The Redistributive Role of Fiscal Policy: Latin America and the Rest of the World

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Motivation and focus

- Increasing inequality is putting greater pressure on the redistributive role of fiscal policy

- Presentation focuses on how redistributive fiscal policy can be designed to minimize associated efficiency cost
  - Emphasis is on achieving desired redistribution more efficiently
  - Also emphasize policies that have favorable impact on poverty

- Presentation builds on ongoing work within and outside the IMF and have broad country coverage
  - Focus on Latin America and developing economies
Structure of the presentation

- **Trends in inequality**
  - Including inequality of income and wealth, inter-generational mobility, and perceptions of inequality

- **Redistributive role of fiscal policy (and fiscal consolidation)**

- **Design of efficient redistributive fiscal policy**
  - Conceptual framework in the design of redistributive fiscal policy
  - Design of spending measures (cash and in-kind transfers)
  - Design of tax measures (direct and indirect taxes)
I. Trends in Inequality
Inequality has been declining in Latin America, but remains high.

Disposible income inequality: 1980-2010

- Latin America and Caribbean (19)
- Asia and Pacific (14)
- Emerging Europe (21)
- Middle East and North Africa (12)
- Advanced (21)
- Sub-Saharan Africa (22)
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
Wealth is even more unequally distributed, including in Latin America.
Intergenerational income mobility is lower in countries with higher income inequality.

\[ y = 0.0251x - 0.3709 \]

- **Generational earnings elasticity (less mobility →)**
- **Gini (around 1985; higher inequality →)**
While public support for redistribution, on average, has been increasing, it is mixed in Latin America.
II. Redistributive Role of Fiscal Policy
Redistributive fiscal policy reduces inequality by one third in advanced economies, especially through spending.

Average market income Gini: 0.43
Average disposable income Gini: 0.29

Total redistribution: 0.14
From transfers: 0.09
In-kind spending further reduces inequality in advanced economies

Redistributive impact of in-kind spending

Average Gini Reduction: 0.058
The level and composition of fiscal policy reduces its redistributive impact in developing economies

Levels and composition of tax revenues and social spending
Furthermore, a large share of the benefits from spending often goes to higher-income groups.

Social protection includes pensions and social assistance transfers.
In-kind social spending is also regressive in many developing economies, including in Latin America.

In-kind Social Spending Benefit Share of Poorest 40%

Education

Health

40 percent

40 percent
A large part of the difference in inequality between Latin America and advanced economies is due to fiscal policy.
Fiscal consolidation typically does not worsen inequality in developing economies.
III. Designing Efficient Redistributive Fiscal Policy
Designing efficient redistributive fiscal policy

- Redistributive fiscal policy should be consistent with broad 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
Reform options to achieve more efficient redistribution of social spending in developing economies

- **Pensions**
  - Increase statutory retirement ages while protecting low-income groups with shorter life expectancy
  - Tighten link between contributions and benefits
  - Expand noncontributory means-tested social pensions

- **Other social transfers**
  - Develop unemployment savings accounts
  - Consolidate social assistance programs and improve targeting
  - Replace general price subsidies with targeted transfers
  - Expand conditional cash transfer programs as administrative capacity improves
  - Improve design of public works programs as a safety net instrument
Reform options to achieve more efficient redistribution of social spending in developing economies

- **Education**
  - Improve access to education of low-income families
  - Increase cost recovery in tertiary education

- **Health**
  - Expand coverage of publicly financed basic health package
Reform options to achieve more efficient redistribution of taxation in developing economies

- **Direct taxes**
  - Implement progressive PIT rate structures
  - Expand coverage of PIT
  - Reconsider income tax exemptions
  - Impose a reasonable PIT exemption threshold
  - Develop more effective taxation of multinationals
  - Automatically exchange information internationally
  - Exploit more fully opportunities to tax property
Reform options to achieve more efficient redistribution of taxation in developing economies

- **Indirect taxes**
  - Minimize VAT exemptions and special VAT rates
  - Set a sufficiently high VAT registration threshold
  - Use specific excises mainly for purposes other than redistribution
Conclusions

- High and rising inequality is a concern in many economies.

- In developing economies, fiscal policy has played a smaller role because of lower levels of taxation and spending and the way policies have been designed.

- There are a range of fiscal policy measures to help achieve redistribution with no or small efficiency cost, with some actually improving efficiency.
Thank You!