Inequality on the rise

Between the early 1990s and 2014, Asia’s income inequality, as measured by population-weighted Gini coefficient, increased by 4 percentage points, from 33.5 to 37.5. The actual increase in income inequality is likely to be higher because these estimates are based on household expenditure, rather than income, data. A recent study based on household income data estimates that Asia’s population-weighted Gini coefficient increased by 11 percentage points, from 37 to 48, since early 1990s. The increase in inequality is also apparent from increases in the share of the richest quintile in national income increased along with declines of the shares of the 3 lowest quintiles (Figure 1).

At the same time, the region’s economic success has led to fast accumulation of private wealth, with a concentration at the top. The number of the region’s high net worth individuals (HNWI) went up from 3 million to 5 million between 2009 and 2015, and their total wealth almost doubled, reaching $17.4 trillion in 2015. In countries such as Indonesia, Thailand, India and Russia, the top 1 percent account for more than half of the total wealth pool.

High inequality of outcomes may undermine social cohesion, hurt long-term growth, and reinforce inequality of opportunities. In light of this, many countries are aiming for more balanced and inclusive growth in their national development plans. Globally, reducing inequalities and moving to a pattern of development that leaves no one behind is also a fundamental goal of the 2030 Agenda for Sustainable Development. “Impact-driven” small and medium sized enterprises could be the backbone of an economy for sustainable development.

Source: ESCAP, based on WDI, SWIID 5.1 and Credit Suisse

Note: Gini coefficients based on household consumption (C) and income (I) estimates.
How can tax policy narrow the gap?

- Adequate and more balanced tax revenues

Redistribution through taxes and transfers played an important role in developed countries throughout the 20th century. Despite a decline in tax progressivity since the early 1980s, direct taxes such as taxes on personal incomes and property still account for more than half of total tax revenues in these countries. Such redistribution has not taken place in most Asian developing countries. This is partly due to their lower levels of tax collection and their heavier reliance on indirect taxes such as taxes on goods and services and international trade, which are generally less progressive than direct taxes. Indeed, most Asian countries collect less than 2 per cent of GDP in personal income tax compared to 5 to 10 per cent in taxes on goods and services. In contrast, OECD countries on average collect more than 8 per cent of GDP from personal income tax.

At the same time, many countries of the region still suffer from extremely low tax revenue levels. Countries like Afghanistan, Bangladesh, Pakistan, Iran (Islamic Republic of) and Sri Lanka mobilize less than or barely 10 per cent of GDP in tax revenue, half of what other developing countries mobilize. Such low revenue is becoming a primary bottleneck for these countries to finance necessary investment in education, infrastructure, healthcare and social protection, in order to achieve the SDGs. Strengthening tax revenue would be a key priority for these countries as highlighted in previous ESCAP analysis.

- A more progressive income tax

Globally and in most of Asia, the progressivity of the personal income tax has declined in the past few decades, as reflected in steep cuts in top marginal tax rates. For a sample of 10 Asian countries, top marginal rates have on average declined from 60 per cent in 1981 to 31 per cent in 2015 (Figure 3). Other aspects which are relevant for tax progressivity include (i) the income threshold for the top bracket, which in some case is as high as 80 times the country’s per capita income, thus making the top marginal rate less meaningful; (ii) the income threshold for exemption, which should be high enough so as not to burden the poor but low enough to broaden the tax base, especially as incomes rise; (iii) allowances, deductions and credits, which sometimes disproportionately benefit the rich; and (iv) the taxation of capital income, which is often taxed separately from labour income at a lower flat rate, thus reducing progressivity.

In Asia, albeit with varying country circumstances, there seems to be room to increase the tax burden at the top by raising the top marginal rate and/or lowering the income threshold for the top bracket. The revenue implication would depend on how responsive their taxable income is to a higher marginal tax rate, including tax avoidance and evasion responses – for which better enforcement is required, for instance, through large taxpayer offices – as well as impacts on labour supply. To properly tax capital income, domestic measures such as withholding and third-party information reporting, especially by financial institutions, could be complemented by exchanges of information between national tax authorities.

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**Figure 2. How balanced is the tax mix?**

![Tax mix chart](image-url)

**Source:** ESCAP, based on IMF GFS, WDI and CEIC DATA.

**Note:** For change in direct-indirect tax ration, earliest and latest year vary significantly by countries. The figure does not show social security contributions, which are quite high in OECD countries.

**Figure 3. How progressive is the personal income tax?**

![Progressive income tax chart](image-url)

<table>
<thead>
<tr>
<th>Country</th>
<th>Standard tax reliefs (basic)</th>
<th>Standard tax reliefs (family)</th>
<th>Non-standard tax reliefs (basic)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>Allowance of CNY 2,000 per month; Employee SSC fully deductible</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>India</td>
<td>Zero rate band in tax schedule; Employee SSC fully deductible</td>
<td>Educational allowance of INR 100 per month per child</td>
<td>Voluntary contributions to private pension plans deductible; Medical insurance premiums deductible up to INR 15,000; medical expenses deductible up to INR 40,000</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Allowance of IDR 15,840,000; Employee SSC fully deductible</td>
<td>Spouse allowance of IDR 1,320,000; Dependents allowance of IDR 1,320,000 per dependant (max 3)</td>
<td>Voluntary contributions to private pension plans deductible; Allowance for work related expenses (up to 5 per cent of income)</td>
</tr>
</tbody>
</table>

- **Greater use of wealth related taxes**

There is a renewed interest in wealth related taxes amidst increases in the ratio of private wealth to national income and the concentration of wealth at the top. Such taxes may be levied at regular intervals, one time only, or when there is a change in ownership. They are broadly categorized into (i) recurrent taxes on immovable property; (ii) taxes on financial and capital transactions; (iii) estate, inheritance and gift taxes; and (iv) taxes on net wealth. Albeit at varying degrees, these taxes are considered highly progressive, including from an inter-generational perspective.

Compared to OECD countries, where they collect around 2 per cent of GDP on average (and as much as 4 per cent in France and the United Kingdom), wealth taxes only play a marginal role in developing Asian countries, collecting less than half a percentage of GDP in most countries. Such differences partly reflect the administrative challenges of wealth taxes, most notably disclosure and valuation. Capacity constraints, coupled with lack of mature property markets and financial transparency, make the task of estimating and taxing personal wealth extremely challenging.

![Graph of wealth related taxes](source)

**Figure 4. How much do wealth related taxes collect?**

**Source:** ESCAP, based on IMF GFS.

**Note:** General governments unless otherwise indicated for recurrent property tax and financial transaction tax.
Nevertheless, several countries are moving forward to reap the social and economic benefits of wealth taxes. Thailand, for instance, introduced inheritance tax for the first time in 2016 while China is preparing for the nationwide introduction of property tax and inheritance tax.

Way forward

Tax reforms in the recent decades have largely focused on revenue and efficiency considerations, sometimes based on an understanding that redistribution should come primarily through the spending side. While spending on education and health and social transfers are certainly important for inclusive growth and contain some elements of redistribution, they are relatively ineffective in addressing the concentration of income and wealth at the top. Tax policy can play a particularly useful role in this regard, as discussed in this policy brief. This is in line with the view that the fairness of the fiscal system should be assessed in a comprehensive manner. Tax reforms in general and progressive tax reforms in particular are challenging, as they require institutional capacity strengthening, effective governance and a broad national agreement on what is fair. To steer these reforms successfully, setting medium-term strategies and targets and engaging all stakeholders

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5 ESCAP calculations based on Credit Suisse.
6 For instance, China’s 13th five year plan (2016-20) emphasizes a more balanced, inclusive, and sustainable growth model, as do India’s 12th five year plan (2012-17) and the Philippines Development Plan (2011-16).
7 Tax progressivity measures the relative tax burden on rich and the poor of a tax. A tax is “progressive” when the richer individuals are subject to a higher tax rate compared to the poorer. In this case it redistributes income in favour of the poor. A tax is “regressive” if the opposite is true.
9 This section focuses on the personal income tax, which is particularly weak in Asia, compared to the corporate income tax, whose revenue contribution has been fairly buoyant but whose tax incidence is less clear given possible forward and backward shifting.
11 Social security contribution.
12 An estate tax is one levied on the value of assets at death; an inheritance tax is levied on the recipients.