

# Addressing Inequalities and Challenges to Social Inclusion through Fiscal Policy

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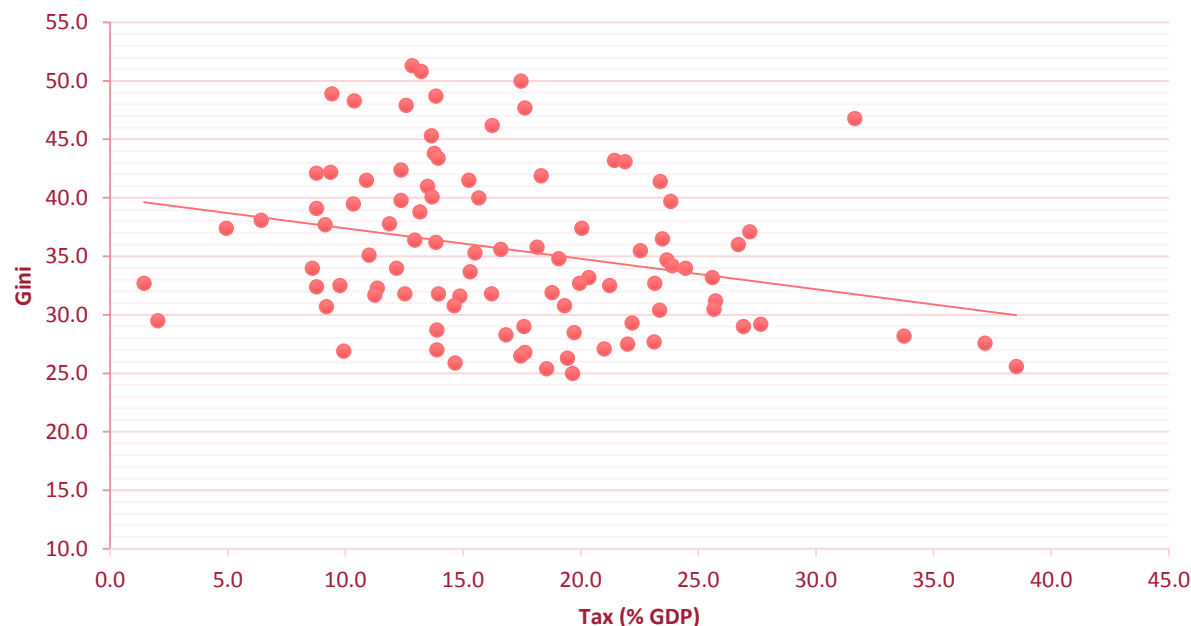
# Outline

- Fiscal policy and inequality – key stylized facts
- Trends in fiscal instruments
- Impacts on inequality
- A framework for redistributive fiscal policy
- Concluding remarks – role of macroeconomic policy

# Fiscal policy and inequality - Stylized facts

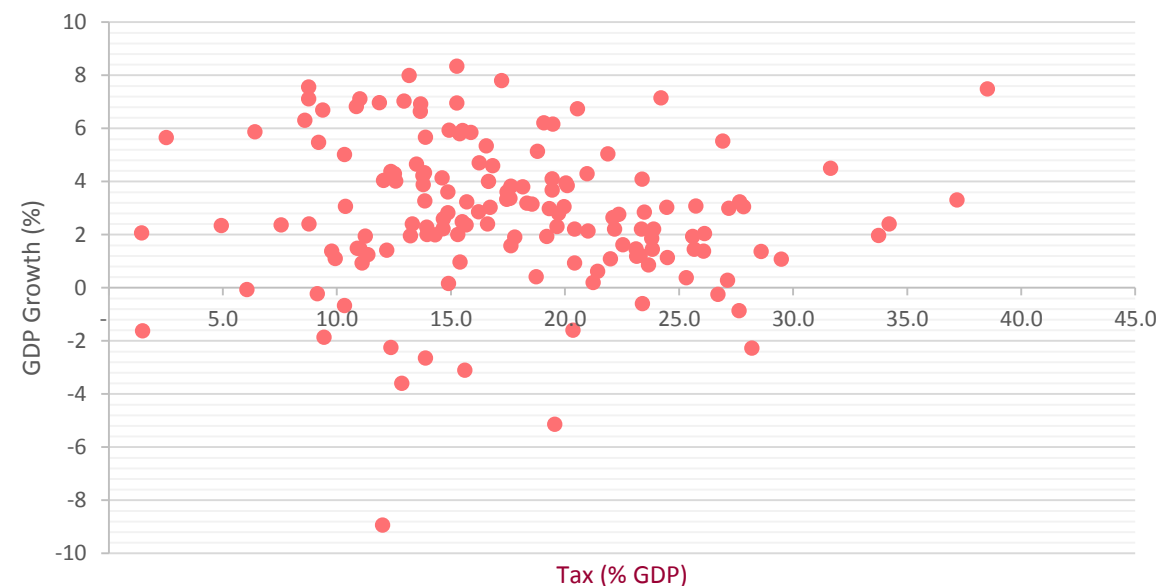
## Tax & Inequality

(WDI, 2016 or latest available)



## Tax & GDP growth

(WDI, 2016 or latest available data)



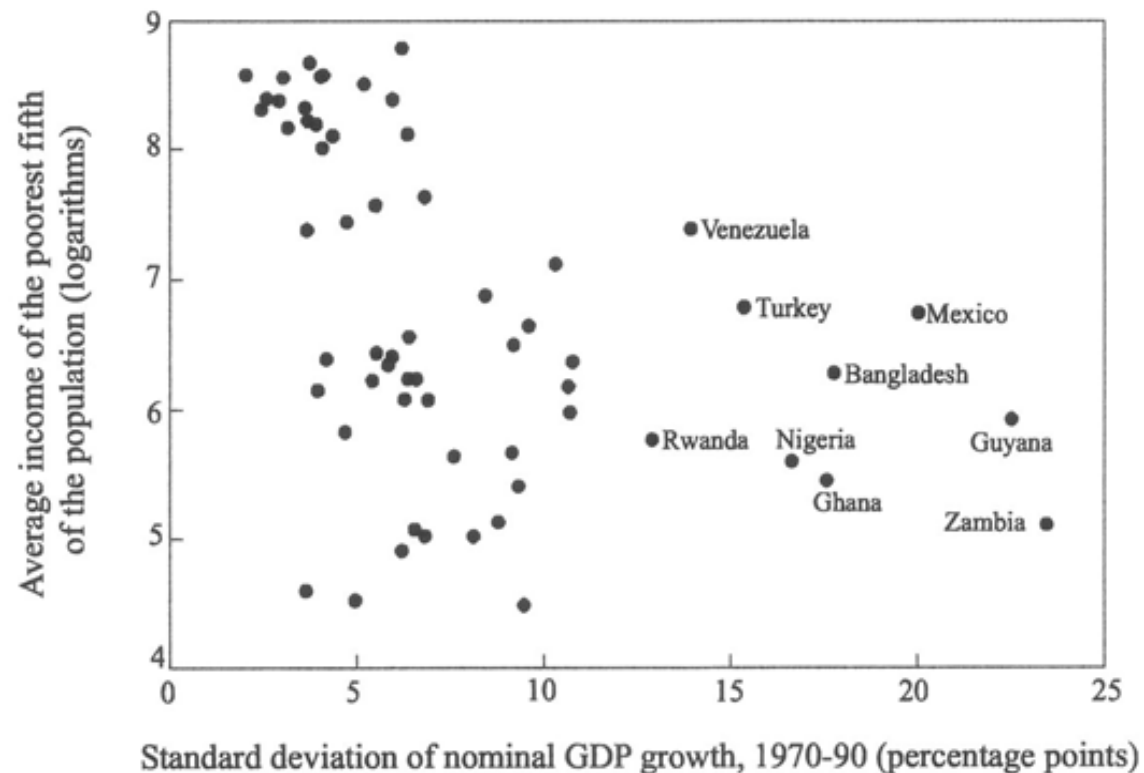
- Higher the tax-GDP ratio, lower is inequality
- Weak and statistically insignificant negative association between tax-GDP ratio and economic growth
- Therefore, higher tax efforts may not harm growth, casting doubts about 'optimal taxation' theory, but may reduce inequality

# Fiscal policy and inequality - Stylized facts

**Gini and Education spending**  
(WDI, 2016 or latest available data)

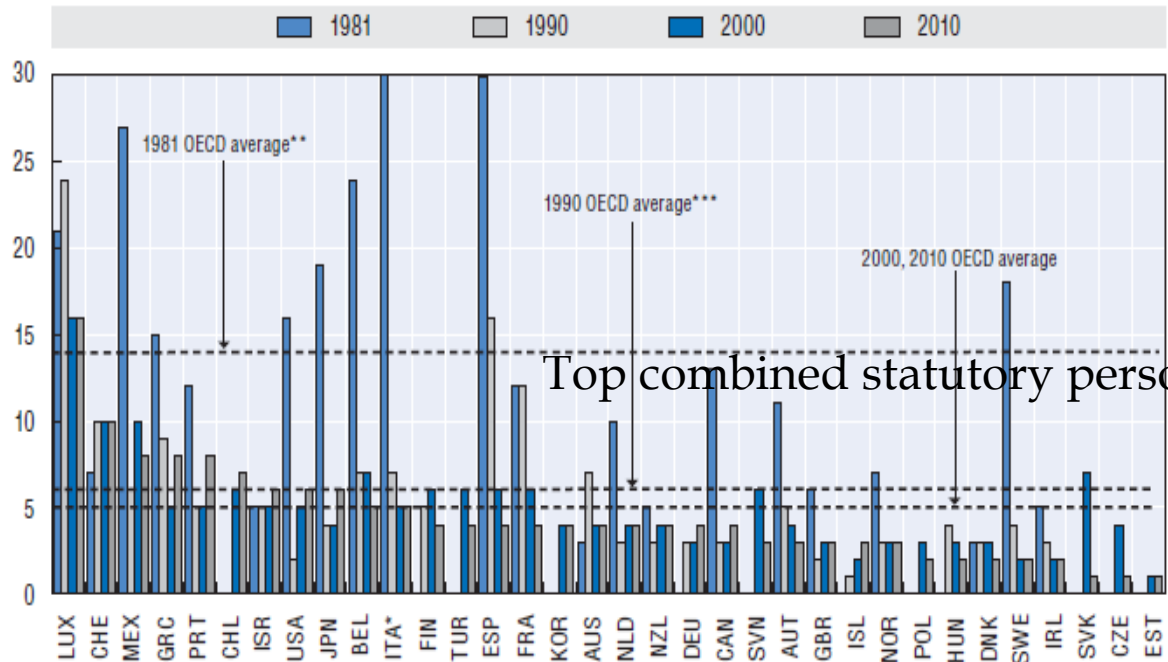


Higher education/social spending,  
lower inequality

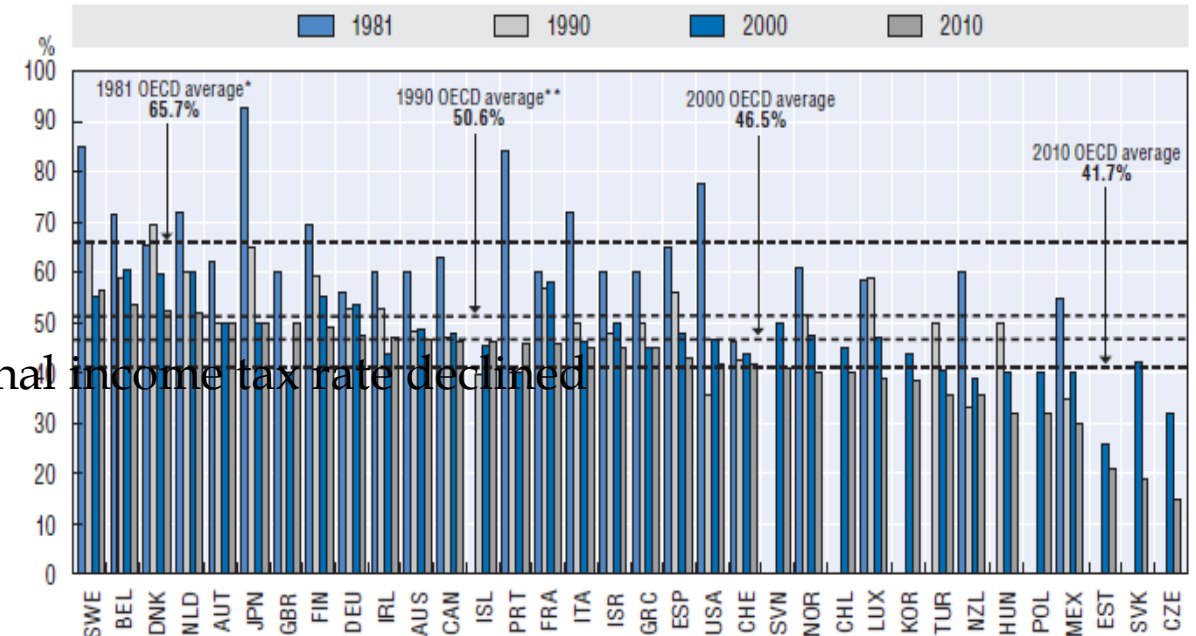


Counter cyclical fiscal policy,  
lower inequality

# Trends in fiscal instruments - tax system less progressive

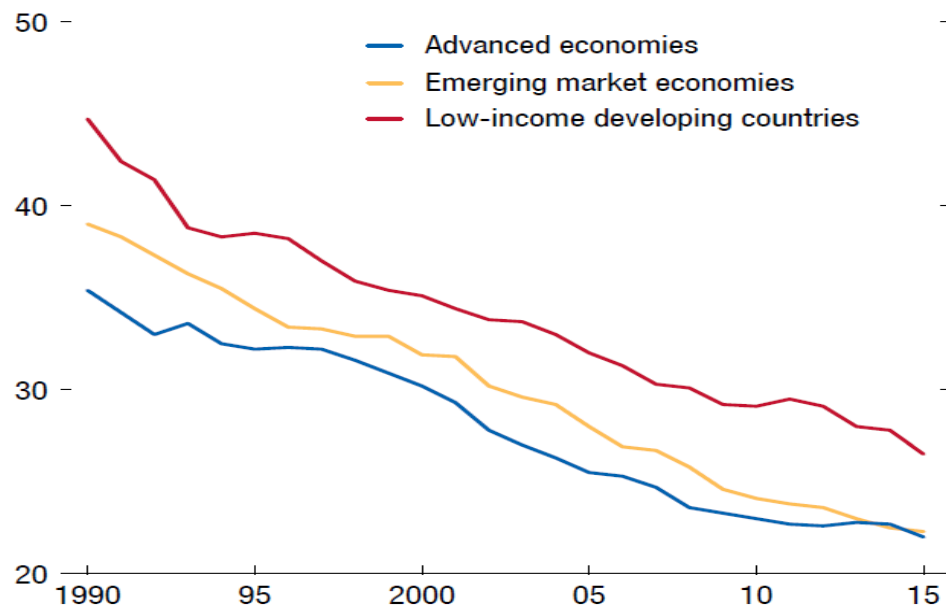


Number of central personal income tax brackets declined in OECD from 14 in 1981 to 5 in 2010

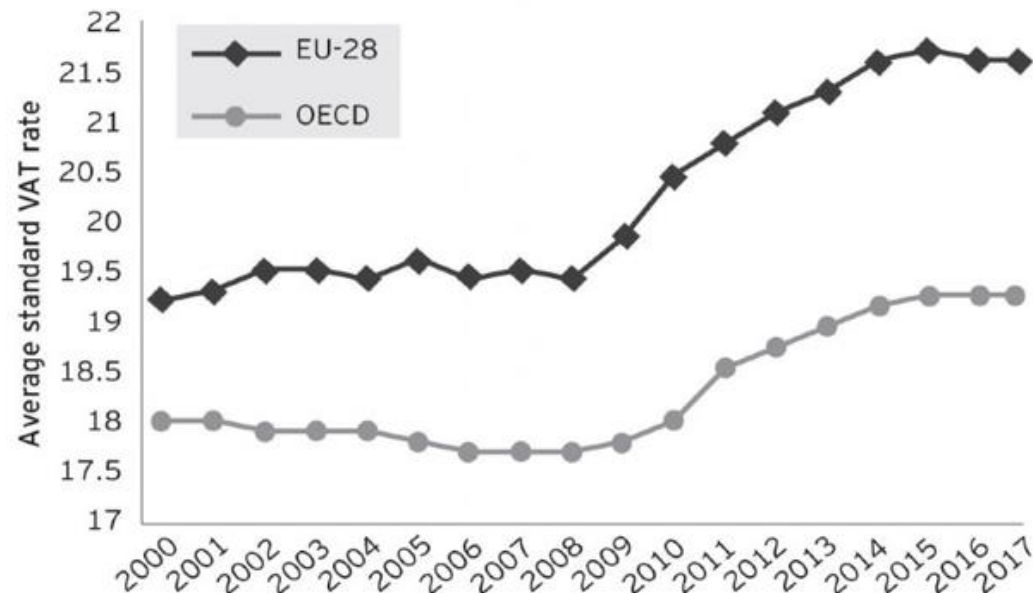


Top combined statutory personal income tax rates declined in OECD from 65.7% in 1981 to 41.7% in 2010

# Trends in fiscal instruments



Corporate tax rate declined in all countries – a race to the bottom



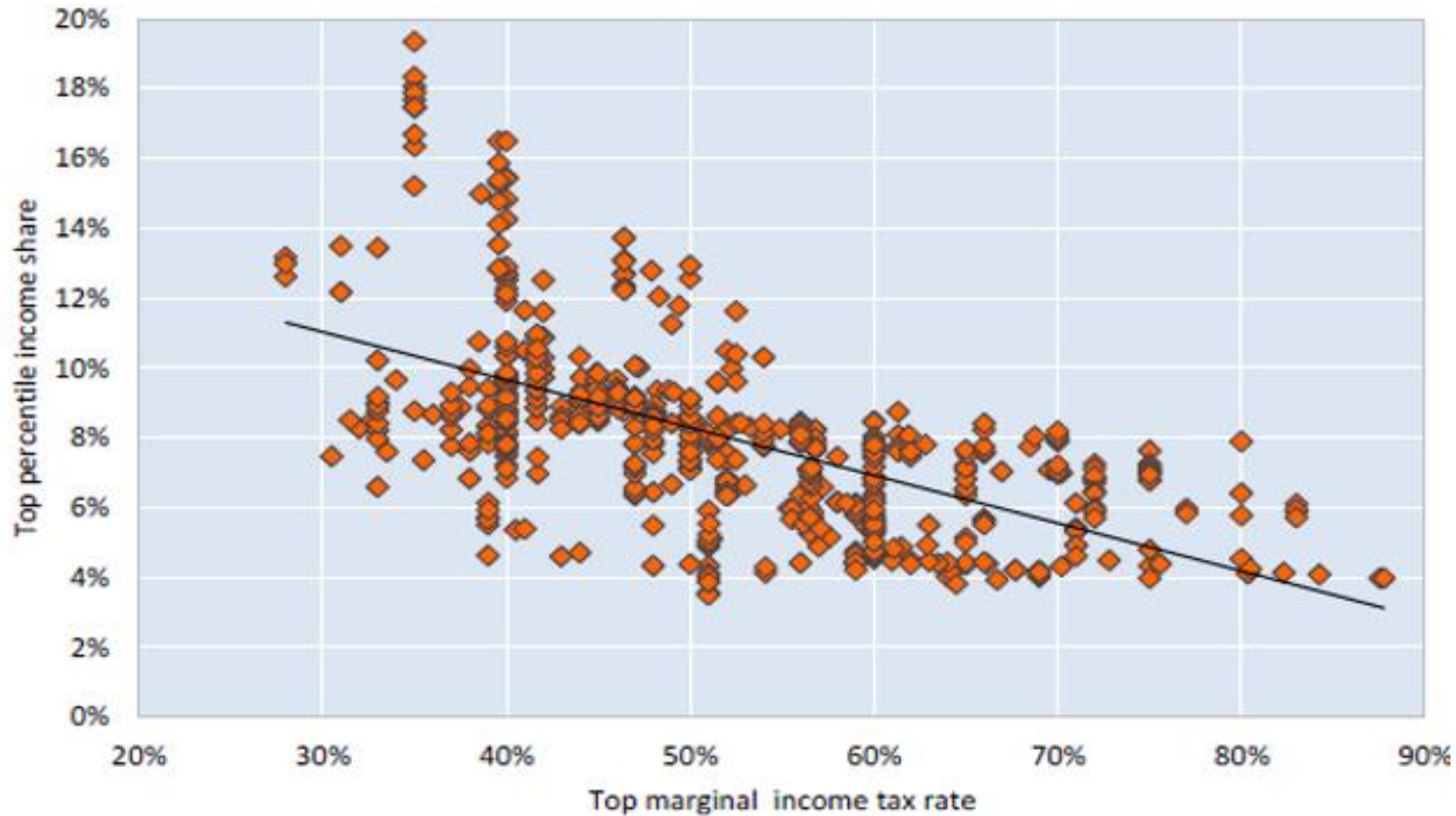
VAT rates increased

The declines in personal & corporate tax rates *plus* the rise in indirect taxes, especially VAT or GST made the tax system less progressive

# Privatization & PPPs damaged fiscal space

- Transferred profitable SOEs and public assets to the private sector
- Had only temporary or short-run impact on public debt
- Impaired governments' long-term revenue capacity
- New private owners avoid & evade taxes
- Negatively affected budget balance in transition economies.
- PPPs can pose a huge financial risk to the public sector
- Usually socialize costs & risks while guaranteeing profits for the private partner.
- Risks of 'contingent liabilities' acknowledged by the IMF, other advocates of PPPs.

# Declines in tax progressivity & inequality



Strong correlation between top tax rates and top pre-tax income shares



# Privatization-PPPs & inequality

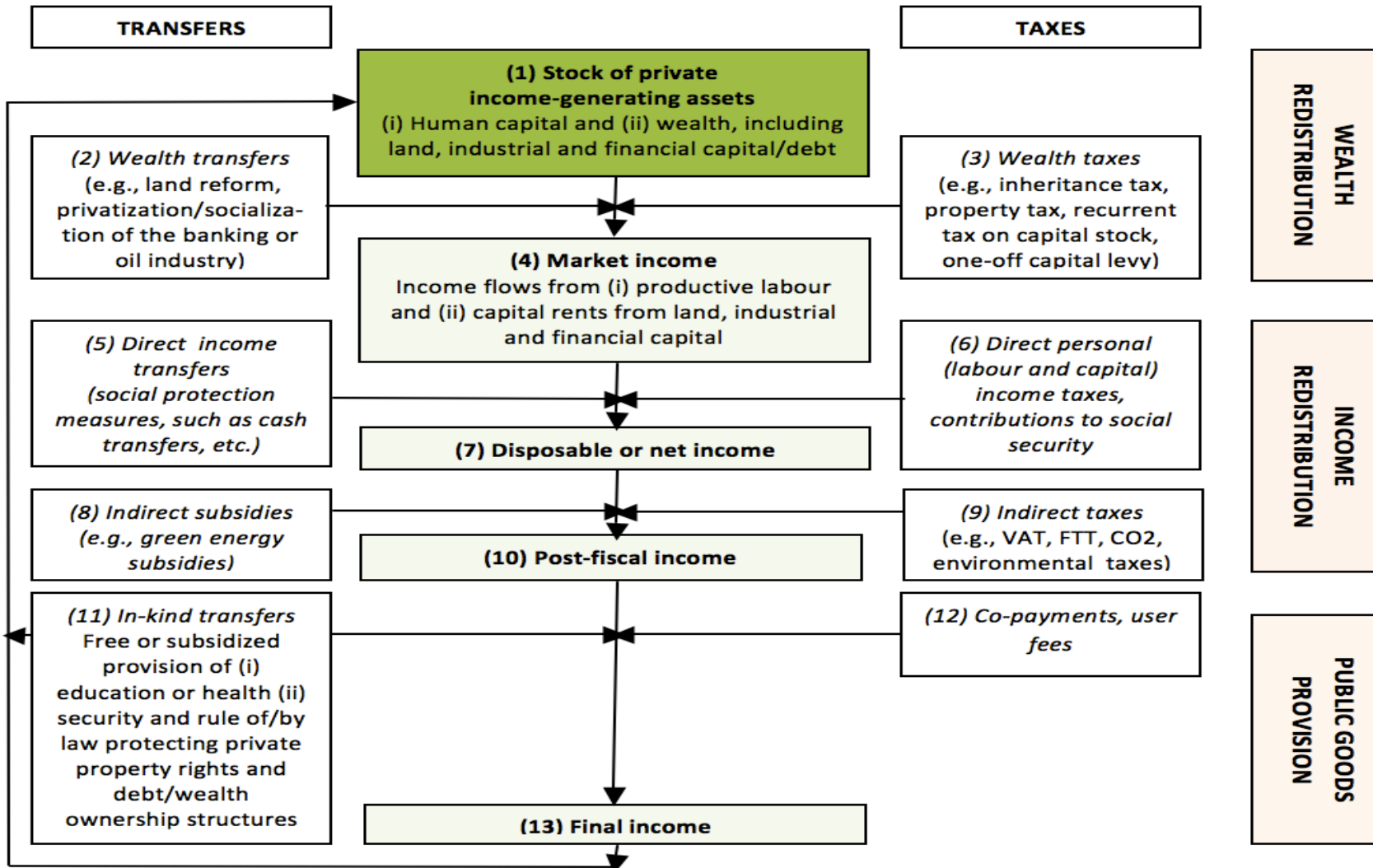
- Privatization **worsened** wealth & income distribution due to
  - job loss, under-priced public asset sales, poor post-sale revenue streams, and reduced access due to price rises.
  - differential reduction of tax burden across households or differential increase of benefits funded by new tax flows.
- PPPs tend to **exacerbate inequality** by enriching politically well-connected businesses.
- Both privatization & PPPs programmes **worsened fiscal space** to spend on quality public education, universal healthcare and social protection.

# Fiscal consolidation & inequality

- IMF's studies found **adverse consequences** for income distribution
- Inequality can rise through various channels including **long-term unemployment**
- Reverse '**Robin Hood**' **widened income gap**
- **Austerity-based consolidations** tend to **worsen inequality** more significantly, relative to tax-based consolidations
- Over **10,000 additional suicides** and an estimated **million extra cases of depression** globally since governments started introducing austerity programmes in 2007

# Recreating distributive fiscal policy

Redistributive fiscal policy instruments for private income-generating assets, & private income flows

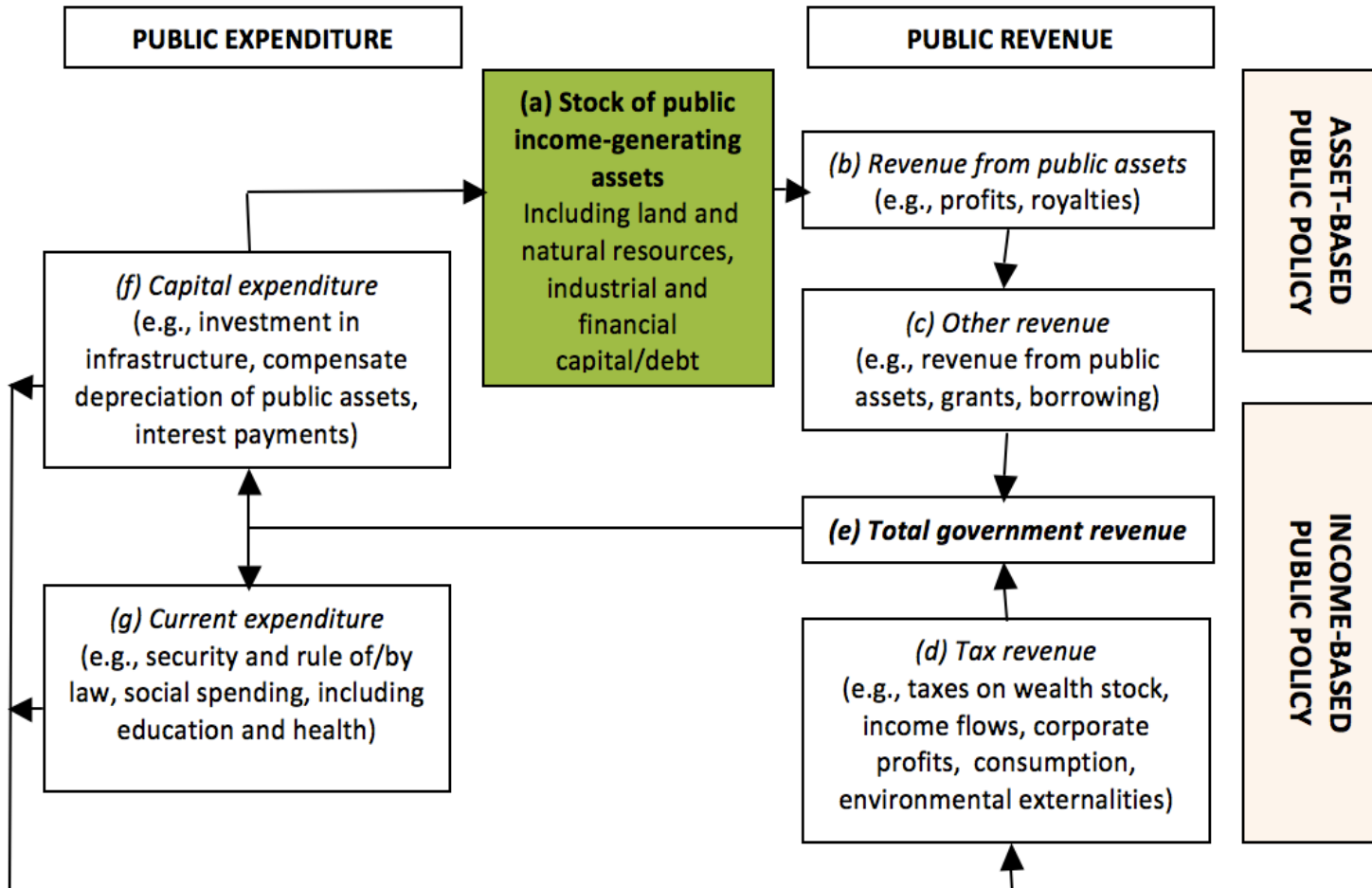


Key policy messages:

- Strengthen tax system
- Improve tax progressivity
- Strengthen automatic stabilizers
- Carefully assess austerity-based fiscal consolidations

# Recreating distributive fiscal policy

Redistributive fiscal policy instruments for public income-generating assets & public revenue-expenditure flows



Key policy messages:

- Carefully assess privatization and PPP programmes.
- Re-nationalization of vital essential services assets.
- Expand fiscal space
- Consistent counter-cyclical fiscal policy

# Concluding reflections: Macroeconomic policy & inequality

- Need to examine the impacts of **monetary** and **exchange rate** policies
- The dominance of **inflation targeting** monetary policy
  - made **fiscal policy subservient** and macroeconomic policy **pro-cyclical**
  - adversely affected **financial inclusion**, especially of SMEs
- Quantitative easing contributed to **uneven asset price inflation** - enriching owners of financial assets, not the 96% relying on income from labour.
- Large **devaluations** also had adverse distributional and growth consequences

# Thank-you