Inequality and Fiscal Policy

Sang-Hyop Lee
University of Hawaii at Manoa (UHM) &
East-West Center (EWC)

Building Forward Fairer – Economic Policies for an Inclusive Recovery and Development
Expert Group Meeting, 1-3 December 2021 (virtual)
Overall Consideration

• A big picture
• Policy target group
• Effective?
• Sustainable?
1. Inequality → Holistic approach is needed

These gears are closely linked to each other→ Covid-19 has brought huge challenges. Countries are different.
Policy options (1)

• Encourage and support work?
  – Appropriate and inevitable. But not sufficient available jobs to meet the challenges (short term vs. long term)
  – Quality (decent jobs) vs. quantity (labor force participation)
  – Issue on labor market structure (informal sector, segmented)

• Encourage family transfers?
  – Family transfers have been important support systems in Asia (important during the pandemic). But it is deteriorating.
  – Singapore stresses this more than the others in Asia
  – May not be sustainable (decline in fertility, women’s Ifpr, urbanization, consensus, etc.)
Policy options (2)

• Increase public transfers? → Fiscal Policy
  – Inevitable for most countries.
    • Rising inequality and poverty
    • COVID-19
    • Public health and education for sub-population can also reduce inequality (but takes long time, failing public education is an issue)
  – Sustainability (issues on fiscal space + rising debt (aging) → intergenerational equity)

• Reduce public transfers (for sustainability)?
  – Pension reform (including from PAYGO to funded system)
    • Old age poverty is an issue—many Asian countries are getting old before they get rich (very different from European countries)
  – Encourage (forced) saving
    • Limited implication on reducing inequality.
2. Finding the target group (under Covid-19)

- The effect of the pandemic is very different across generations
  - Employment, labor income, and private consumption have been affected substantially (working group)
  - Children of working groups are also affected.
  - Elderly rely more on pension and savings. Thus, additional public support (ps) boosting labor income would have a little impact on older people.
  - Government overall deficit will increase dramatically.

- National Transfer Accounts (NTA) (ntaccounts.org) may provide some useful information
NTA integrates population into economy and consistent with National Accounts

NTA integrates information from many different sources to provide a snapshot of the generational economy (90+ countries)

NTA integrates population into economy and consistent with National Accounts

National Transfer Accounts

- National Accounts (NA)
- Census, Population Projections
- Other Surveys and Indicators
- Administrative Data
- Household Surveys
Example of NTA: Thailand (2017)
Government expenditure (benefit) and tax (burden) profiles
Case of Japan (2009)
Impact of Covid-19 on consumption by age group (ratio to labor income)

3. Effectiveness of Fiscal Policy on Reducing Inequality

We need to rely on evidences and countries are all different!—but also should be interpreted with caution.

Effectiveness of Fiscal Policy on Reducing Poverty by Age: South Korea

Measure the poverty rate by age using market income vs. disposable income → effective tool for poverty reduction for older people in S. Korea

Source: Korea Institute of Health and Social Affairs
Poverty rate of pop. 65+ vs. total

4. Sustainable?
Social welfare spending as % of GDP (1980-2019)

Source: OECD data portal. www.data.oecd.org
Impact of Covid-19 on debt-to-output (%)

Thought experiment:

- **Demographic shock** (Infected Covid-19)
- **Labor income shock**
  - Year 2020 = -7.5%
  - Year 2021 = -3.7%(1-ps)
  - Year 2022 = -1.8%(1-ps)
- **Public support** = ps

<table>
<thead>
<tr>
<th>Country</th>
<th>Public support ps=0%</th>
<th>Public support ps=100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>4.89</td>
<td>7.75</td>
</tr>
<tr>
<td>India</td>
<td>2.96</td>
<td>6.30</td>
</tr>
<tr>
<td>Philippines</td>
<td>2.10</td>
<td>5.86</td>
</tr>
<tr>
<td>Singapore</td>
<td>1.99</td>
<td>6.18</td>
</tr>
<tr>
<td>Thailand</td>
<td>2.53</td>
<td>6.43</td>
</tr>
<tr>
<td>Japan</td>
<td>5.53</td>
<td>8.36</td>
</tr>
</tbody>
</table>

Per capita government transfers has increased rapidly (as ratio of labor income ages 30-49)!

Source: ntaccounts.org database.
But, countries do not increase taxes as much as an increase in expenditure.

Japan's actual tax profiles as ratio of average labor income of 30-49

Should have been this to make fiscal balance

Source: ntaccounts.org database.
Concluding Remarks

• A big picture
• Policy target group (age, gender, etc)
• Effective?
• Sustainable?
  → Evidence driven policies targeting sub-population (by age, income level, ...)
  → The recovery should be a platform on which to build a better nation
  → But no silver bullets (all countries are different).