

Fiscal Sustainability and the Challenges of Inequality



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International Tax Dialogue Global Conference

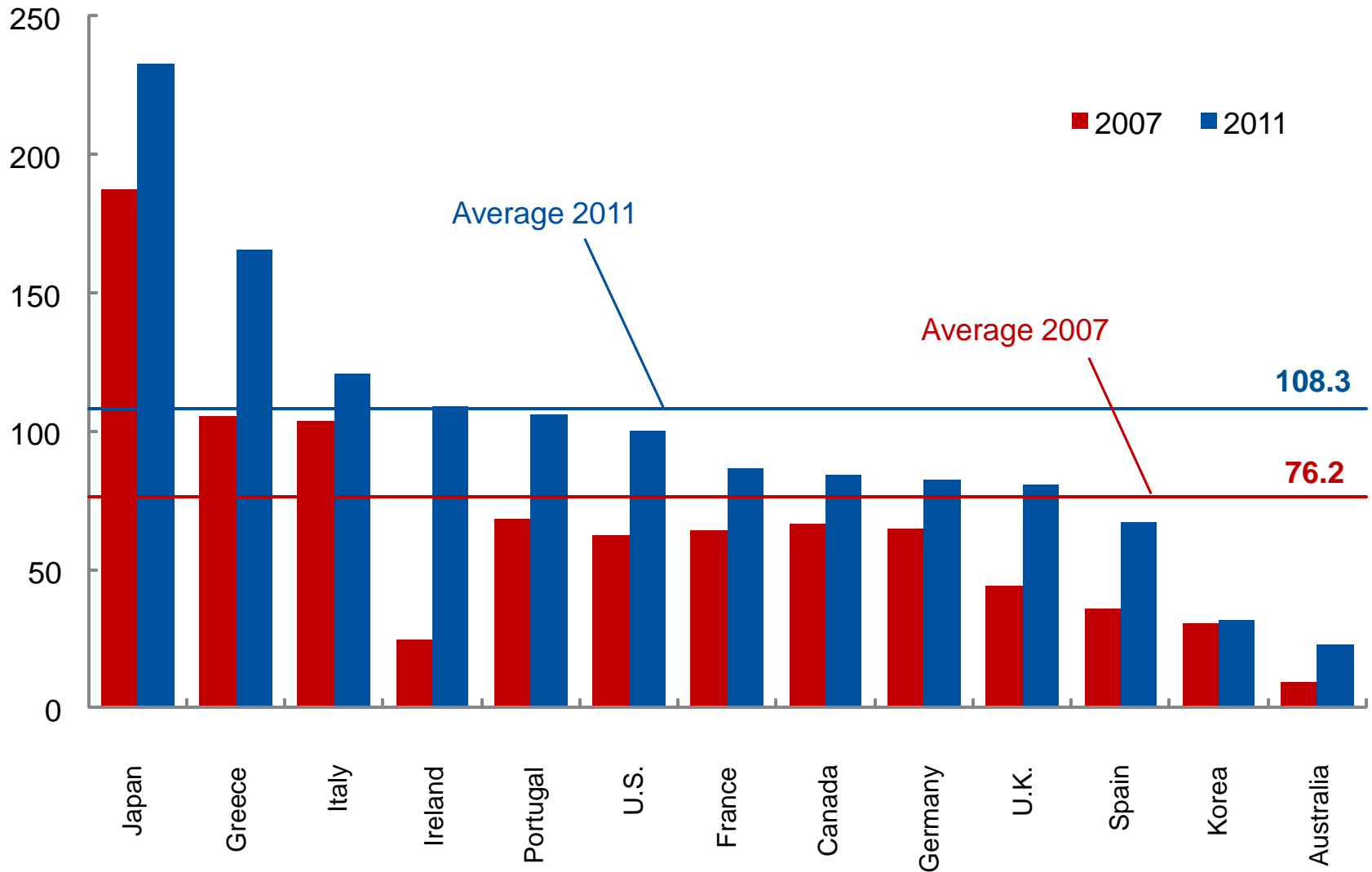
Delhi, December 2011

Outline

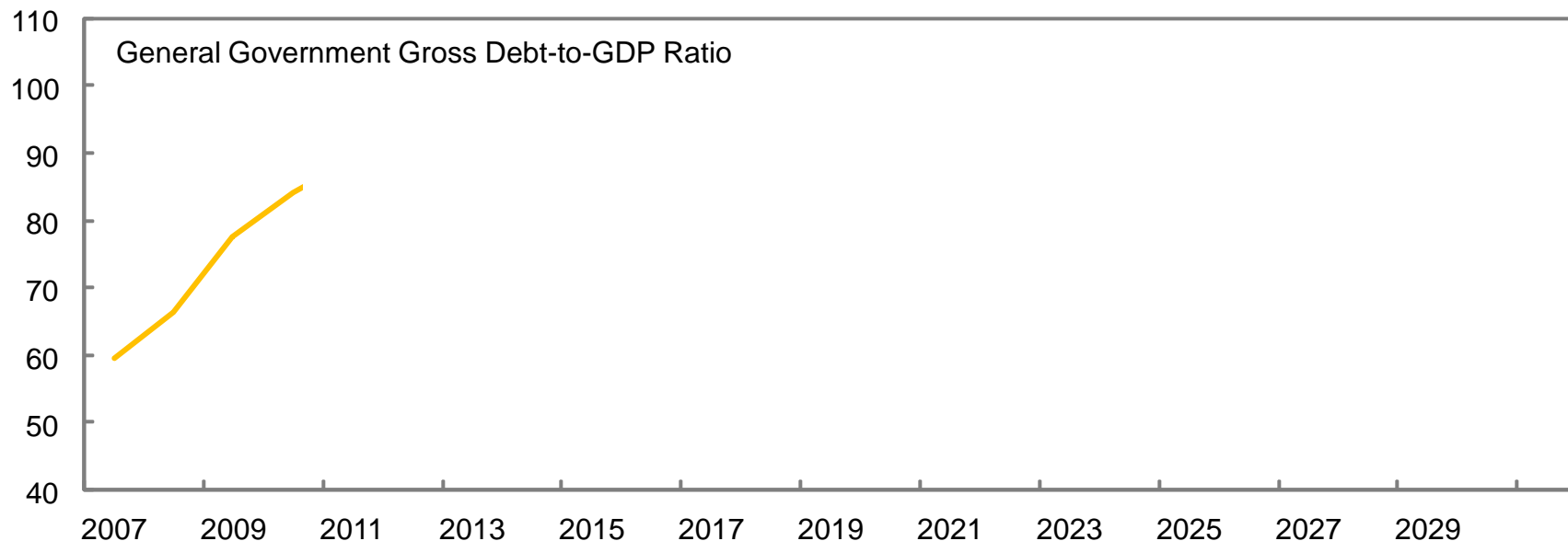
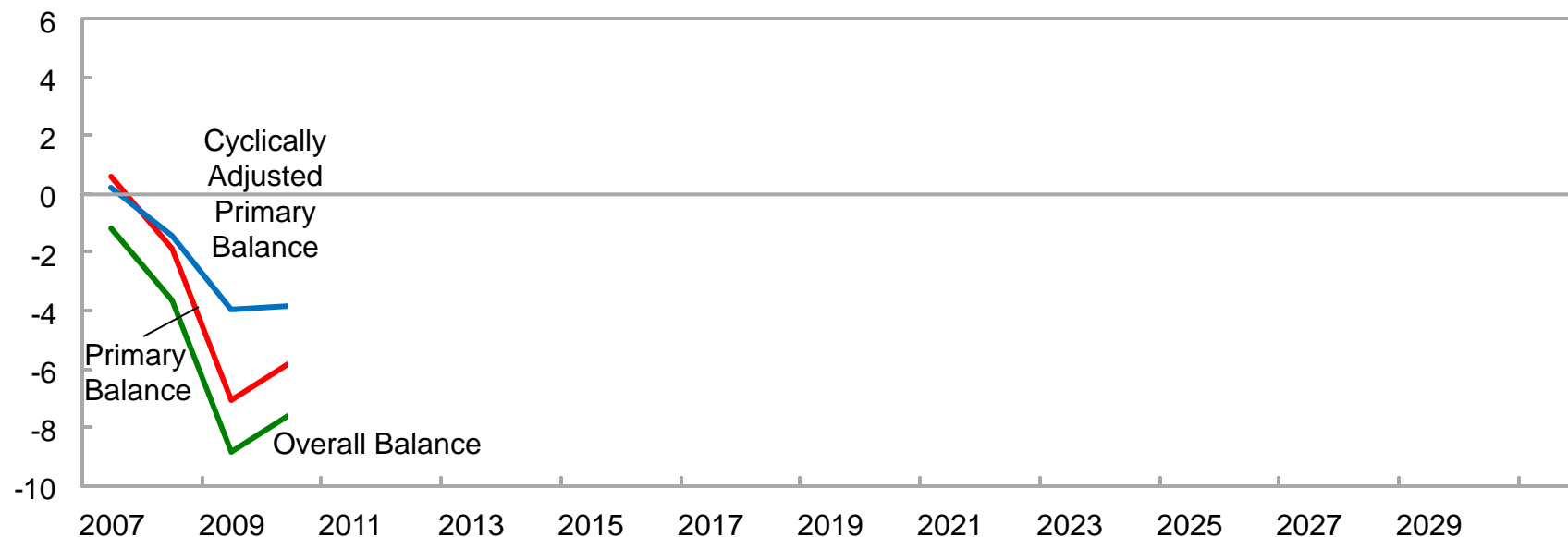
- Fiscal stress in advanced, emerging and developing countries
- The Critical Challenge: Achieving Sustainability while Fostering Greater Equality
 - The role of macroeconomic stability
 - The role of fiscal policies
 - Potential impact of various revenue sources

Fiscal Stress in Advanced, Emerging and Developing Countries

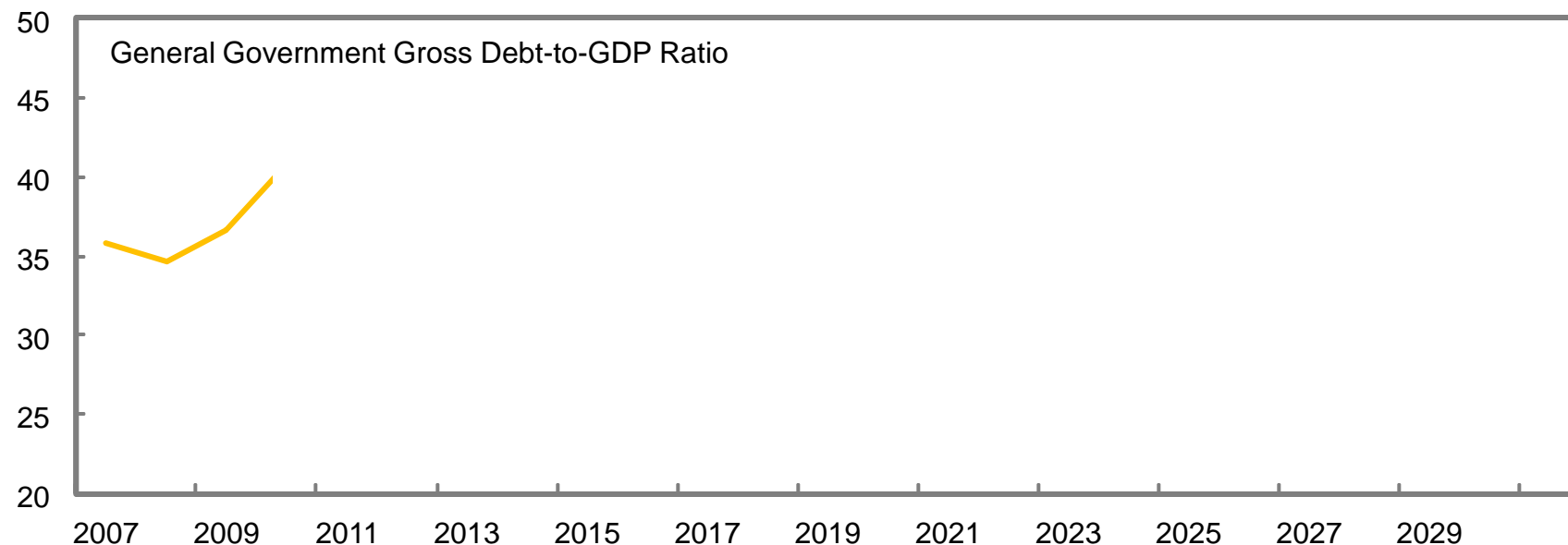
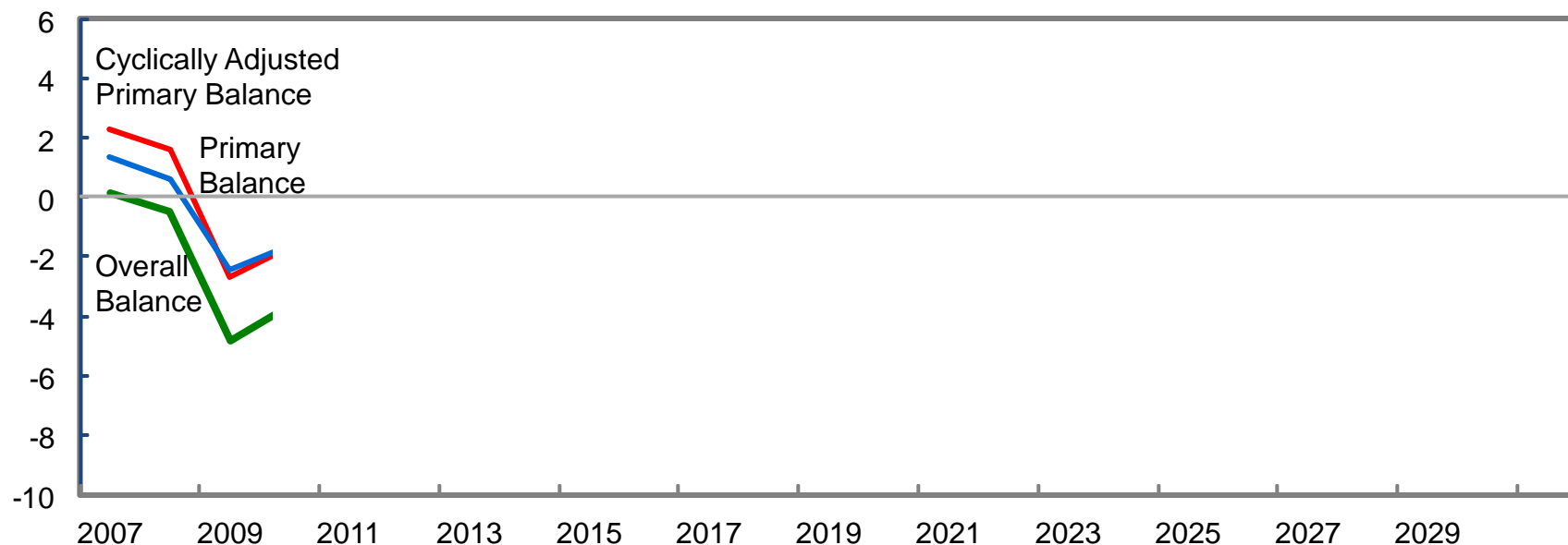
Debt Ratios in Advanced Economies: Pre-crisis vs. 2011



Illustrative Scenarios for Primary Balance Adjustment and Debt, Advanced Economies, 2010-30

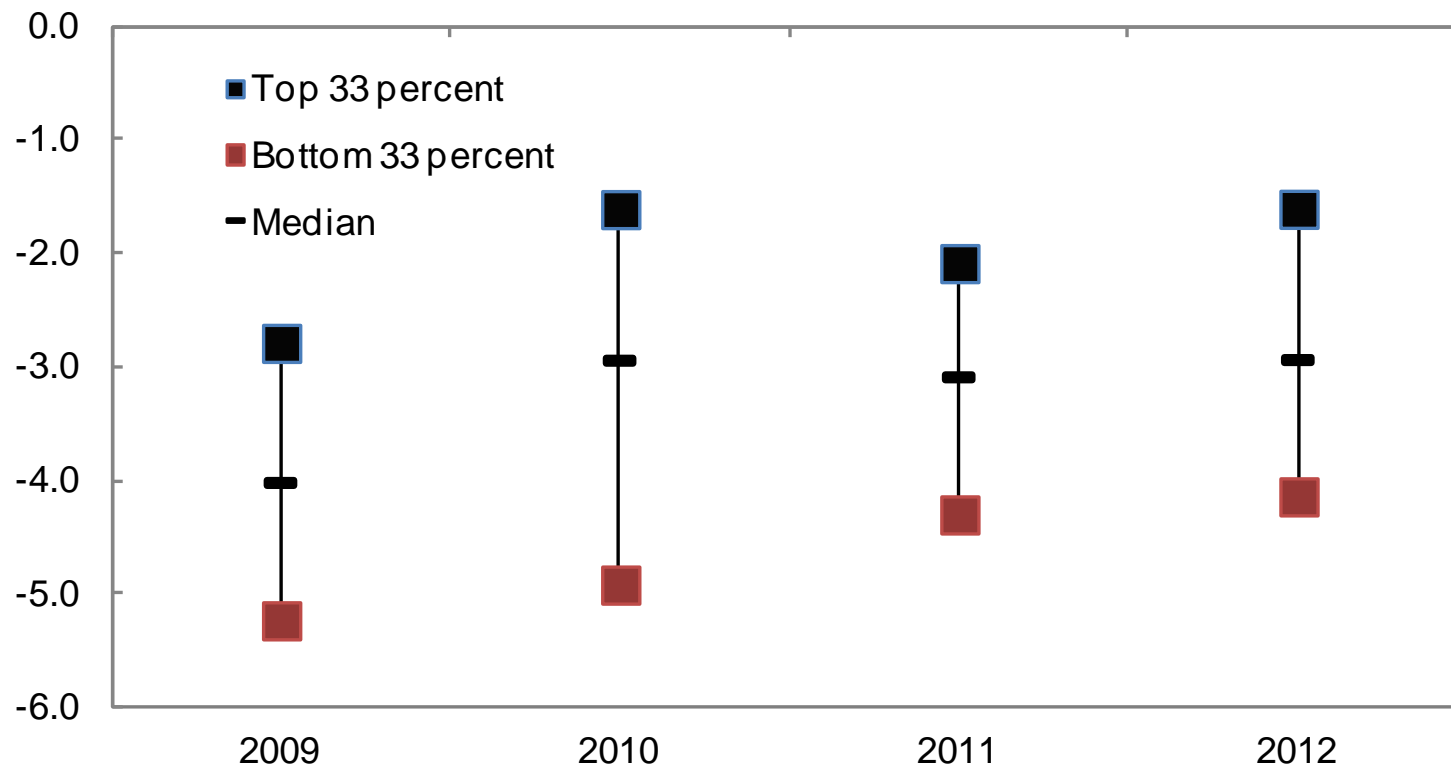


Illustrative Scenarios for Primary Balance Adjustment and Debt, Emerging Economies, 2010-30



Fiscal Balances Strengthened in Low-income Countries in 2010

Overall Fiscal Balance in Low-Income Countries (Percent of GDP)

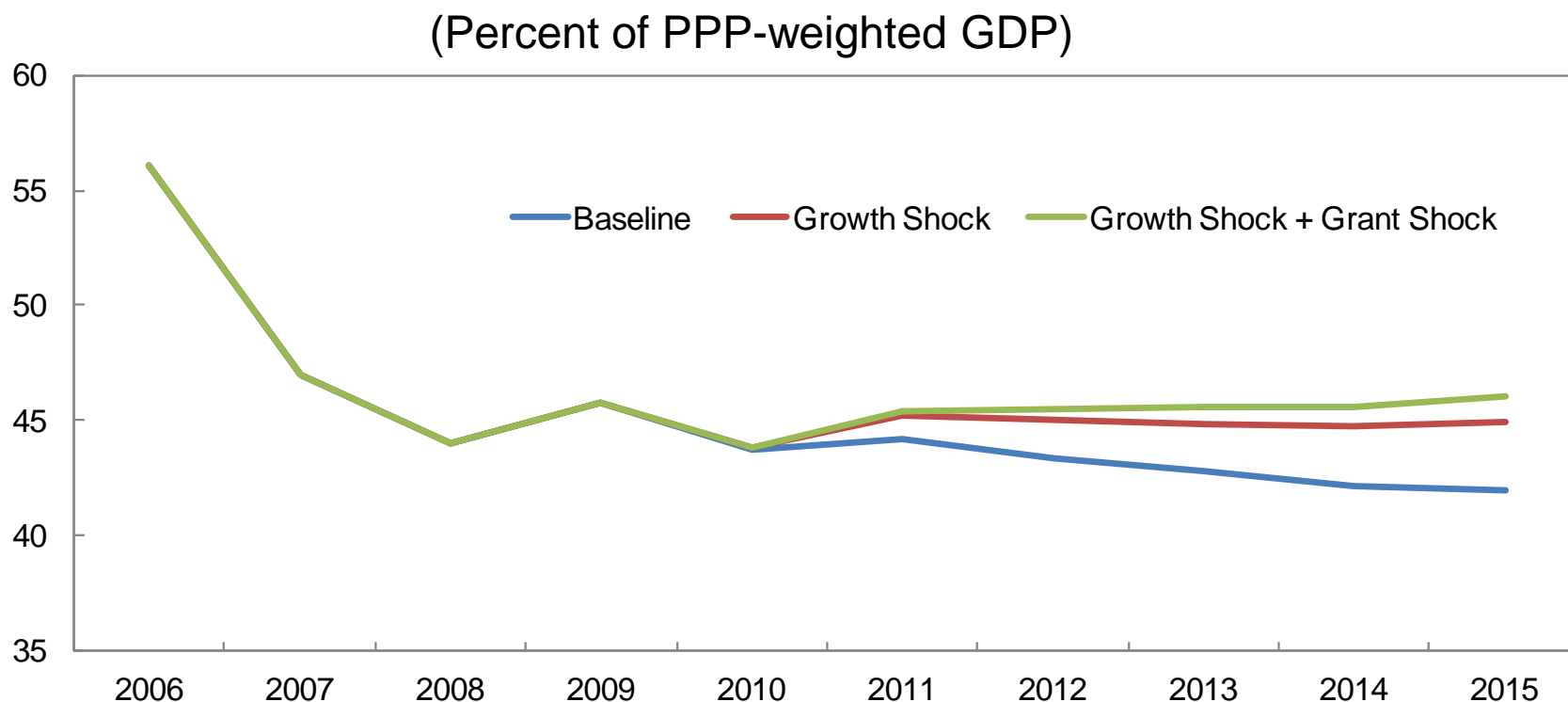


Sources: IMF staff estimates and projections.

Note: Weighted average based on 2009 purchasing power parity-GDP.

Low-Income Country Debt Paths

- One third are in debt distress or under debt sustainability risk



Source: IMF staff estimates.

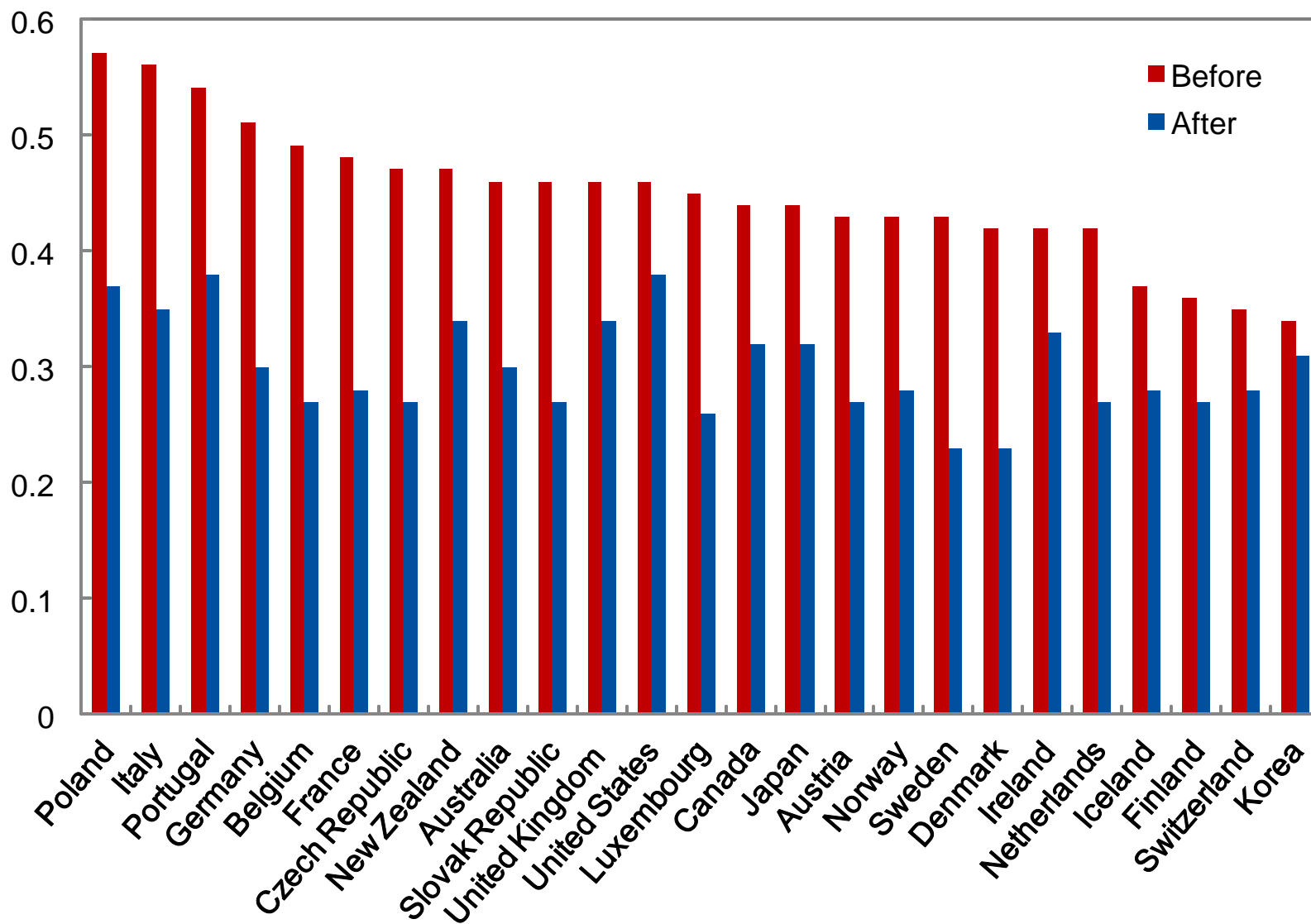
Note: Weighted GDP based on 2009 PPP-GDP.

**The Critical
Challenge:
Achieving
Sustainability
While Fostering
Greater Equality**

Macroeconomic Stability is Crucial for Sustained Poverty Reduction

- Inflation erodes real disposable incomes
- The poor lack buffers in the form of financial assets to smooth consumption
- Rising unemployment puts further pressure on real incomes

Gini Coefficients for Advanced Countries: Before and After Taxes and Transfers, 2005

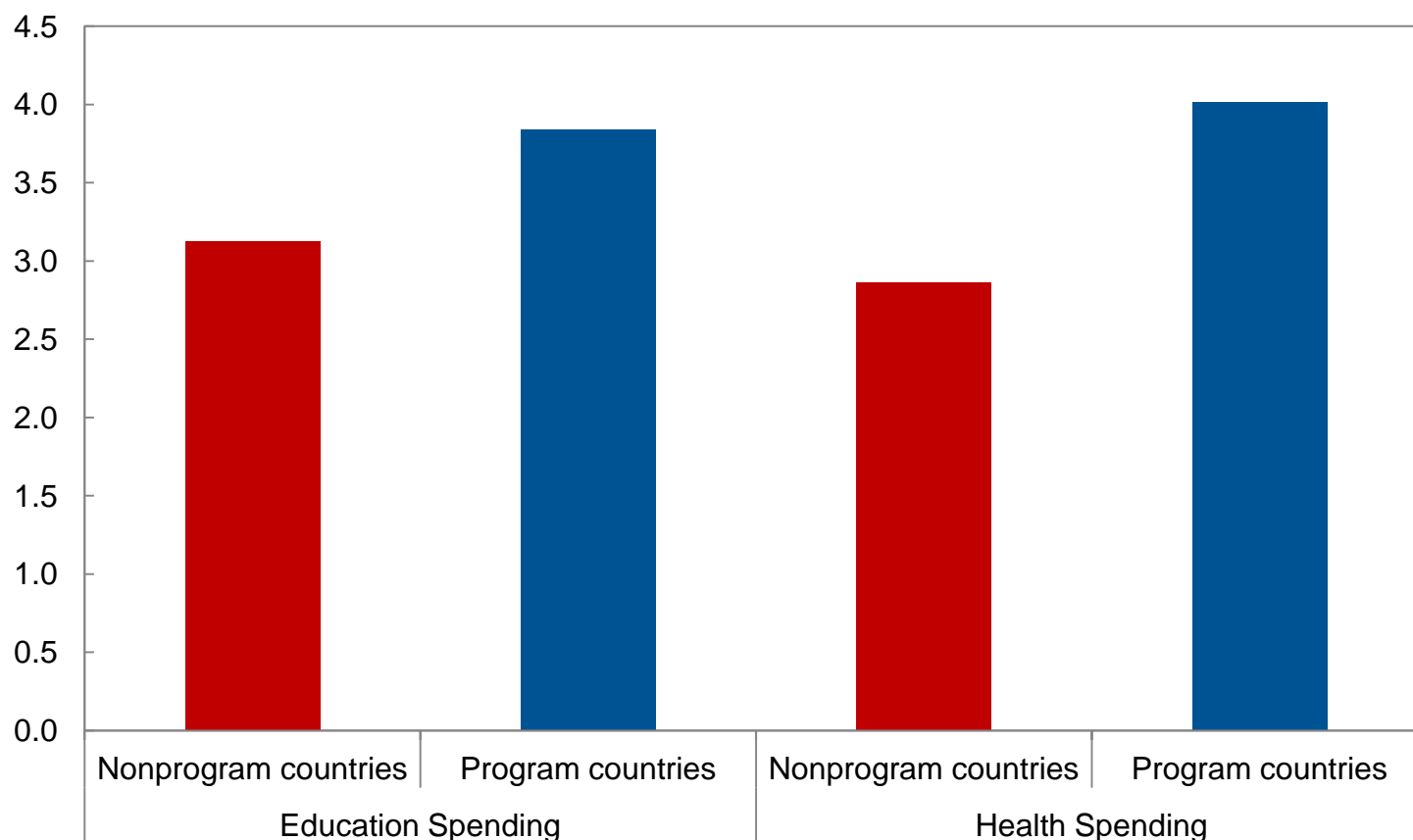


Government In-Kind Spending has Important Equality Impacts

- In-kind spending patterns have large effects on equality of outcomes and access—e.g., in health, education, nutrition—particularly in developing countries
- IMF recognizes this in IMF-supported programs
 - Health and education spending, 1985-2009
 - Group of IMF-supported program countries: per capita education and health spending rose at about 4 percent per year
 - Non-program countries: averaged about 3 percent per year

Fund-supported Programs Increase or Protect Health and Education Spending

Median Annual Change in Real Per Capita Spending for All Countries, 1985–2009



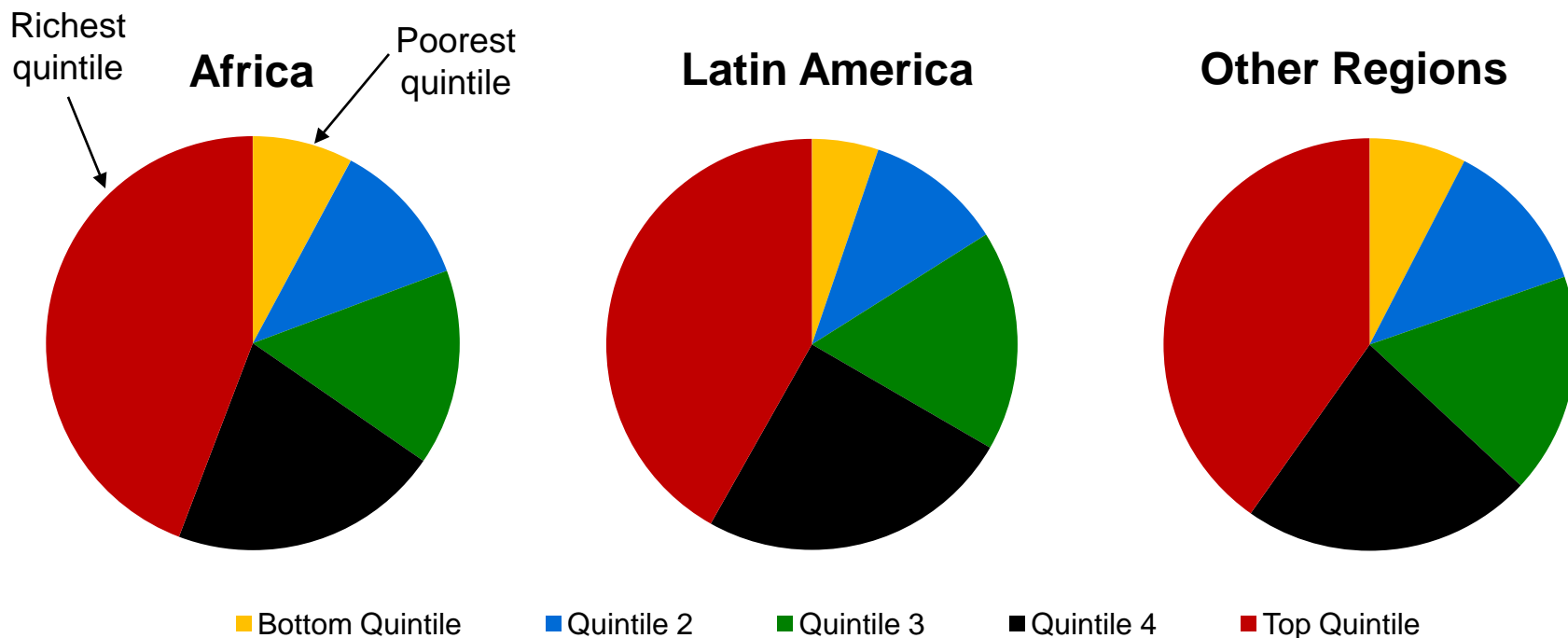
Source: IMF staff calculations.

CEE and CIS, LAC, MENA, and SS Africa refer to Central and Eastern Europe and Commonwealth of Independent States, Latin America and the Caribbean, Middle East and North Africa, and Sub-Saharan Africa, respectively.

Improving the Composition and Efficiency of Public Spending

- Example: 2/3 of fuel subsidies accrue to the richest 40 percent of households

Distribution of Petroleum Product Subsidies by Income Group



Source: Arze del Granado, Coady, and Gillingham (forthcoming).

Note: The countries covered are Bangladesh, Bolivia, Burkina Faso, Cameroon, Central African Republic, El Salvador, Gabon, Ghana, Jordan, Mali, Peru, Republic of Congo, and Senegal. Welfare quintiles are based on per capita household consumption.

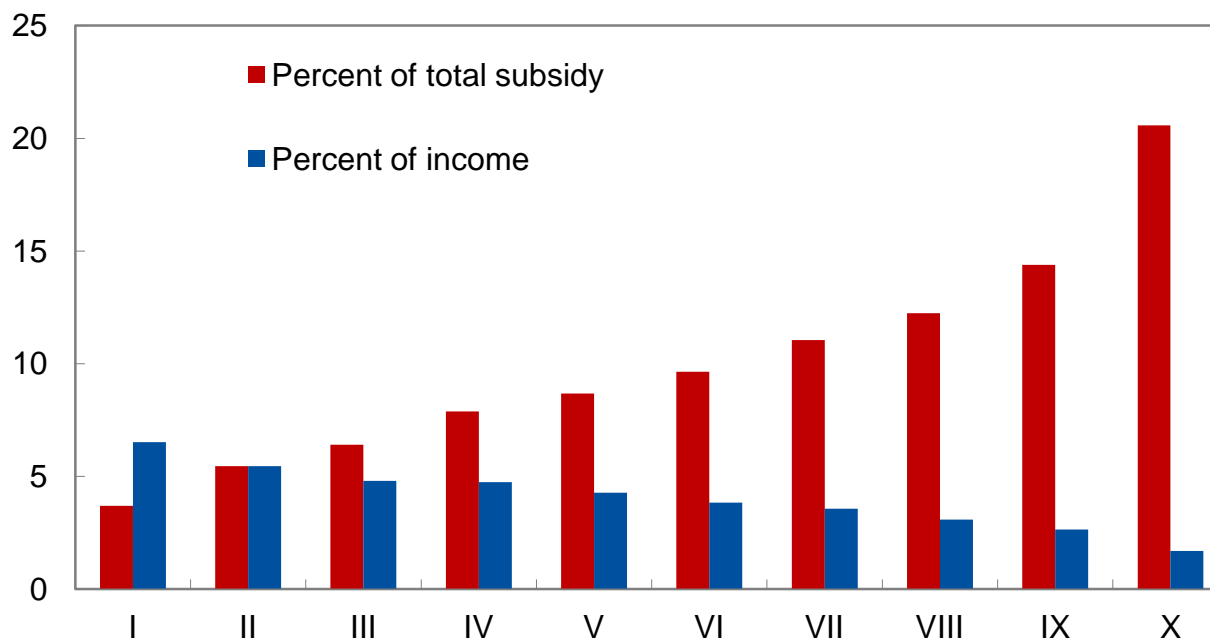
Progressive Income Taxes

- Emphasizing increases in progressive income taxation where these are not already too high
 - Ideally in low-income countries as alternative to underdeveloped income transfer systems
 - In practice used most successfully in advanced countries with well developed tax administrations
- Concerns over international mobility of high net worth individuals
 - But taxable income elasticities unlikely to be sufficiently high to preclude raising additional revenues

Isn't the VAT Regressive?

- Likely to be less regressive than the trade and excise taxes it has replaced
- Benefit of preferential rates/exemptions goes mainly to the better off (since they spend more on all items)

Benefits from Zero-Rating Relative to Income Shares
Mexico (by income decile)



Source: OECD 2007

- But spending instruments can do a better job of protecting the poor

Oil Producers, 1975



Oil Producers, 2005



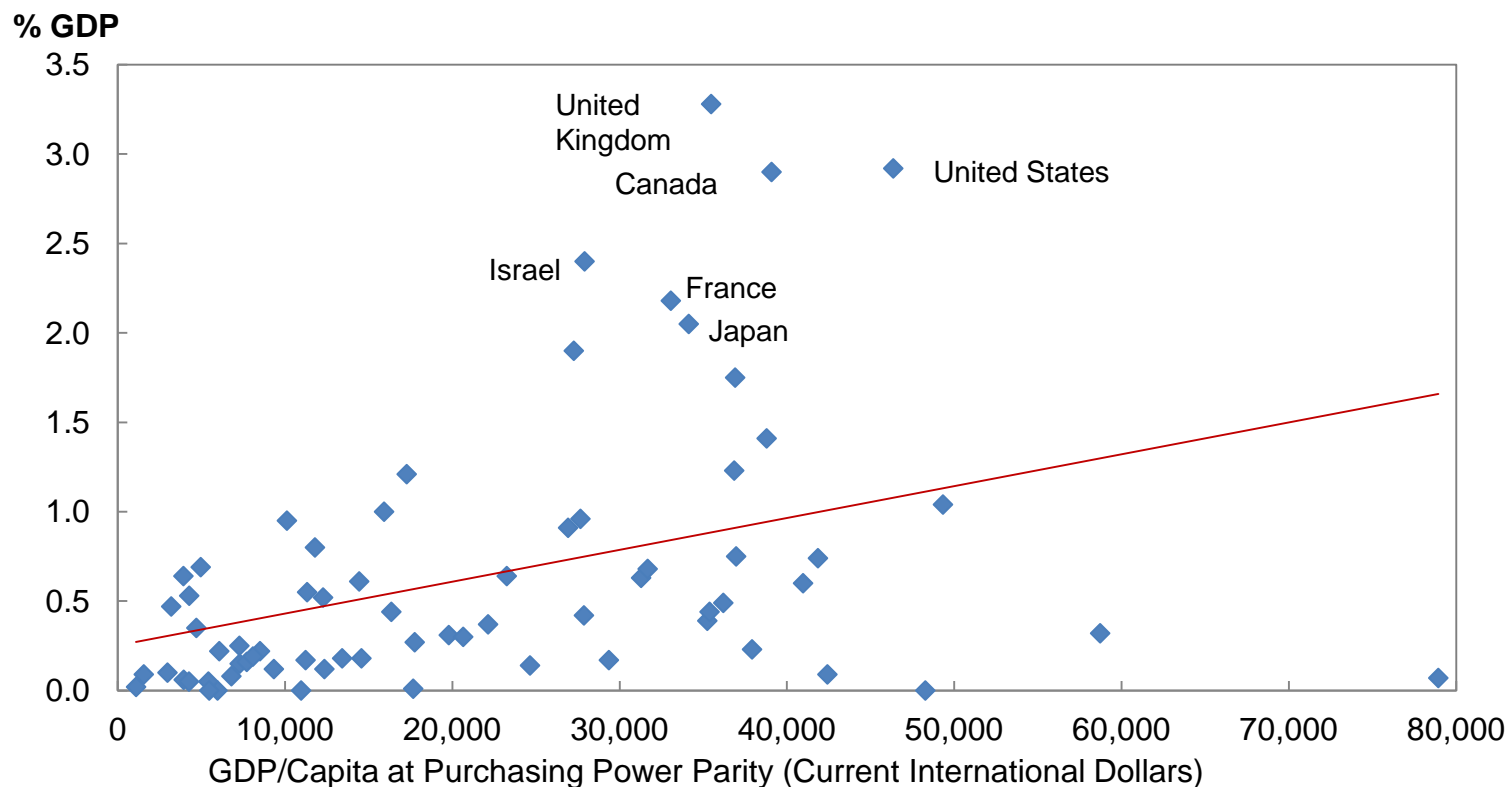
Oil Producers, 2015



Property Taxes are Under-exploited in Low and Middle-income Countries

- Efficient and equitable revenue source
- Revenue potential is largely untapped

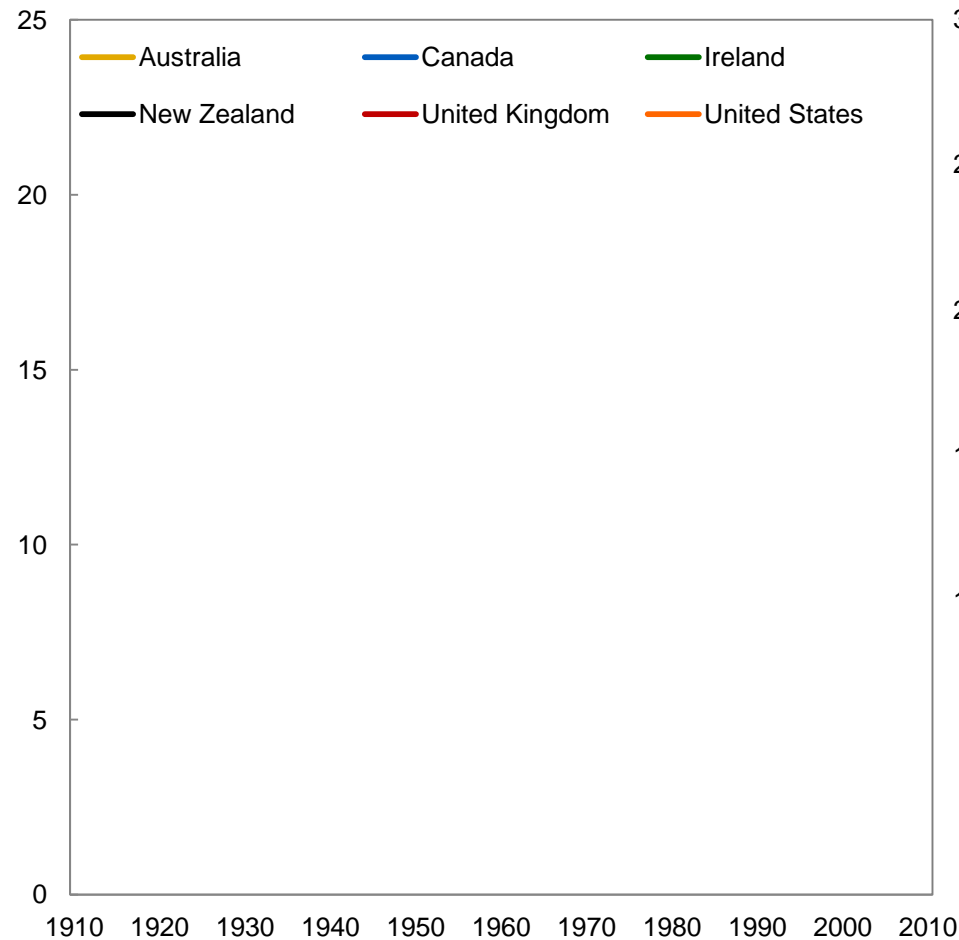
Immovable Property Tax Collections
(OECD and selected non-OECD countries, 2008)



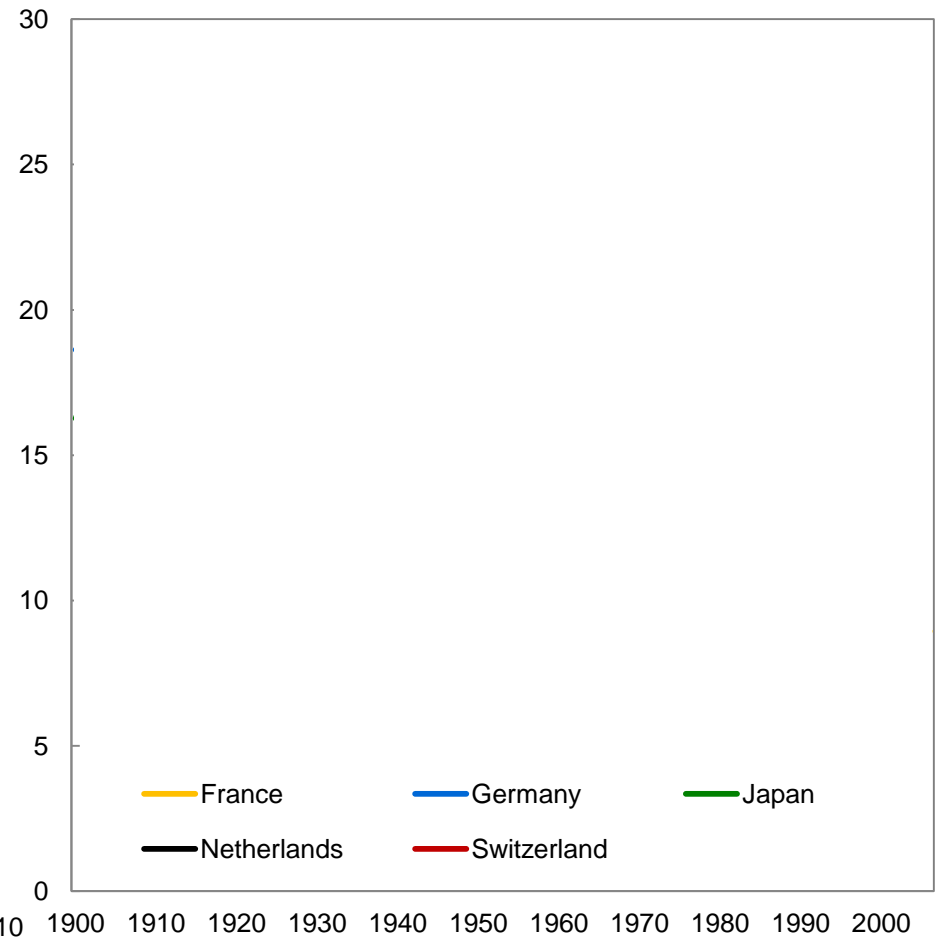
Source: IMF staff calculations.

Top 1% Income Share

1910-2008



1900-2006



Source: Alvaredo, Facundo, Anthony B. Atkinson, Thomas Piketty and Emmanuel Saez, The World Top Incomes Database, <http://g-mond.parisschoolofeconomics.eu/topincomes>, 01/12/2011.

Thank you!