

Taxes, Social Transfers, and Inequality in Asia



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Key Questions



- **Why care about income inequality?**
- **What is the role of fiscal policy in income distribution?**
- **How do Asian tax systems compare with other regions in terms of redistribution?**
- **What can we do to improve the situation in Asia for better income distribution?**

Why care about income inequality?



- **Income distribution is an integral part of socio-economic policy**
 - Social justice as an ethical imperative
 - Essential element for social cohesion
 - Equity to enhance efficiency and promote economic growth
 - Need to reduce negative impacts on health, education, future growth
 - Income inequality as a political burden
- **Inequality can be addressed through a combination of taxation, social transfers and social expenditure**
- **Yet, whether and to what extent taxation should be used for active redistribution remains under debates**

Poverty and Income Inequality in Asia



Key development indicators by region, 2000–2010

Region	Headcount Index		GDP per capita, PPP (constant 2005 international \$)	Income share held by highest 20%	Income share held by lowest 20%	GINI Index
	Poverty headcount ratio at \$1.25 a day (PPP) (% of population)	Poverty headcount ratio at \$2 a day (PPP) (% of population)				
Developing Asia	27.00	53.90	3,060.90	45.98	7.00	38.46
East Asia and Pacific	16.78	38.70	4,200.00	48.33	6.27	41.43
South Asia	40.34	73.93	2,222.73	47.53	7.03	39.93
Central and West Asia	19.20	40.20	3,551.50	41.93	7.06	30.27
Europe and Central Asia	3.67	8.83	9,611.53	41.73	7.56	33.68
Latin America & Caribbean	8.12	17.17	8,824.01	54.17	7.85	51.04
Middle East and North Africa	3.64	17.16	5,707.66	40.45	7.37	37.12
Sub-Saharan Africa	50.91	72.87	1,789.97	51.07	5.63	44.71
OECD	-	-	29,478.61	42.25	7.37	34.52
World	25.20	47.00	8,989.50	47.79	6.13	40.88

Note: Values for the following represent the average of the latest available data for all countries in each country group: income shares held by highest and lowest 20% of the population and GINI index.

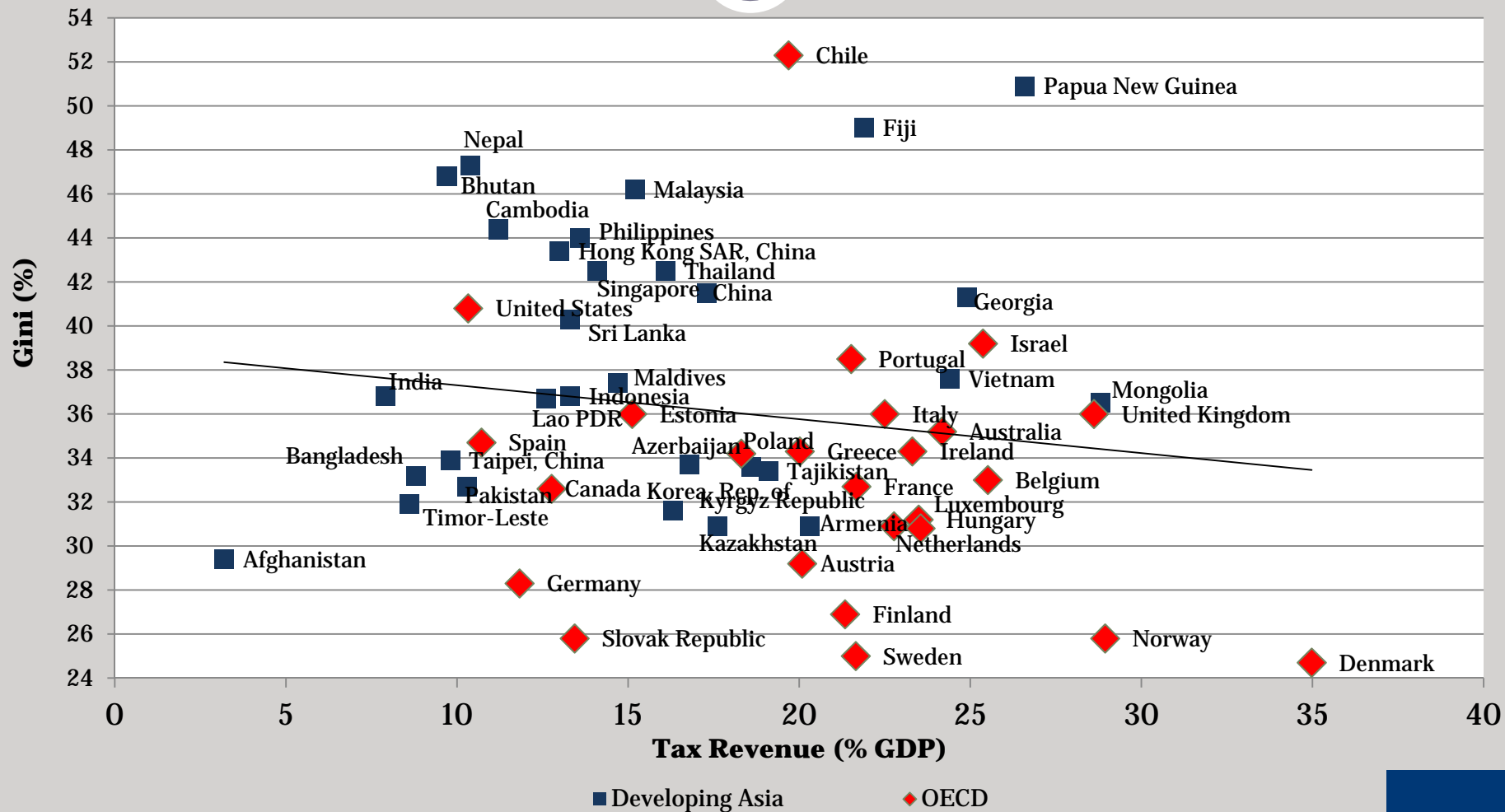
Source: World Development Indicators Database, World Bank

The Role of Fiscal Policy

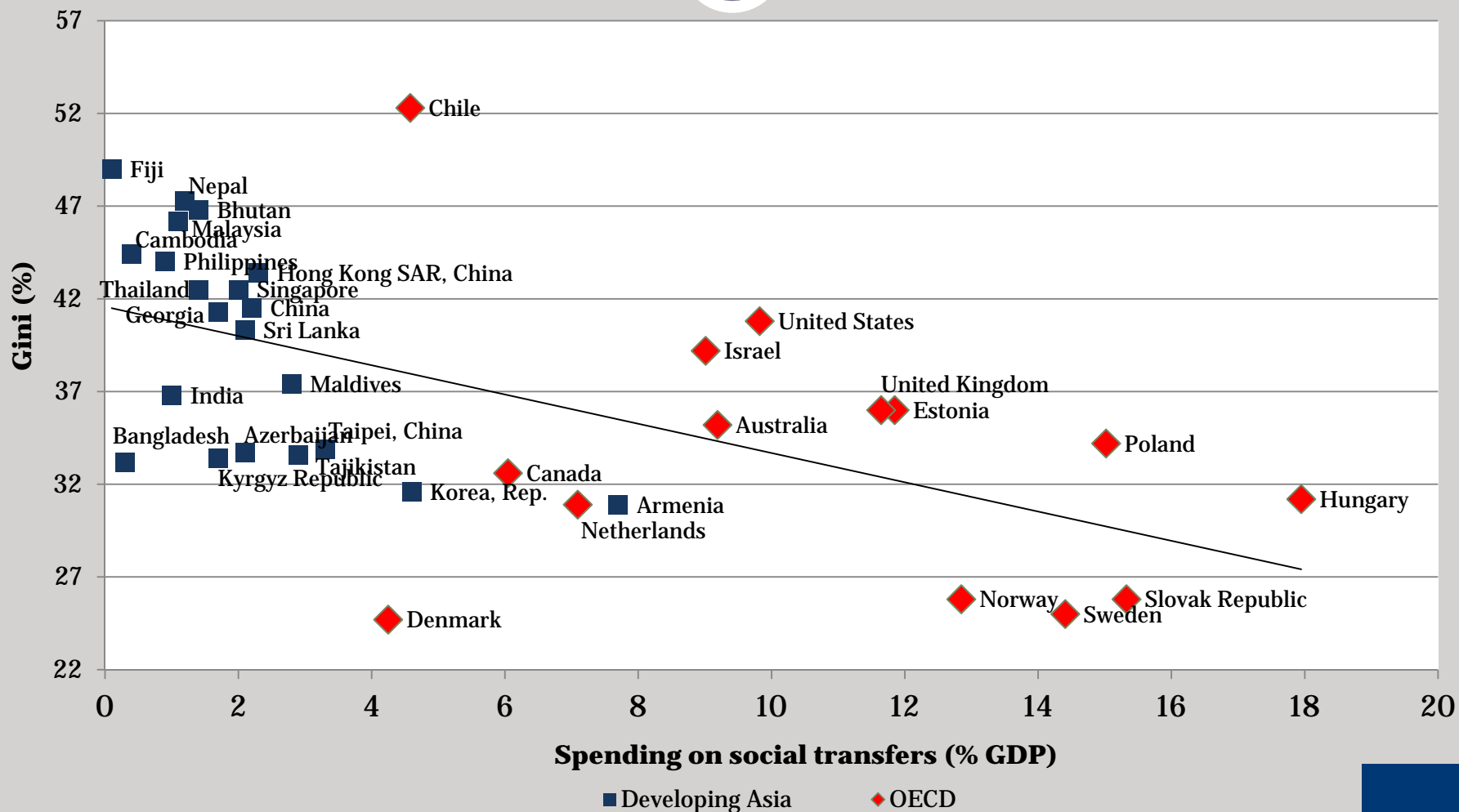


- **Primary purpose of taxes is to raise revenue for public spending, but also important is the role of:**
 - Providing incentives for certain activities
 - Correcting market failures
 - Redistributing income and helping reduce inequality
- **Taxes and social transfers can have an immediate effect on income distribution, while social expenditure on education, health, and infrastructure investment tends to have a more long-term impact**
- **Using tax instruments to reduce income inequality should consider possible impact on economic growth and employment; limit distortions on incentives to work, invest and create wealth**

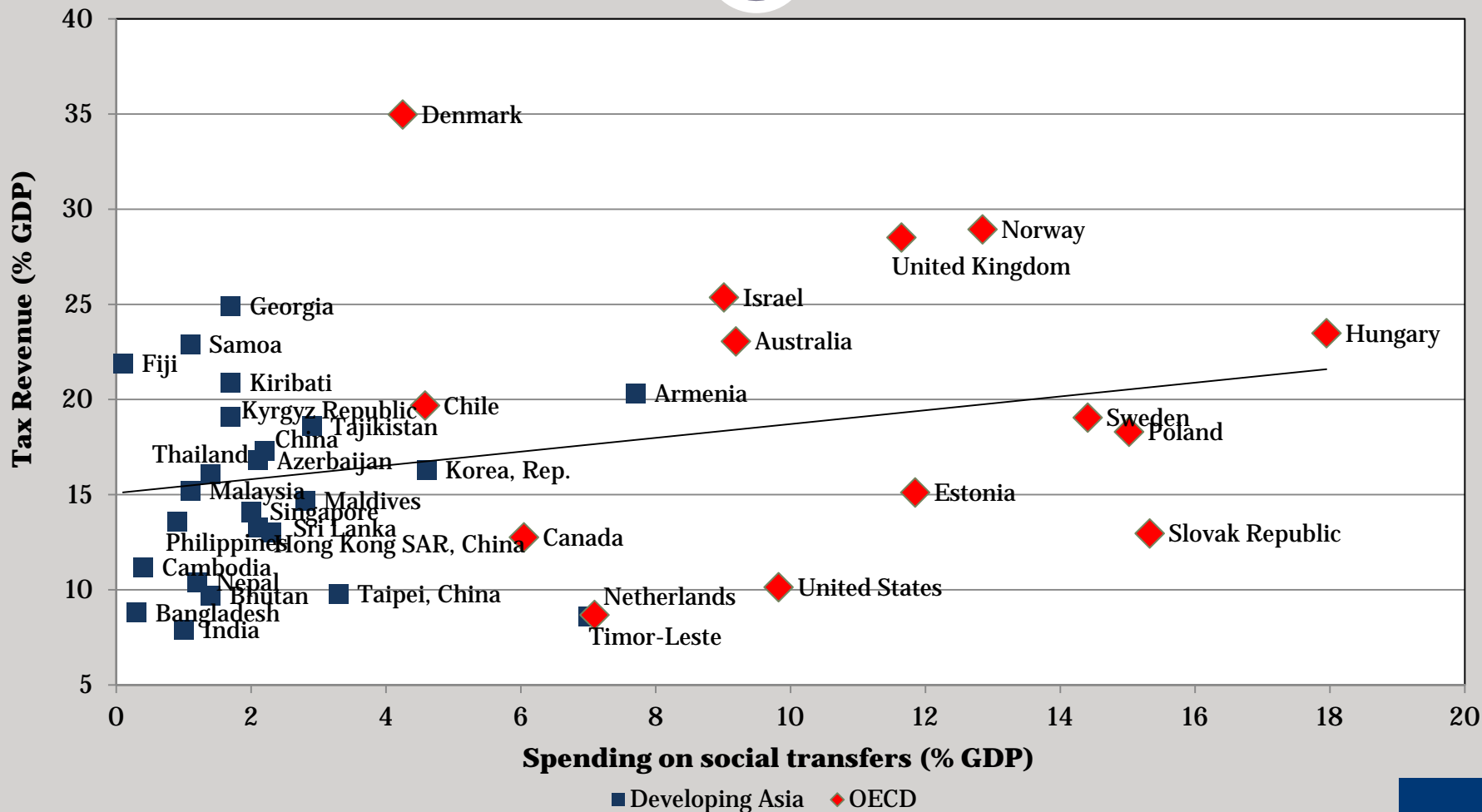
Tax revenues and income inequality



Social Transfers and Income Inequality



Social Transfers and Tax Revenues



Asian Tax Systems

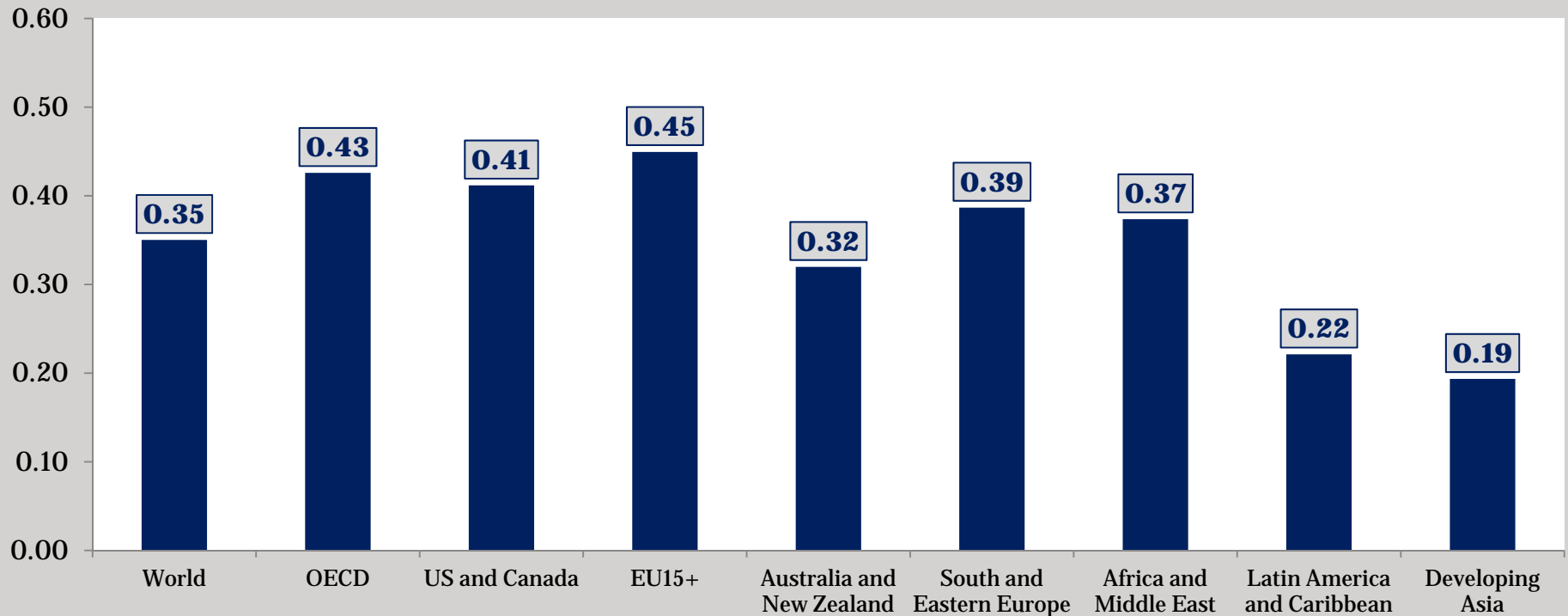


- **Low tax revenues: lowest tax burdens in the world**
- **Tax composition: higher share of indirect taxes**
 - Small tax base
 - Inefficiency of tax collection
 - High tax evasion
 - large informal sector
- **Weak personal income tax/property tax**
- **Limited social security contributions**
- **Inefficient tax system and administration**

Asia has the lowest tax burdens...



Total Revenue to GDP by Region, Average 1990-2008



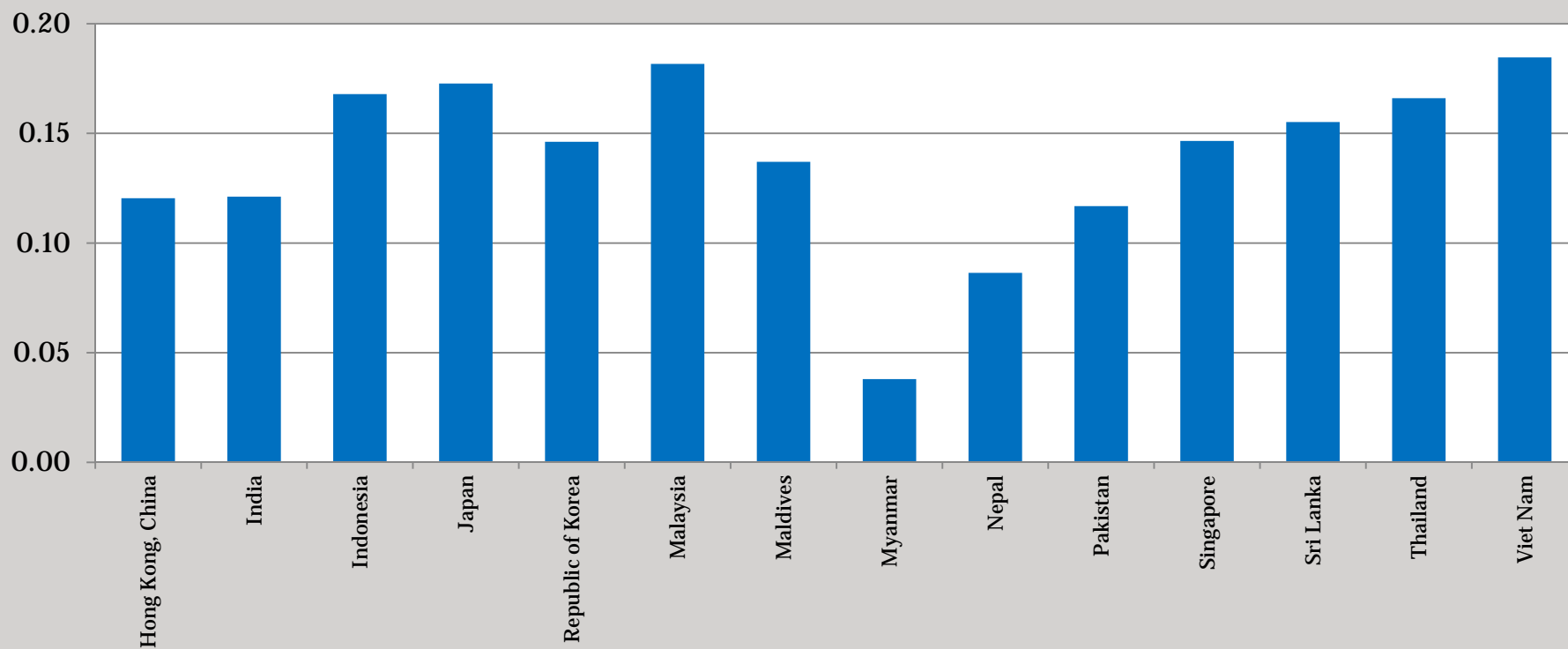
Source: IMF Government Finance Statistics Database

Data at the consolidated general government level.

...with albeit wide variation across the region



Total Taxes to GDP Ratio in Selected Asian Countries, Average 1990-2010

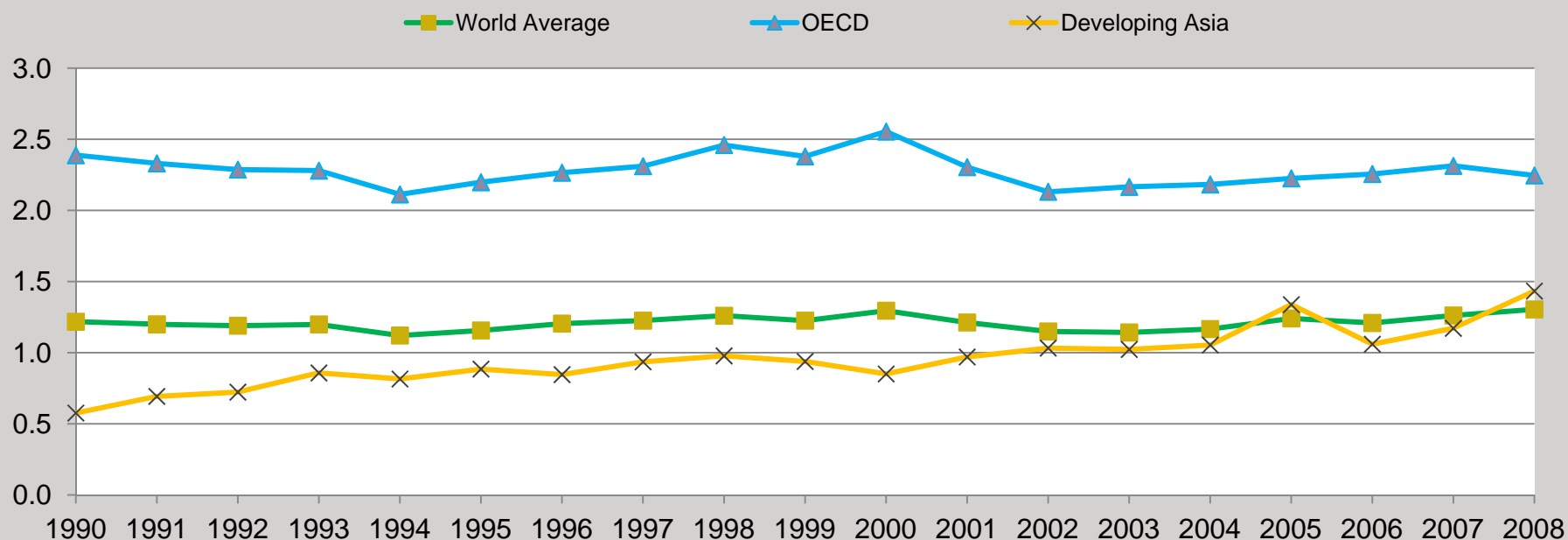


Source: IMF Government Finance Statistics Database

Note: Due to unavailability of data, data for different countries from different government sectors and methodology: Hong Kong, China (Accrual; General Govt - 2002-2008); India (Cash; General Govt - 1999-2006, Central Govt - 1990-1998 and 2007-2008); Indonesia (Cash; Budgetary Central Govt, 1991-2009); Japan (Accrual; General Govt - 2001-2008); Korea, Republic of (Cash; Central Govt - 1990-2008); Malaysia (Cash; Central Govt - 1990-2003); Maldives (Cash; General Govt - 1990-2008); Myanmar (Cash; Central Govt - 1990-2005); Nepal (Cash; Central Govt - 1990-2009); Pakistan (Cash; Central Govt - 1990-2007); Singapore (Cash; Central Govt - 1990-2009); Sri Lanka (Cash; Budgetary Central Govt - 1990-2008); Thailand (Cash; General Govt - 1995-2002)(Accrual; General Govt - 2003-2009)

Direct to indirect tax ratio in Asia below that of the OECD

Direct to Indirect Tax Ratio, 1990-2008



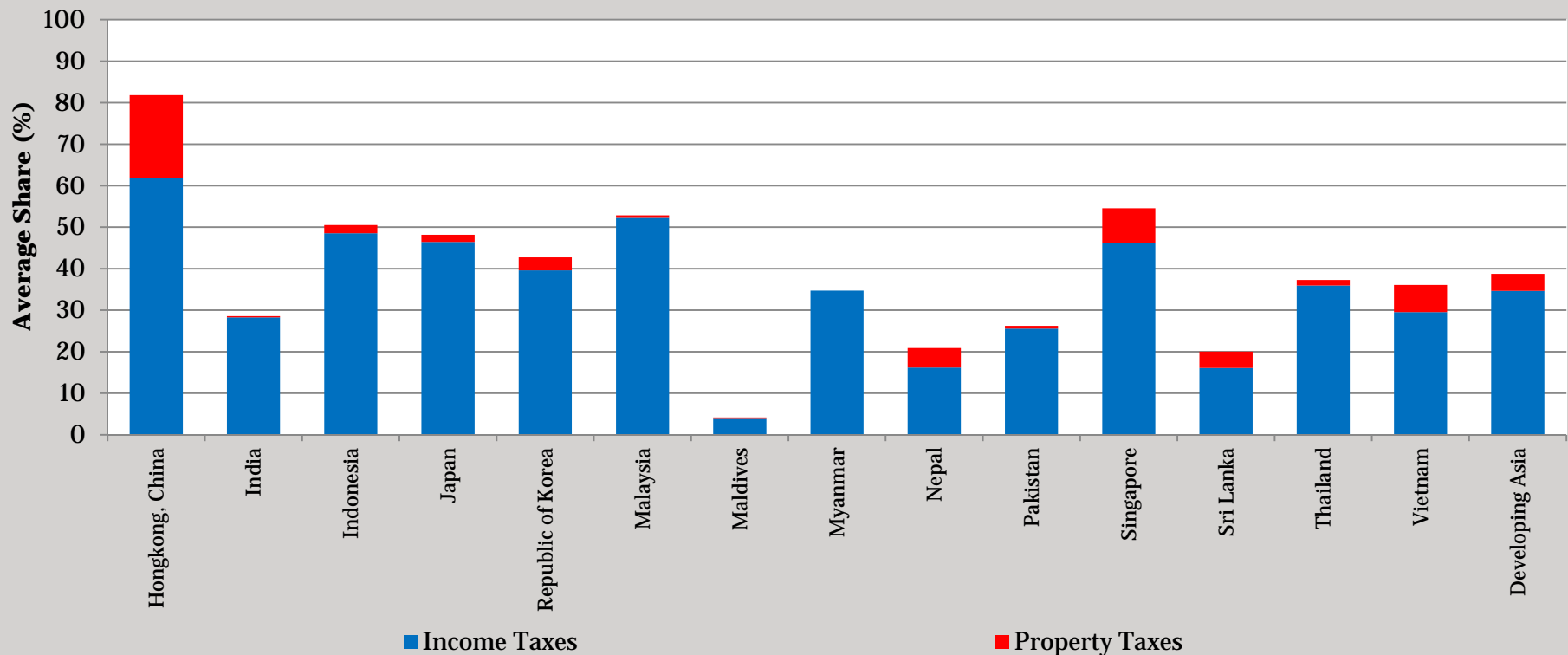
Direct tax is the sum of Taxes on Income, Profit and Capital Gains; Social Security Contributions; Taxes Paid on Payroll and Workforce; and Taxes on Property. Indirect tax is the sum of General Taxes on Goods and Services; and Other Taxes. The computation of indirect tax followed the indirect tax template found in the OECD Revenue Statistics 2011. Developing Asia refers to ADB DMCs in East (ex-PRC), South and Southeast Asia. PRC figures were excluded due to the absence of indirect tax data from 1995 to 2001. The following hierarchy was applied in using available data: consolidated general government data (accrual; cash); consolidated central government (accrual; cash); budgetary central government data (accrual; cash); extrabudgetary central government data (accrual; cash); state/regional data; and local government data (accrual; cash).

Source: IMF Government Finance Statistics Database available in CD-ROM and IMF e-Library.; and OECD Revenue Statistics 2011.

...with lower use of PIT



Tax Structure in Selected Asian Economies: Share of Total Taxes, Average 1990-2010



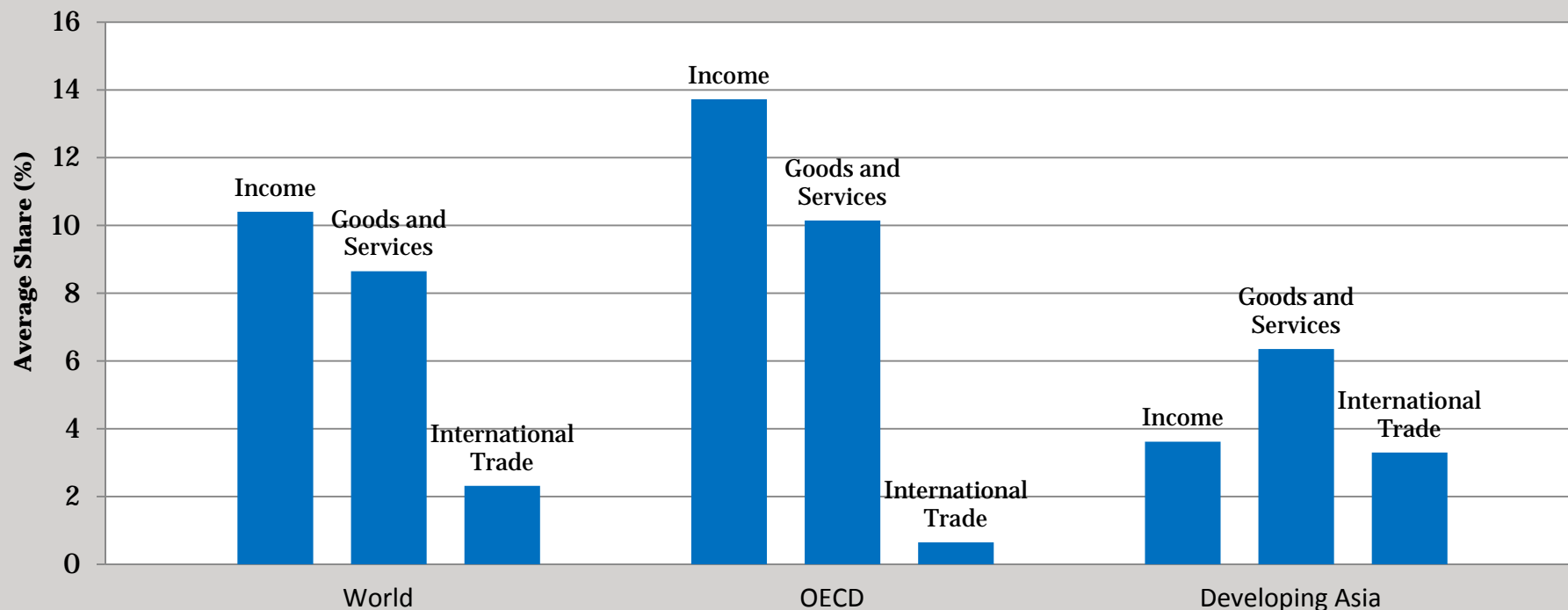
Source: IMF Government Finance Statistics Database

Note: Due to unavailability of data, data for different countries from different government sectors and methodology: Hong Kong, China (Accrual; General Govt - 2002-2008); India (Cash; General Govt - 1999-2006, Central Govt - 1990-1998 and 2007-2008); Indonesia (Cash; Budgetary Central Govt, 1991-2009); Japan (Accrual; General Govt - 2001-2008); Korea, Republic of (Cash; Central Govt - 1990-2008); Malaysia (Cash; Central Govt - 1990-2003); Maldives (Cash; General Govt - 1990-2008); Myanmar (Cash; Central Govt - 1990-2005); Nepal (Cash; Central Govt - 1990-2009); Pakistan (Cash; Central Govt - 1990-2007); Singapore (Cash; Central Govt - 1990-2009); Sri Lanka (Cash; Budgetary Central Govt - 1990-2008); Thailand (Cash; General Govt - 1995-2002)(Accrual; General Govt - 2003-2009)

Increased role of taxes on goods and services



Evolution of Selected Tax Instruments as Share in GDP: World Average, OECD and Developing Asia, Average 1991-2008



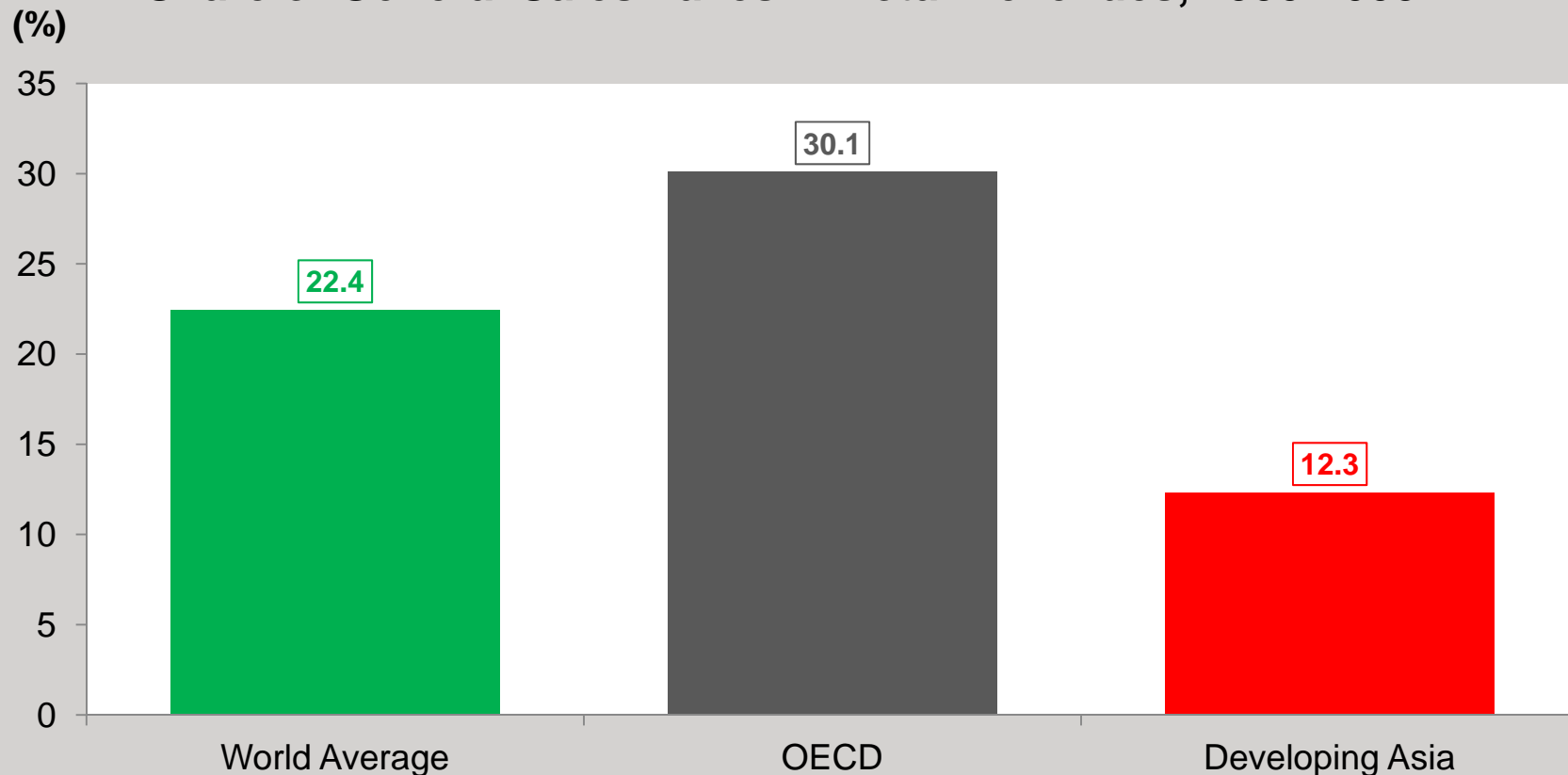
Source: IMF Government Finance Statistics Database

Data at the consolidated general government level.

However, VAT and excise remain small in terms of total revenues



Share of General Sales Taxes in Total Revenues, 1990-2008



General sales tax refers to general taxes on goods and services (with IMF GFS code 1141) and is equal to the sum of value added taxes, sales taxes and other general taxes on goods and services. Total revenues refer to values with IMF GFS code 1. Developing Asia refers to ADB developing member countries in East, South and Southeast Asia. The following hierarchy was applied in using available country data: consolidated general government data (accrual; cash); consolidated central government (accrual; cash); budgetary central government data (accrual; cash); extrabudgetary central government data (accrual; cash); state/regional data; and local government data (accrual; cash).

Source: IMF Government Finance Statistics Database available in CD-ROM and IMF e-Library.; and OECD Revenue Statistics 2011.

Considerations for tax reforms (1)



- **Inequality concerns play a limited role in the region's tax reforms**
- **Lower taxes may constrain infrastructure investments to suboptimal levels and retard industrial development**
 - Broaden tax bases
 - Increase tax rates
 - Widen the role of VAT: Adoption of VAT has been relatively new and generally low in the region

Considerations for tax reforms (2)



- The recent trend in the tax system (increasing use of indirect taxes and declining tax rates on high income groups) tends to make the tax system regressive
- Poor tax administration is a paramount constraint to using tax policy in income redistribution
 - Failure to tax capital gains
 - Establish a property tax
 - Inability to include the informal sector

Implications for developing Asia



- **Income redistribution better addressed by the expenditure side of the budget**
- **Social transfers to be better targeted to low income**
- **Further efforts to increase the progressivity of the tax system**
- **Improvement of tax system and administration is essential for effective taxation**
 - Modernize tax administration
 - Devise tax systems that could work with bad tax administration

Thank You



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