

Taxes, Social Transfers, and Inequality in Asia



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Key Questions



- What is the situation of poverty and income inequality in Asia?
- What is the role of fiscal policy in income distribution?
- What are the salient features of tax systems in Asia? How do Asian tax systems compare with other regions in terms of redistribution?
- How should we improve income distribution?

Why care about income inequality?



- **Income distribution is an integral part of economic/social policy**
 - Social justice as an ethical imperative
 - Social cohesion
 - Equity to enhance efficiency and promote economic growth
 - 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 under debates**

Poverty and Income Inequality in Asia



Key development indicators by region

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	44.18	6.24	33.88
East Asia and Pacific	16.78	38.70	4,200.00	43.27	6.08	35.30
South Asia	40.34	73.93	2,222.73	44.47	5.88	33.22
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	-	-	-
Latin America & Caribbean	8.12	17.17	8,824.01	-	-	-
Middle East and North Africa	3.64	17.16	5,707.66	-	-	-
Sub-Saharan Africa	50.91	72.87	1,789.97	-	-	-
OECD	-	-	29,478.61	46.7	6.4	31
World	25.20	47.00	8,989.50	47.8	6.1	40.9

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.

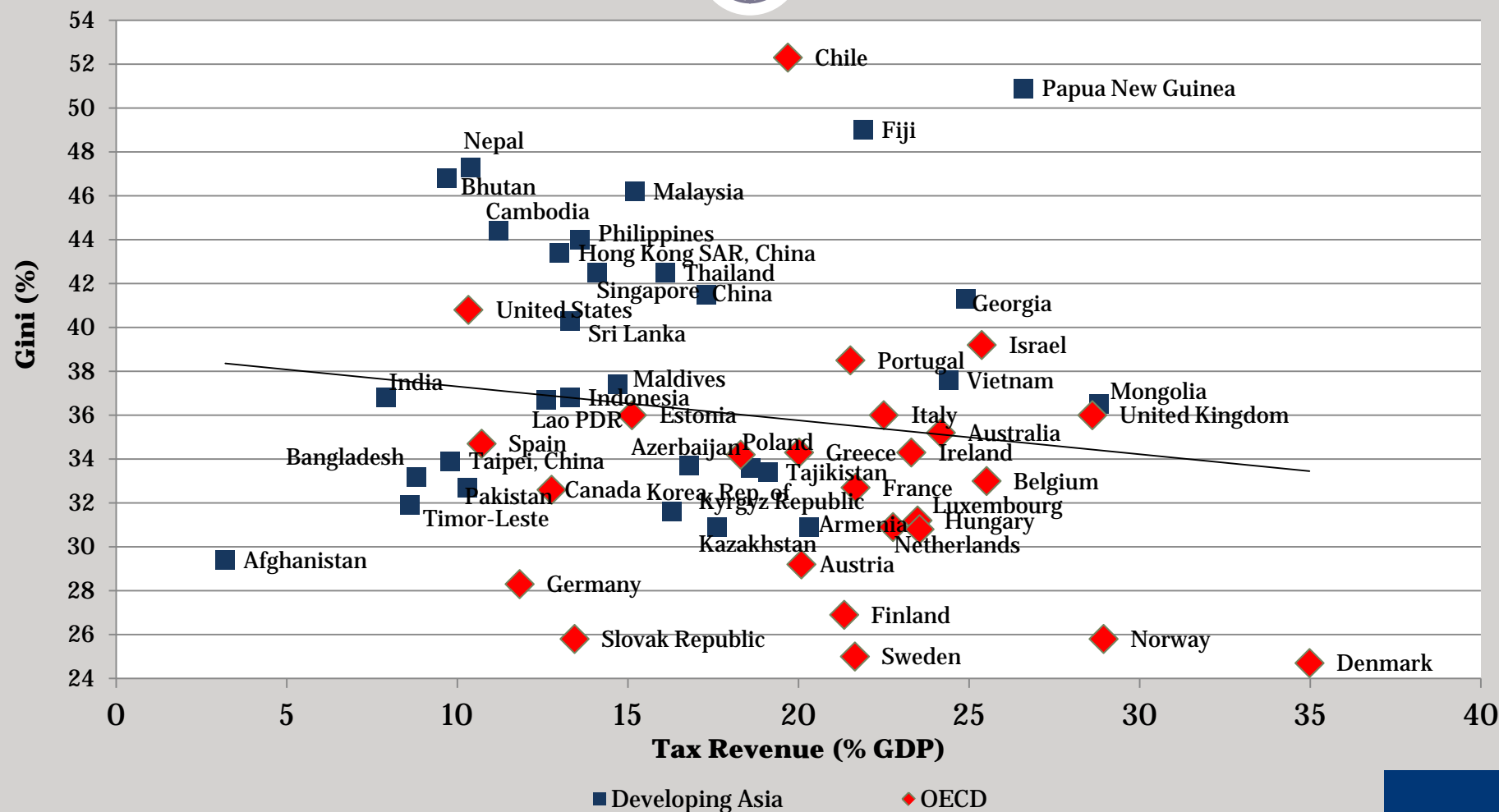
Source: World Development Indicators Database, World Bank

The Role of Fiscal Policy

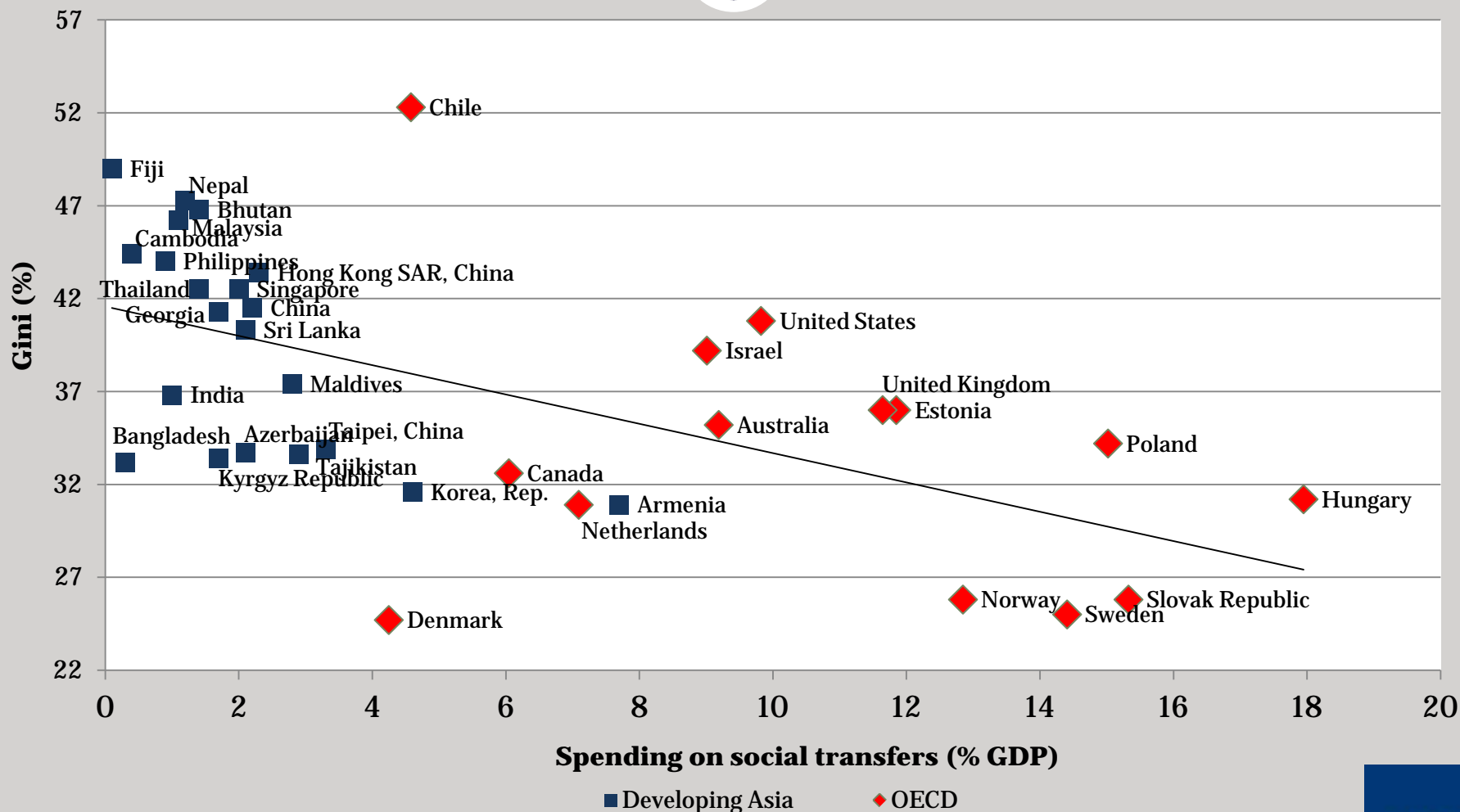


- Primary purpose of taxes is to raise revenue for public spending, but other purposes include:
 - Provide incentives for certain activities
 - Correct market failures
 - Distribute income and help reduce inequality
- Taxes and social transfers can have an immediate effect on income distribution, while 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

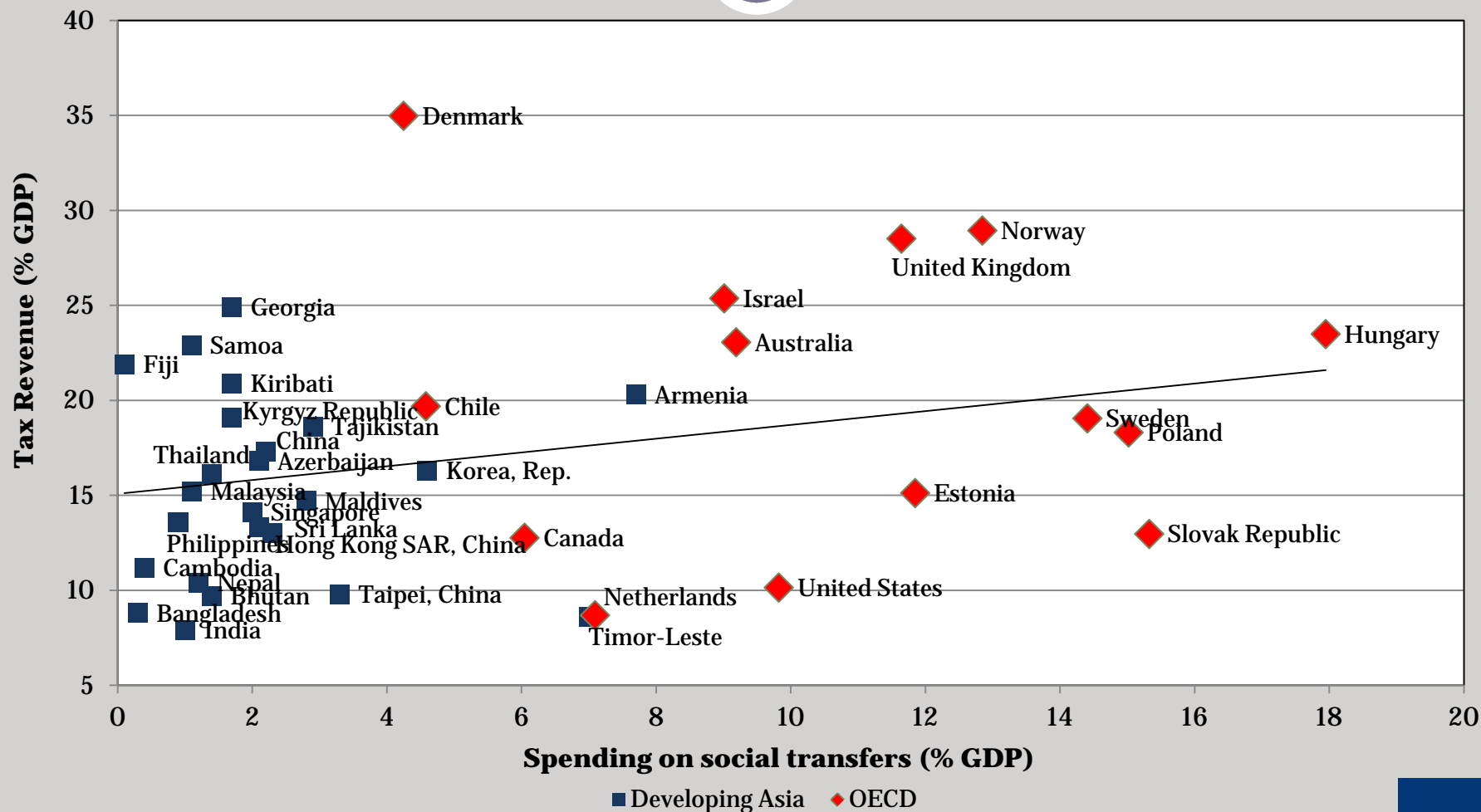
Tax revenues and income inequality



Social Transfers and Income Inequality



Social Transfers and Tax Revenues



Asian Tax Systems

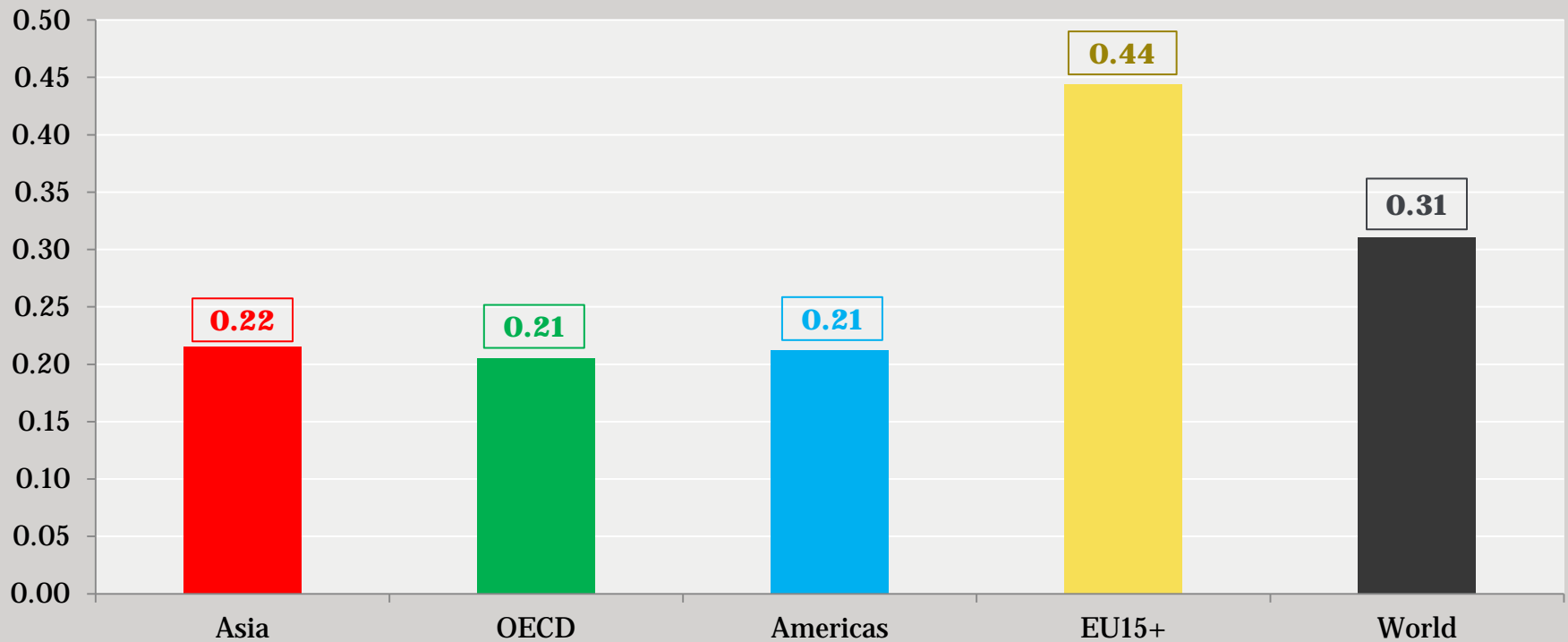


- **Low tax revenues: lowest tax burdens in the world**
- **Tax composition: higher share of indirect taxes**
 - Small tax base
 - Inefficiency of tax collection
 - High tax evasion
 - large informal sector
- **Weak personal income tax/property tax**
- **Adoption of VAT: relatively new and generally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

Asia has the lowest tax burdens...



Total Revenue to GDP by Region, Average 1990-2005

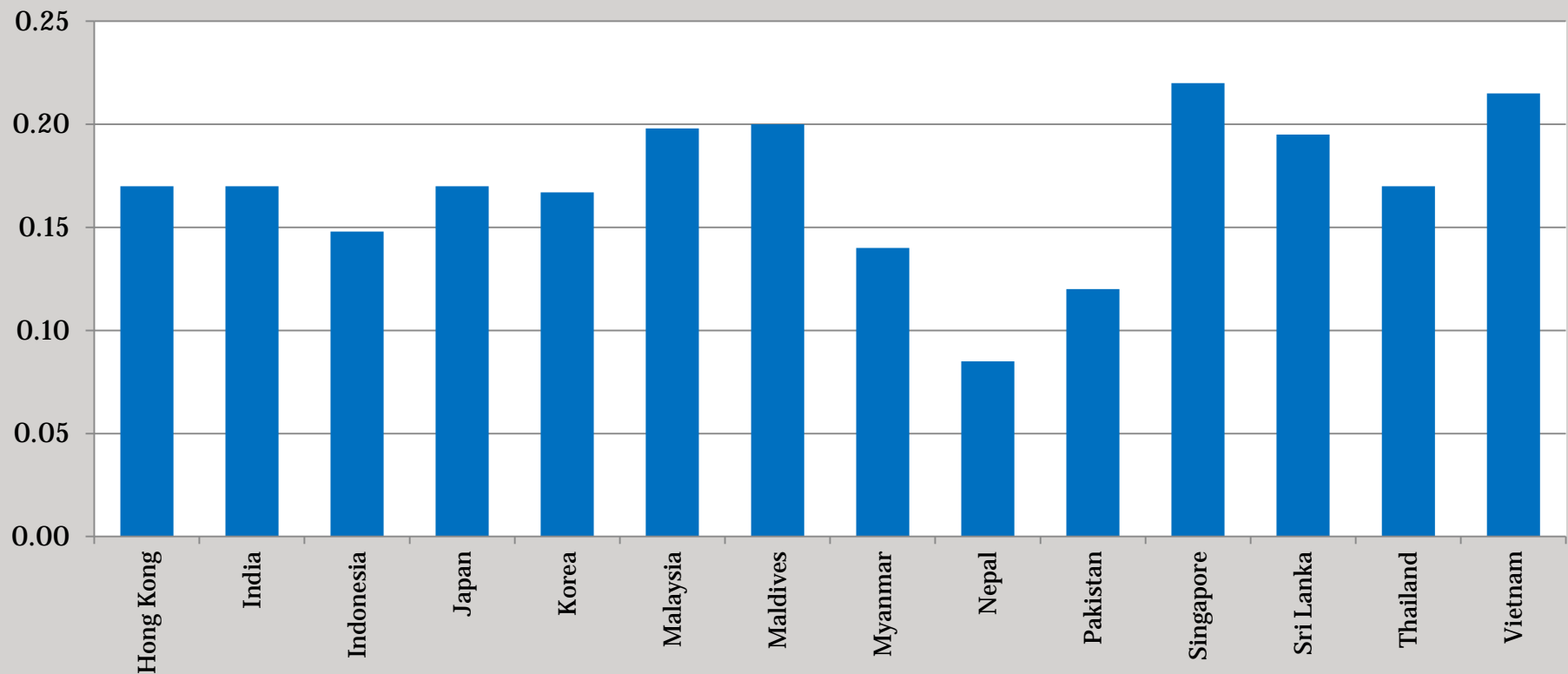


Data at the consolidated government level; EU15 includes EU15, Iceland, Norway and Switzerland
Source: IMF Government Finance Statistics Database; World Development Indicators

...with albeit wide variation across the region



Total Taxes to GDP Ratio in Selected Asian Countries, Average 1990-2005



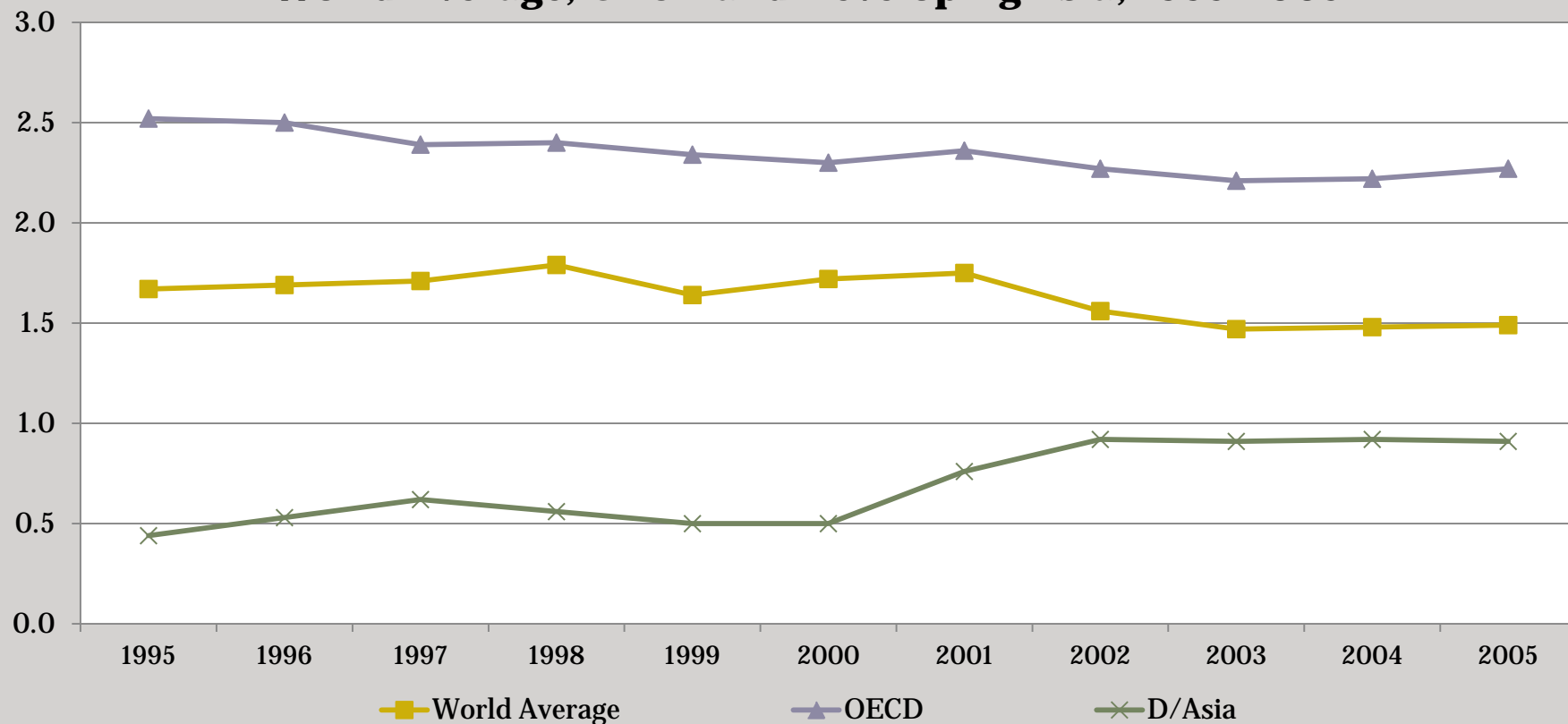
Data at the consolidated government level.

Source: IMF Government Finance Statistics Database; World Development Indicators

Direct taxes are small relative to indirect taxes...



Direct to Indirect Tax Ratio: World Average, OECD and Developing Asia, 1995-2005

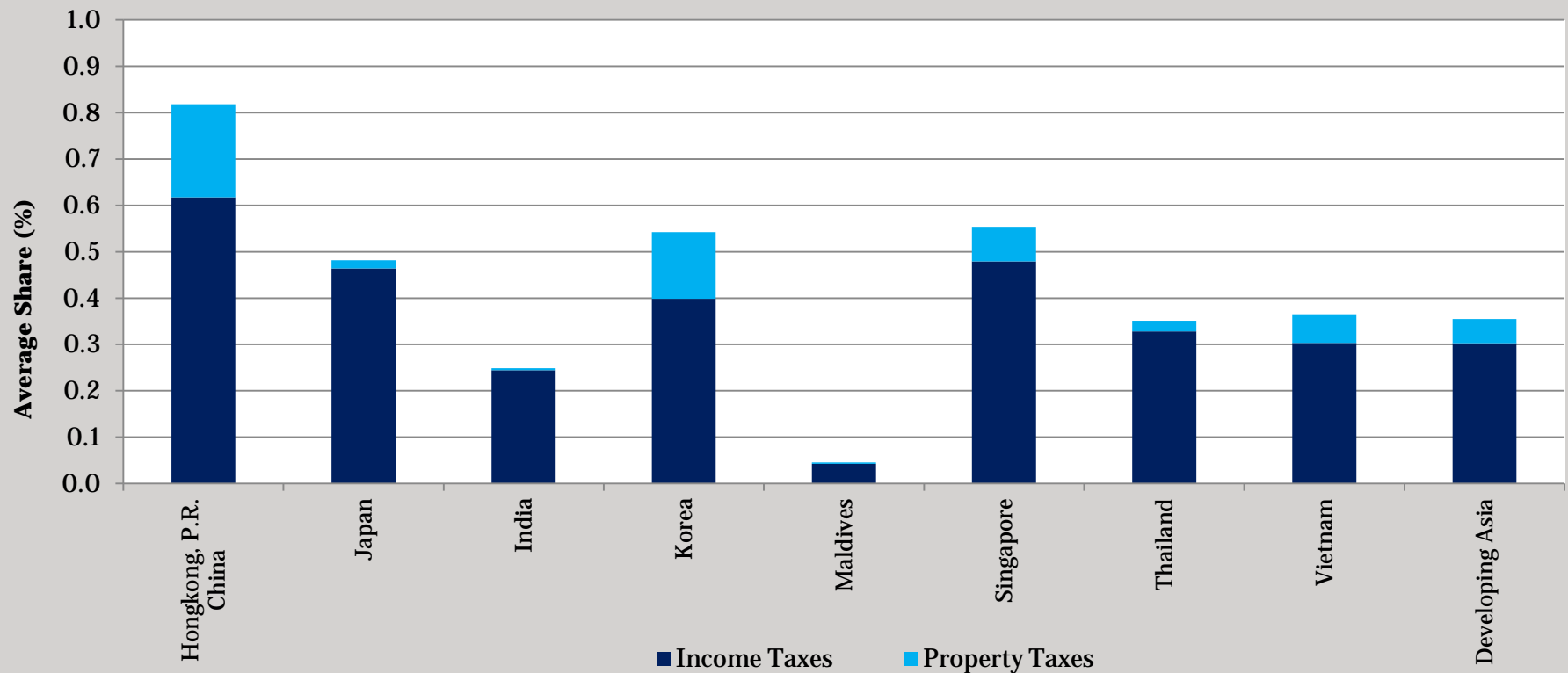


Data at the consolidated government level; property taxes treated as direct taxes.
Source: IMF Government Finance Statistics Database.

...with lower use of PIT



Tax Structure in Selected Asian Economies: Share of Total Taxes, Average 1995-2008

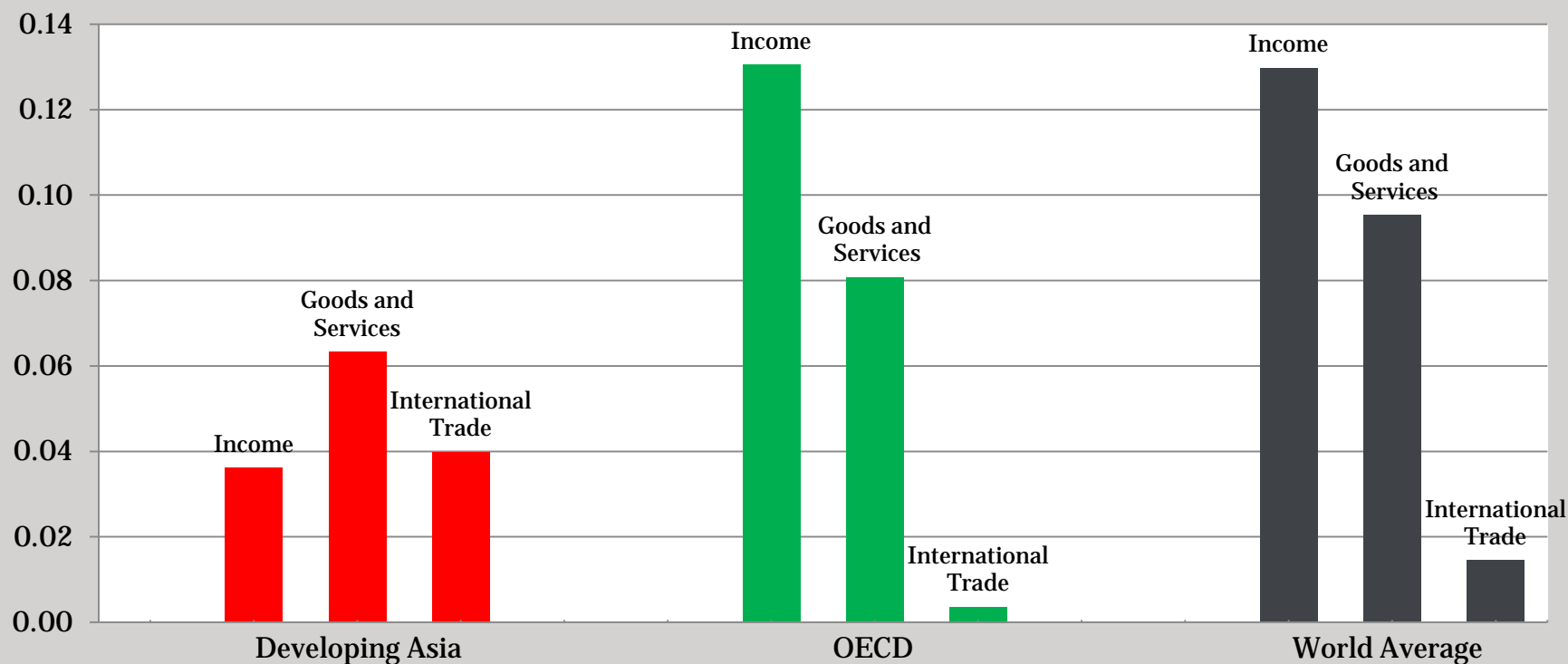


Data at the consolidated government level; property taxes treated as direct taxes.
Source: IMF Government Finance Statistics Database.

Increased role of taxes on goods and services



Evolution of Selected Tax Instruments as Share in GDP: World Average, OECD and Asia, Average 1990-2005



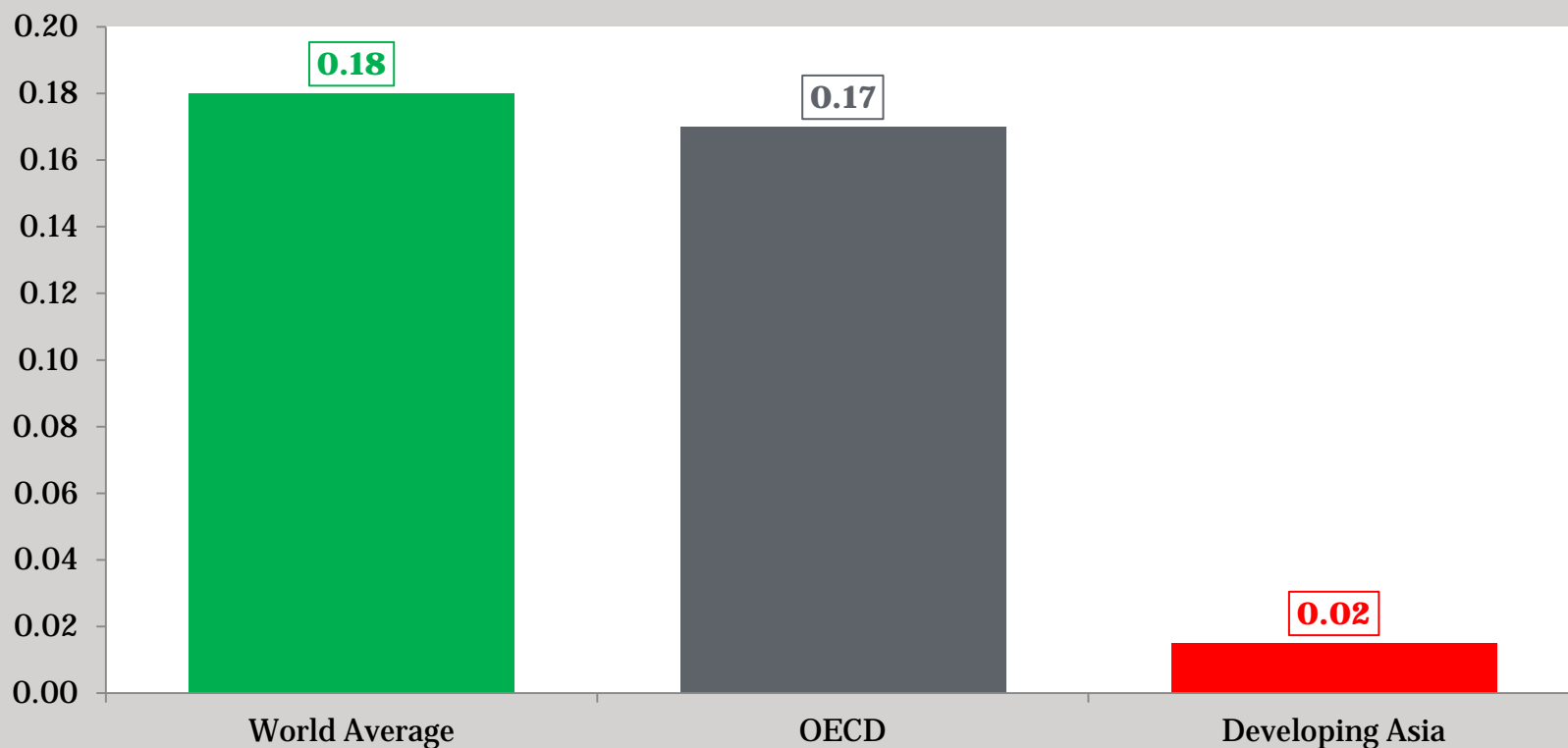
Data at the consolidated government level.

Source: IMF Government Finance Statistics Database; World Development Indicators

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



Share of General Sales Taxes in Total Revenues: World Average, OECD and Developing Asia, Average 1990-2008



Data at the consolidated government level; property taxes treated as direct taxes.
Source: IMF Government Finance Statistics Database.

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
- **Poor tax administration pose a significant constraint**
 - Modernize tax administration
 - Devise tax systems that could work with bad tax administration

Implications for developing Asia



- Inequality concerns play a limited role in tax reforms
- Poor tax system and administration don't allow effective income redistribution
- Income redistribution is better addressed by the expenditure side of the budget
- Social transfers may be better targeted to low income
- 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

Thank You



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