

The IMF's Research on Inequality

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Views expressed are those of the presenter and should not be ascribed to the IMF

Main messages

1) Causes of inequality:

- There are many causes but the effects of economic policies are an important one. So countries cannot say that inequality is largely due to deep causes that cannot be easily changed or megatrends (e.g. technology) that are difficult to resist. A lot of inequality is due to policies that countries are free to choose or contain.

2) Consequences of inequality:

- Inequality is detrimental to the durability of growth.

3) Cures for (excessive) inequality

- Follows from the causes: economic policies should be designed taking into account both efficiency and equity impacts
- Redistribution: unless extreme, it does not hurt growth.
- So need to fear that the 'cure' of redistribution is worse than the 'disease' of inequality

Main implications for IMF's work

1) Causes of inequality:

- Since economic policies (on which the IMF routinely gives advice) can themselves be a cause of inequality, we have to understand the distributional impacts of policies

2) Consequences of inequality:

- Since inequality has an economic impact (on growth), IMF cannot say that the impact is moral, social or political and outside of our realm of expertise.

3) Cures for (excessive) inequality

- IMF policy advice should account for efficiency and equity impacts so we can advise governments on trade-offs

Structure of the presentation

- Overview of work and main findings
- A glimpse at the research
 - 1) Causes
 - Deep factors; megatrends; economic policies
 - Among economic policies
 - Fiscal consolidation
 - Capital account liberalization
 - Labor market policies
 - 2) Consequences
 - 3) Cures

OVERVIEW

Causes, Consequences, Cures

IMF's research has tried to answer three questions:

- 1) What are the **causes** of inequality?
- 2) What are the **consequences** of inequality?
- 3) What are the **cures** for (excessive) inequality?
 - How should IMF policy advice change to account for distributional considerations?

Measuring Inequality

- We distinguish between *global* inequality (inequality among people ignoring national identity) and *within-country* inequality
- Focus of much of our work is on understanding *within-country* inequality in incomes
 - An important additional focus of our work: understanding drivers of *gender inequality*
- We use standard measures of income inequality:
 - Gini coefficient
 - share of incomes going to top $x\%$ ($x=1, 5, 10$)

Causes of within-country inequality: Who Let the Gini Out?

Like previous studies we find there are many drivers of inequality

- Deep structural factors
 - societal preferences; demographic
- Global 'mega-trends'
 - technology and trade
- Economic policies
 - Fiscal policies
 - Capital account liberalization (policies to boost mobility of capital across national boundaries)
 - Labor market policies
 - Monetary & financial policies



Consequences of inequality

Main finding from IMF research:
Inequality lowers the durability of growth

Other (non-IMF) research suggests other detrimental impacts of inequality:

- Decline in social cohesion
- Capture of political process by elites

That said, it is **not** IMF's view that all inequality is bad

- Some inequality unavoidable, indeed desirable, in market economies
- So need a case-by-case approach to decide when inequality is excessive or unhealthy and needs to be addressed

Cures for inequality

We divide cures into 'pre-distribution' and 'redistribution' policies

Main 'pre-distribution' policies: improving access to education, health care and financial markets

- Focus on IMF research has been on the last (financial inclusion)

Main redistribution policies are taxes and transfers

- Important finding from IMF research: redistribution, unless extreme, does not hurt growth

IMF policy advice (e.g. on fiscal and financial policies) should take into account distributional effects

**CAUSES:
A GLIMPSE AT THE RESEARCH**

Causes of Inequality

SDN/15/13

Causes and Consequences of Income Inequality: A Global Perspective

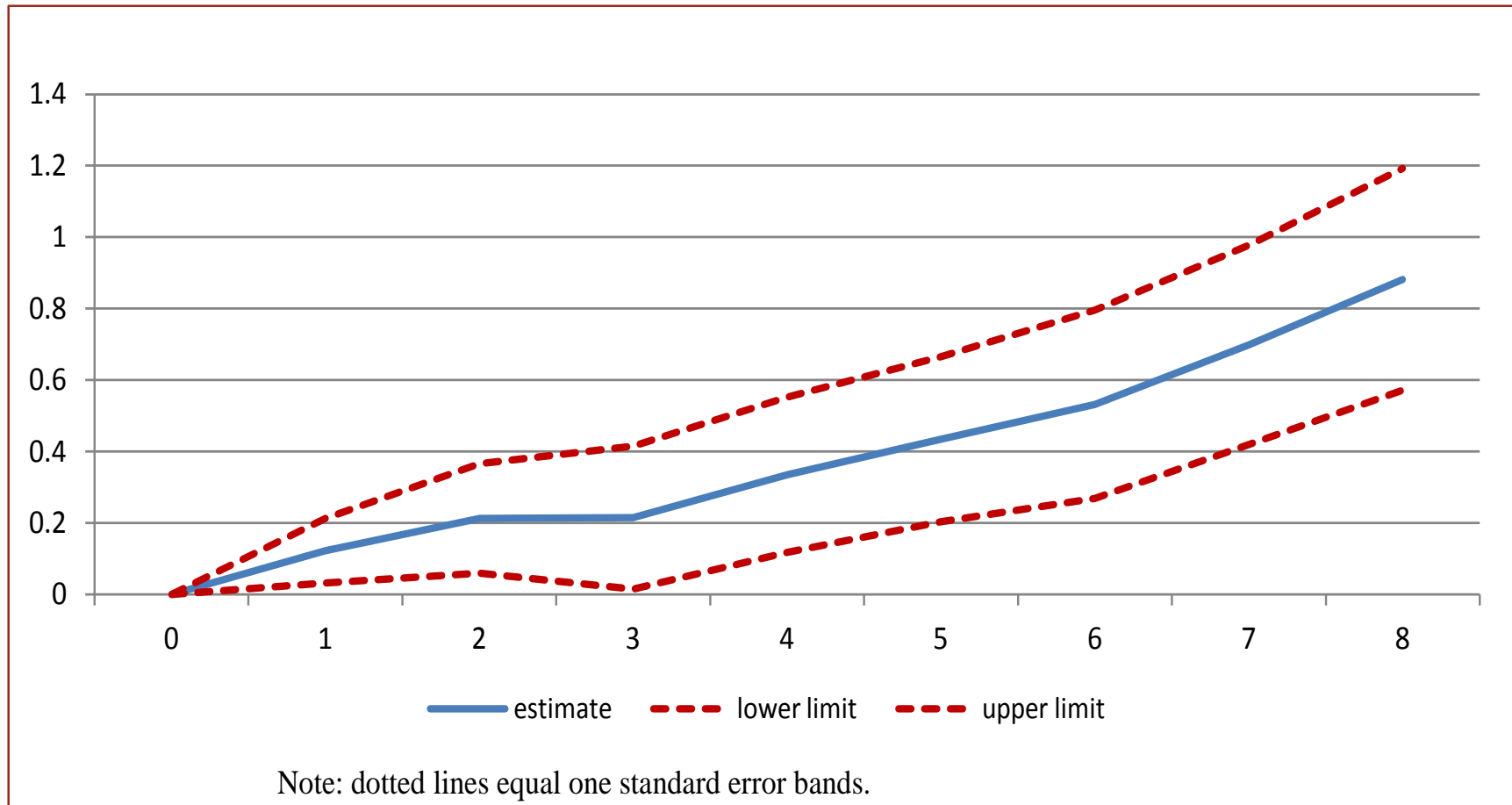
Era Dabla-Norris, Kalpana Kochhar, Nujin
Suphaphiphat, Frantisek Ricka, Evridiki Tsounta

- Illustrates that there are many drivers of inequality: deep factors; megatrends; economic policies
- Shows drivers differ in advanced vs. developing countries

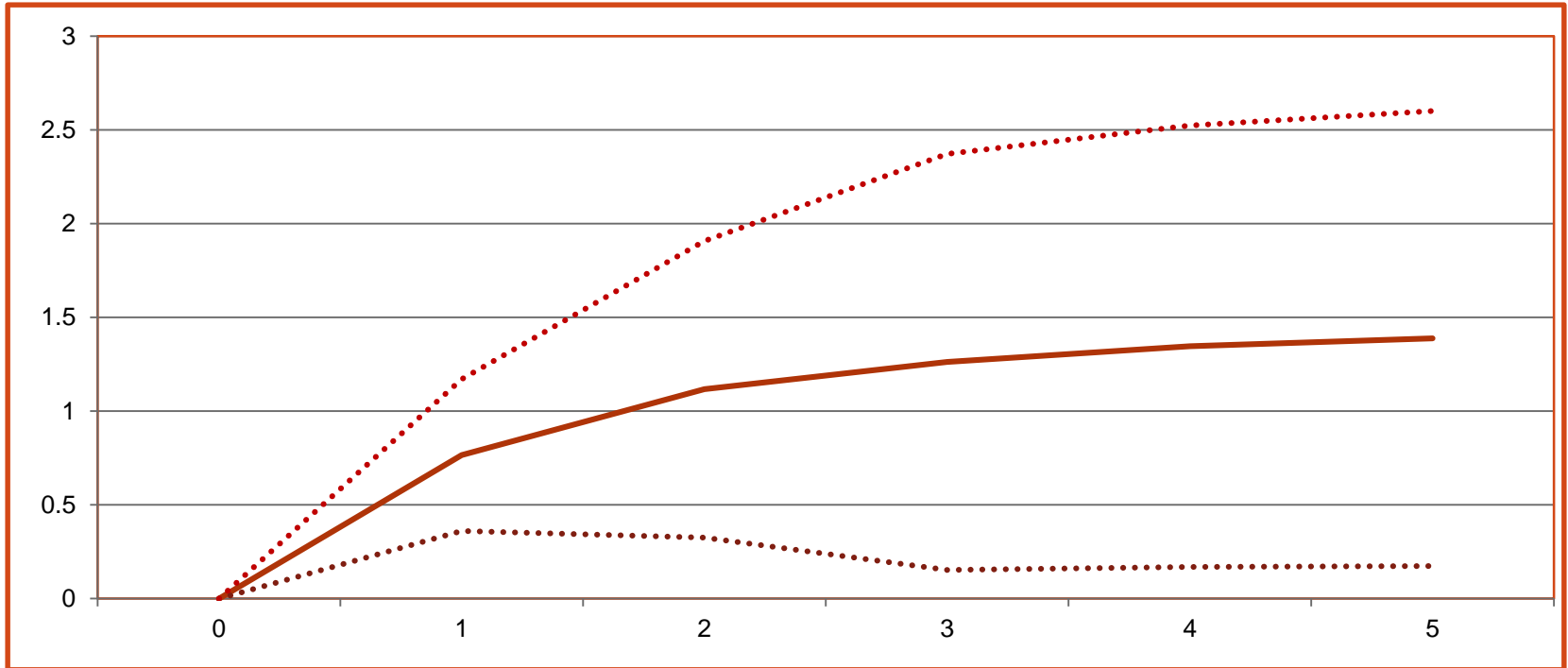
Impact of economic policies: Sources

- Ball, Furceri, Leigh and Loungani, The distributional effects of fiscal consolidation, [UN-DESA working paper](#), [IMF working paper](#)
- Furceri and Loungani, The distributional effects of capital account liberalization, [IMF working paper](#)
- Jaumotte and Osorio-Buitron, Inequality and Labor Market Institutions, [IMF Staff Discussion Note](#)

Impact of fiscal consolidation on the 'Gini' measure of inequality

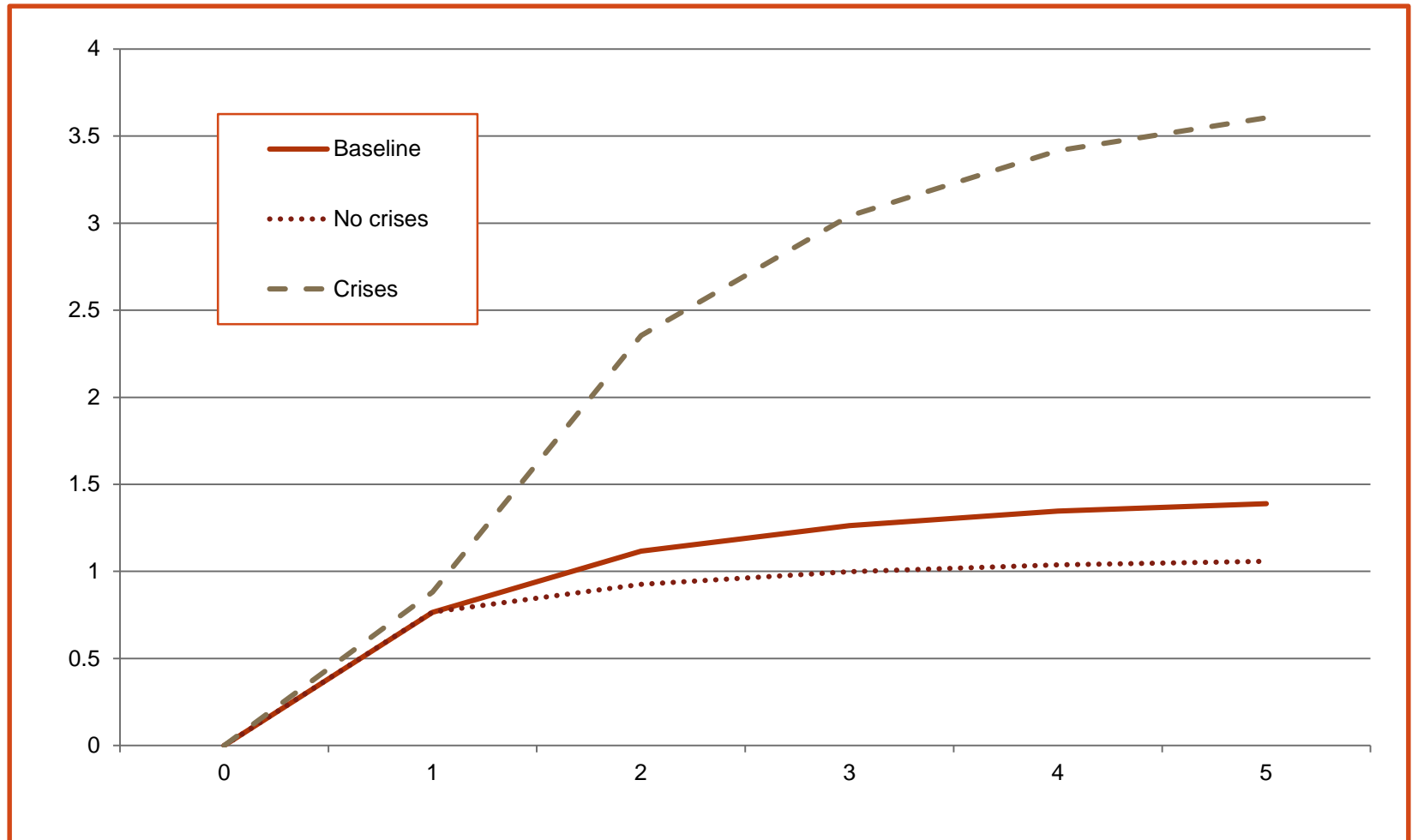


Impact of 'openness' on the Gini



Episodes of capital account liberalization are followed by increases in inequality (as measured by the Gini coefficient)

Impact of 'openness' on the Gini depends on whether opening is followed by a crisis

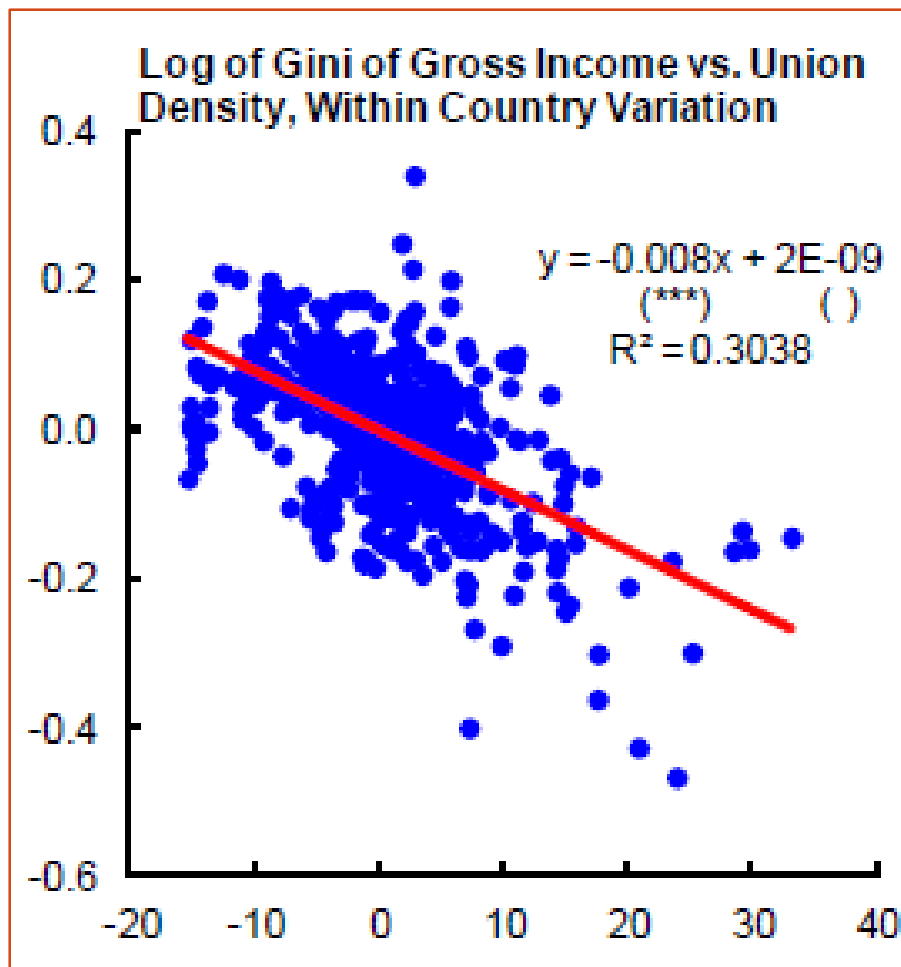


Labor Market Policies and Inequality

IMF STAFF DISCUSSION NOTE

Inequality and Labor Market Institutions

Florence Jaumotte and Carolina Osorio Buitron



**CONSEQUENCES:
A GLIMPSE AT THE RESEARCH:**

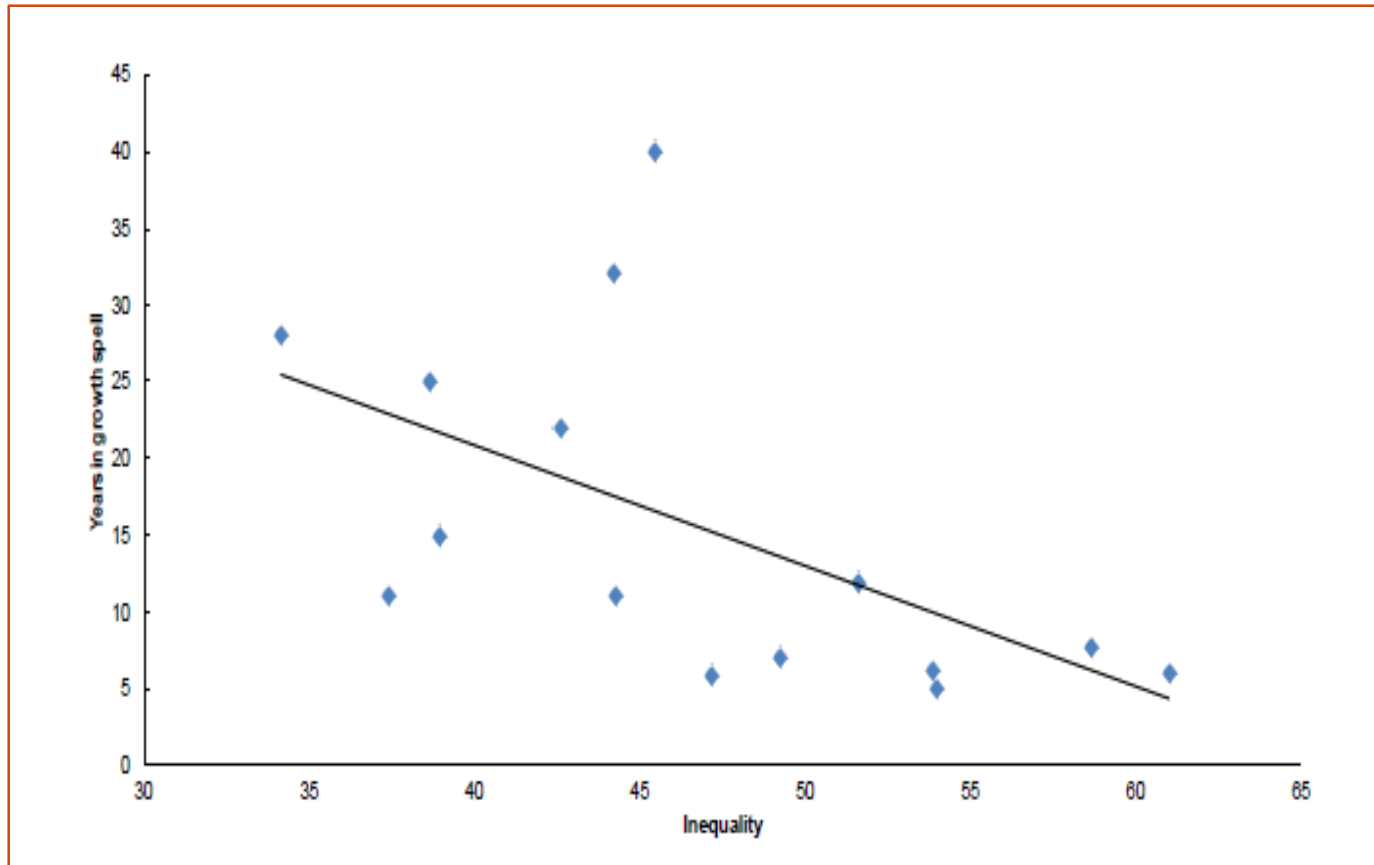
Consequences of Inequality

Inequality and Unsustainable Growth: Two Sides of the Same Coin?

Andrew G. Berg and Jonathan D. Ostry

- Key result:
Inequality lowers the duration of growth spells

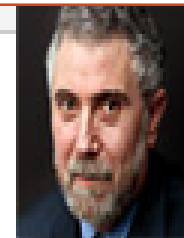
Duration of Growth Spell and Inequality



Source: [Berg and Ostry, 2011](#)

**CURES:
A GLIMPSE AT THE RESEARCH:**

The Conscience of a Liberal



PAUL KRUGMAN

“Daive Furceri and Prakash Loungani use an event-study framework, looking at what happens on average after clear changes in policy, to assess the effects of “neoliberal” policy changes (although they don’t put it that way) on inequality. Sure enough, ***they find that both fiscal austerity and liberalization of international capital movements are followed by noticeable rises in income inequality.***”

“So, ***if you were a ranting leftist, you might say that*** political attitudes are shaped by class, and that ideological justifications for high inequality are just a veil for class interest. You might also say that ***“sound” economic policies are really just policies that redistribute income upwards. And it turns out that the econometric evidence more or less supports your rant.***”

Paul Krugman, Vox Anti-Populi, Feb. 13, 2014

Cures for Inequality: Example of Designing Fiscal Policies to Account for Distributional Effects



INTERNATIONAL MONETARY FUND

IMF POLICY PAPER

FISCAL POLICY AND INCOME INEQUALITY

January 23, 2014

Cures for Inequality: Fiscal Policies in Advanced Economies

Both tax and expenditure policies need to be carefully designed to balance distributional and efficiency objectives, including during fiscal consolidation. The appropriate mix of instruments will depend on administrative capacity, as well as on society's preferences for redistribution, the role envisaged for the state, and political economy considerations. Options for redistributive policies that help minimize efficiency costs, in terms of their effects on incentives to work and save, are the following:

- In advanced economies: (i) using means-testing, with a gradual phasing out of benefits as incomes rise to avoid adverse effects on employment; (ii) raising retirement ages in pension systems, with adequate provisions for the poor whose life expectancy could be shorter; (iii) improving the access of lower-income groups to higher education and maintaining access to health services; (iv) implementing progressive personal income tax (PIT) rate structures; and (v) reducing regressive tax exemptions.

Cures for Inequality: Fiscal Policies in Developing Economies

- In developing economies: (i) consolidating social assistance programs and improving targeting; (ii) introducing and expanding conditional cash transfer programs as administrative capacity improves; (iii) expanding noncontributory means-tested social pensions; (iv) improving access of low-income families to education and health services; and (v) expanding coverage of the PIT.

Innovative approaches, such as the greater use of taxes on property and energy (such as carbon taxes) could also be considered in both advanced and developing economies.

Fiscal consolidation during crises

From Woo, Bova, Kinda and Zhang (IMF Working Paper, 2013)

- “The composition of austerity ... matters, and better-designed tax and social benefits policies can help ... progressive taxation and social benefits are consistently associated with lower inequality”
- *“For reasons of equity and also of political economy, fiscal adjustments that are viewed as being unfair are unlikely to be sustainable. It is therefore critical that the costs associated with fiscal consolidations and weaker growth be shared equitably throughout the economy.”*

Capital Account Liberalization: Taking Distributional Considerations into Account

Findings

1. Capital account liberalization is followed by increases in inequality
2. But:
 - Impact of liberalization on inequality is smaller when financial development and inclusion are higher
 - Impact is smaller if liberalization is 'well-managed' (i.e. not followed by a financial crisis)

Policy Implications

- The first finding does **not** imply that countries should not undertake capital account liberalization, but it suggests an additional reason for caution
- The second finding provides an additional reason to support the IMF's "institutional view" that the benefit-to-cost ratio of liberalization is higher past certain thresholds of financial development

Redistribution as a cure: key paper

IMF STAFF DISCUSSION NOTE

Redistribution, Inequality, and Growth

Jonathan D. Ostry, Andrew Berg, and Charalambos G. Tsangarides

February 2014

SDN/14/02

Findings on impacts of redistribution

- *“lower net inequality is robustly correlated with faster and more durable growth, for a given level of redistribution”*
- *“redistribution appears generally benign in terms of its impact on growth; only in extreme cases is there some evidence that it may have direct negative effects on growth.”*
 - “Thus the combined direct and indirect effects of redistribution—including the growth effects of the resulting lower inequality—are on average pro-growth.”

Source: [Ostry, Berg and Tsangarides](#),
IMF Staff Discussion Note 2014

Conclusions on redistribution

“Extreme caution about redistribution—and thus inaction—is unlikely to be appropriate in many cases.”

“On average, across countries and over time, the things that governments have typically done to redistribute do not seem to have led to bad growth outcomes, unless they were extreme.”

“And the resulting narrowing of inequality helped support faster and more durable growth, apart from ethical, political, or broader social considerations.”

Source: [Ostry, Berg and Tsangarides](#),
IMF Staff Discussion Note 2014