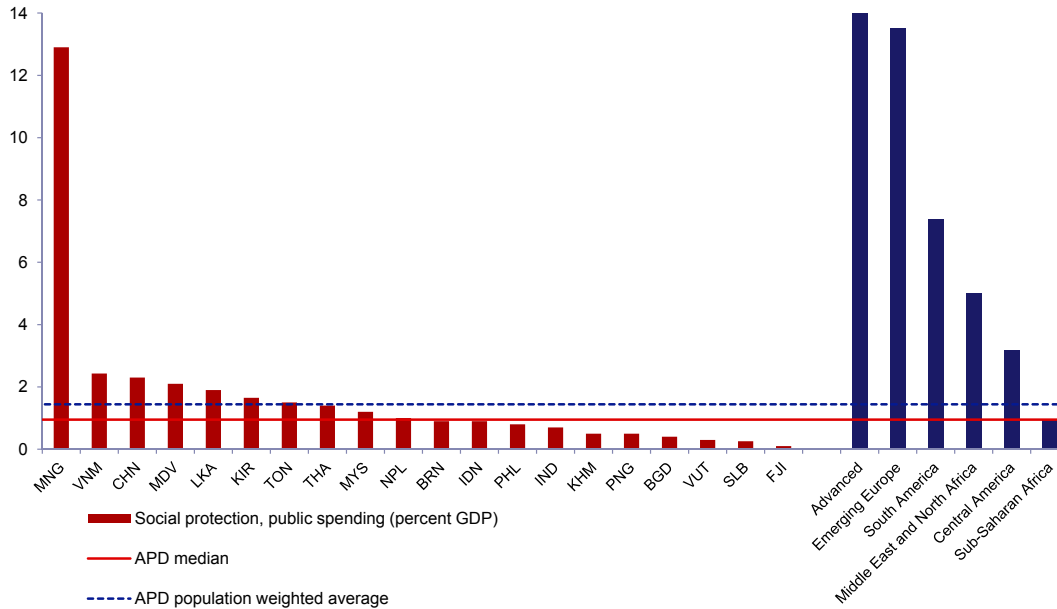
Composition of social spending, 2010  
(Percent GDP)



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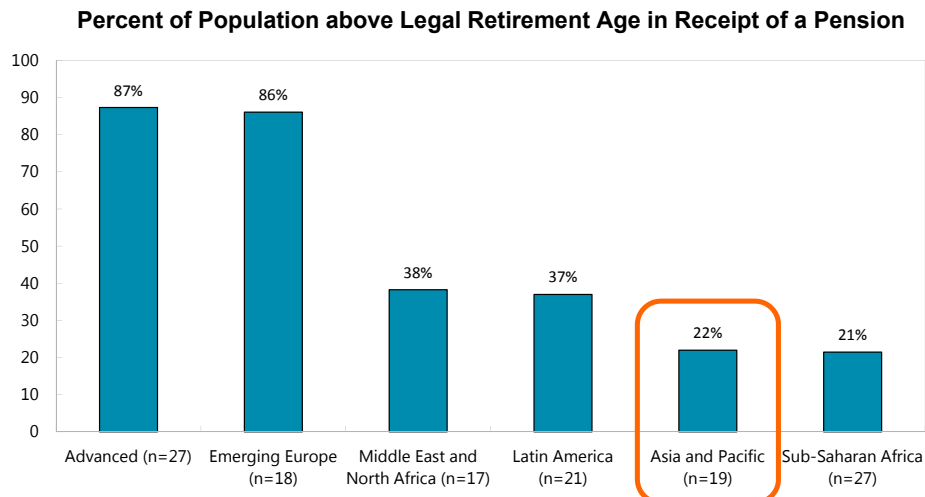
## Social protection spending also low in Asia



Countries included: BGD=Bangladesh; BTN=Bhutan; KHM=Cambodia; CHN=China; FJI=Fiji; IND=India; IDN=Indonesia; KIR=Kiribati; KOR=Korea, Republic of; LAO=Laos; MYS=Malaysia; MDV=Maldives; MHL=Marshall Islands; MNG=Mongolia; MMR=Myanmar; NPL=Nepal; PNG=Papua New Guinea; PHL=Philippines; WSM=Samoa; SLB=Soloman Islands; LKA=Sri Lanka; THA=Thailand; TON=Tonga; VUT=Vanuatu; VNM=Vietnam; PAK=Pakistan. 15



## .... and low spending reflected in low coverage of social insurance.....





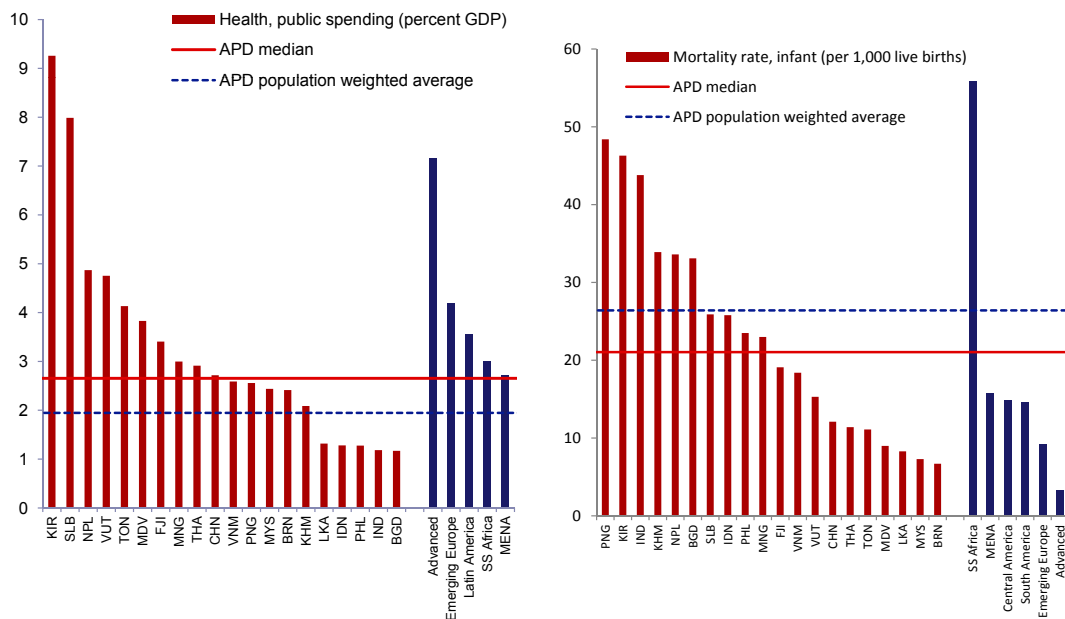


**.....especially among lower-income groups**

Social protection includes pensions and social assistance transfers

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**Health spending low and outcomes poor.....**

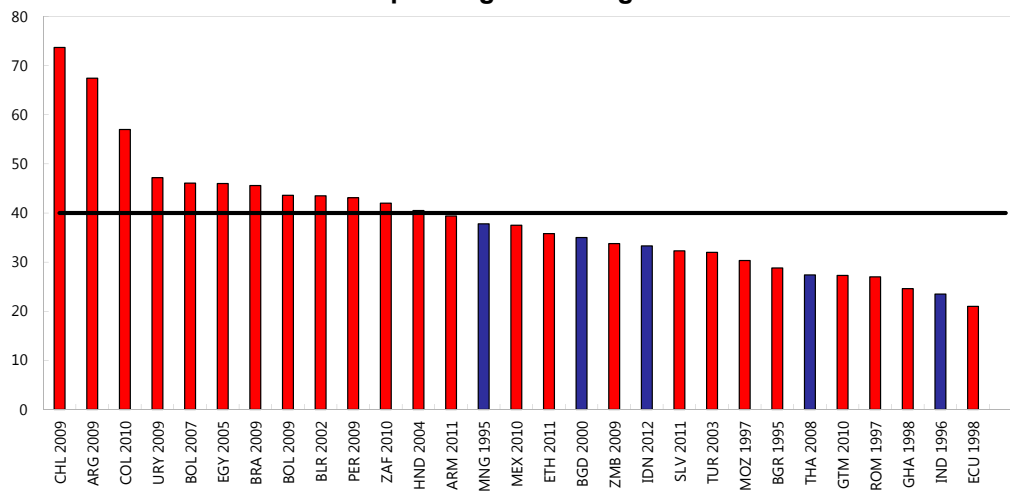


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# .....with gaps in health coverage among lower-income groups



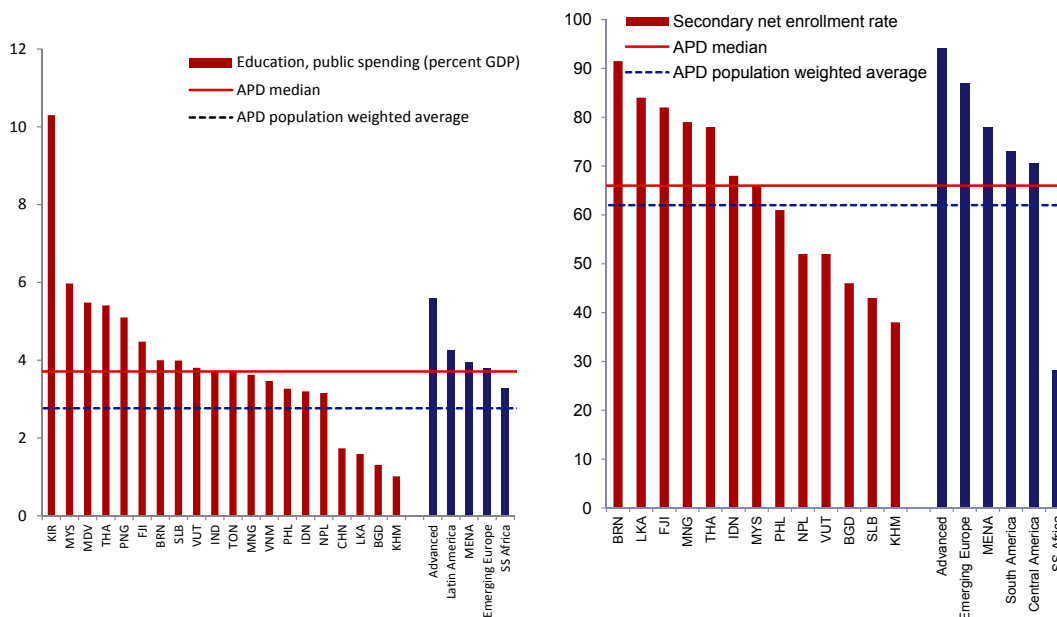
Shares of Health Spending Benefiting the Poorest 40%



Source: Lustig (2015); Davoodi, Tiongson, and Asawanuchit (2010); Lustig et. Al (2011); World Bank..

Countries included: ALB=Albania; ARG=Argentina; ARM=Armenia; AZE=Azerbaijan; BEN=Benin; BGD=Bangladesh; BIH=Bosnia and Herzegovina; BOL=Bolivia; BRA=Brazil; CHL=Chile; CIV=Cote d'Ivoire; COL=Colombia; CRI=Costa Rica; EGY=Egypt; ETH=Ethiopia; GTM=Guatemala; IDN=Indonesia; IND=India; KEN=Kenya; KHM=Cambodia; KSV=Kosovo; LBR=Liberia; LSO=Lesotho; MEX=Mexico; MOZ=Mozambique; NAM=Namibia; NPL=Nepal; PER=Peru; SLV=El Salvador; THA=Thailand; TUR=Turkey; UGA=Uganda; URY=Uruguay; UZB=Uzbekistan; ZAF=South Africa; ZMB=Zambia.

# Low education spending also leads to low education outcomes.....

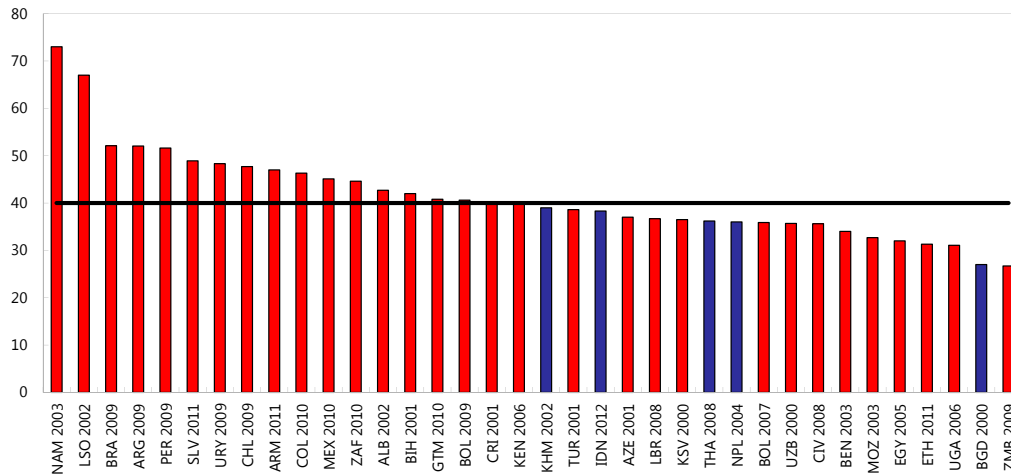


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# .....and gaps in coverage among lower-income groups



Shares of Education Spending and Market Income Benefitting the Poorest 40%



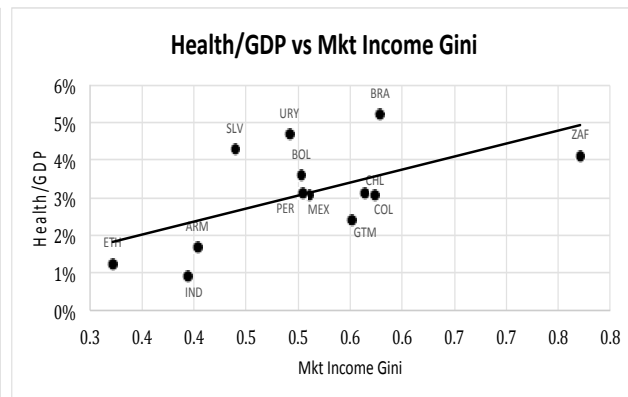
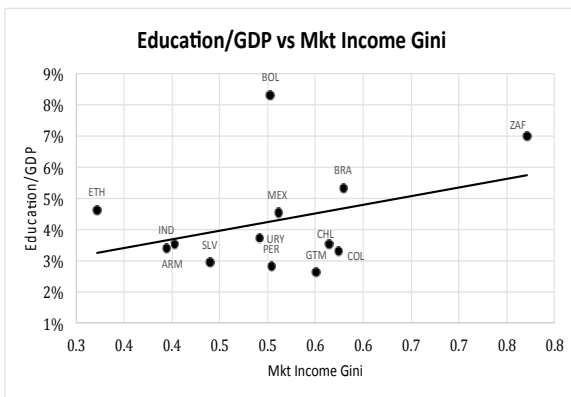
Source: Lustig (2015); Davoodi, Tiangson, and Asawanuchit (2010); Lustig et. Al (2011); World Bank..

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# ...and there is no "Robin Hood" paradox



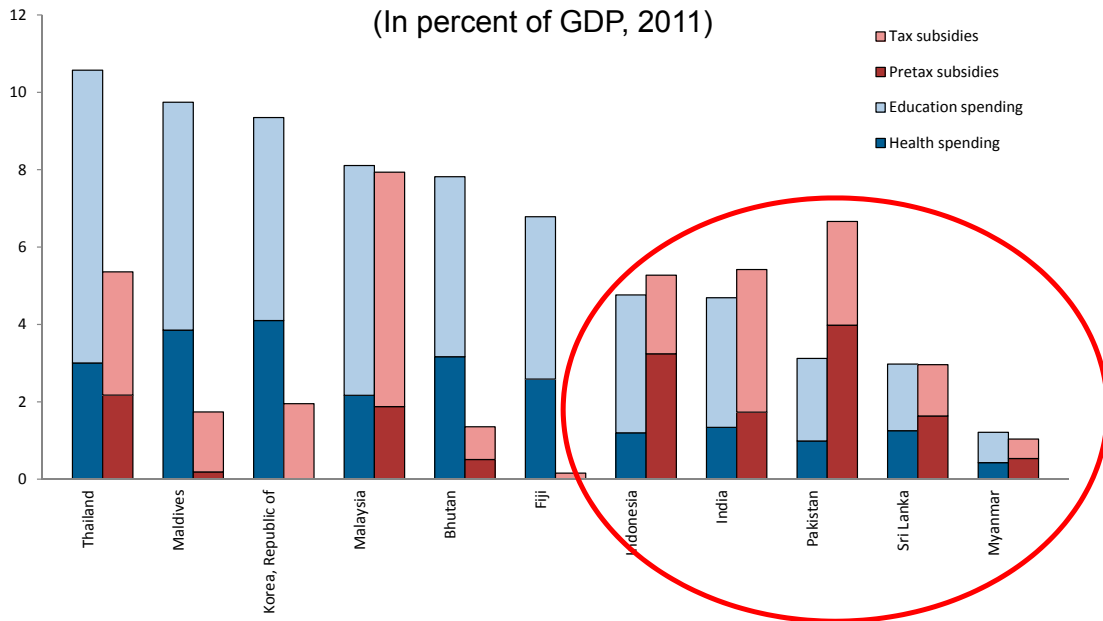
In Kind-Social Spending and Market Income Inequality, 2010



Source: Lustig (2015).

Countries included: ARM=Armenia; BOL=Bolivia; BRA=Brazil; CHL=Chile; COL=Colombia; ETH=Ethiopia; GTM=Guatemala; IND=India; MEX=Mexico; PER=Peru; SLV=El Salvador; URY=Uruguay; ZAF=South Africa.

## Energy subsidies are high and sometimes exceed social spending

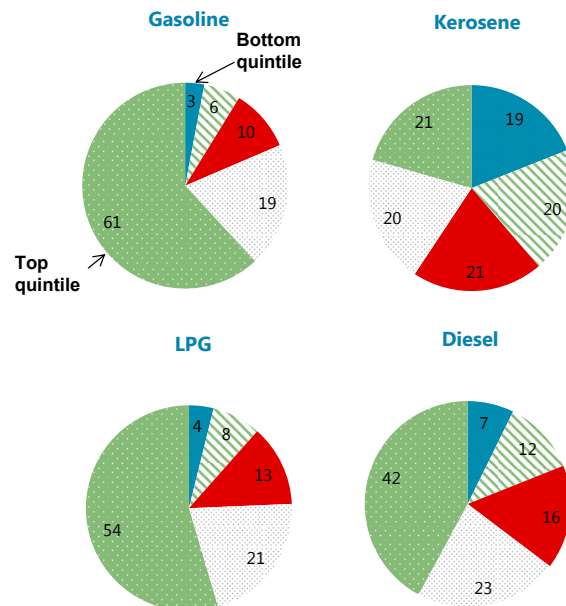


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## Most of the benefits from energy subsidies accrue to upper income households



Distribution of Petroleum Product Subsidies in Asian Countries by Income Groups  
(in percent of total product subsidies)



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### III. Designing Efficient Redistributive Fiscal Policy

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#### ***Designing efficient redistributive fiscal policy***

- Redistributive fiscal policy should be consistent with macroeconomic objectives
- The impact of tax and spending policies should be evaluated jointly
- Tax and expenditure policies need to be carefully designed to balance distributional and efficiency objectives
- Design should take into account administrative capacity

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## ***Reform options to achieve more efficient redistribution of social spending***

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### **Social transfers**

Expand conditional cash transfer (CCT) programs as administrative capacity improves (e.g., programs exist in Bangladesh, Cambodia, India, Indonesia, Nepal and Philippines)

Expand noncontributory social pensions – as means-tested (e.g. Bangladesh, Korea, Malaysia, Nepal, Viet Nam), pensions-tested (e.g. Fiji, Thailand) or a universal cash transfer (e.g. Brunei, PNG, Timor)

Remove general price subsidies and better target social transfers (e.g., Indonesia) by addressing:

- Fragmentation and duplication—reduce number of programs (Vietnam)
- Low coverage and benefits—expand coverage with savings from targeting
- Reliance on costly in-kind benefits—use cash benefit (China, India)

Expand public works programs (e.g., Bangladesh, India)

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## ***Reform options to achieve more efficient redistribution of social spending***

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### **Health**

Expand coverage of publicly financed basic health package and health insurance (China, Vietnam)

Reduce or eliminate user charges for low-income households (e.g., Indonesia)

Address supply-side barriers in less developed areas (e.g. Bangladesh, Laos, Vietnam)

Improve efficiency of health spending

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## ***Reform options to achieve more efficient redistribution of social spending***

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### **Education**

Improve access of low-income families to education by:

- increasing investment in lower levels of education (Philippines)
- focusing on access and progression to primary and lower-secondary education (e.g. Bhutan, Cambodia, Iran, Lao, Mongolia)
- expanding coverage for girls and students in rural areas (e.g. Bangladesh, India)

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## ***Reform options to achieve more efficient redistribution of taxation***

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### **Personal income taxation**

Implement progressive Personal Income Tax (PIT) rate structures (e.g. Korea, Thailand, Viet Nam)

Expand coverage of the PIT

Reconsider income tax exemptions, based on a critical tax-expenditure review (e.g., India, Indonesia, China)

Impose a reasonable PIT exemption threshold

### **Capital income taxation**

Develop more effective taxation of multinationals (e.g. China, India, Japan)

Exchange information internationally

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## ***Reform options to achieve more efficient redistribution of taxation***

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### **Property taxation**

Utilize better the opportunities for recurrent property taxes (e.g. Hong Kong, Singapore, Viet Nam)

- Improve administrative infrastructure

### **Consumption taxation**

Minimize VAT exemptions and special VAT rates

Set a sufficiently high VAT registration threshold (e.g. Indonesia, Singapore, Viet Nam)

Use specific excises mainly for purposes other than redistribution

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**Thank you!**