

Inequality in
developed countries -
how good is a “good
state”

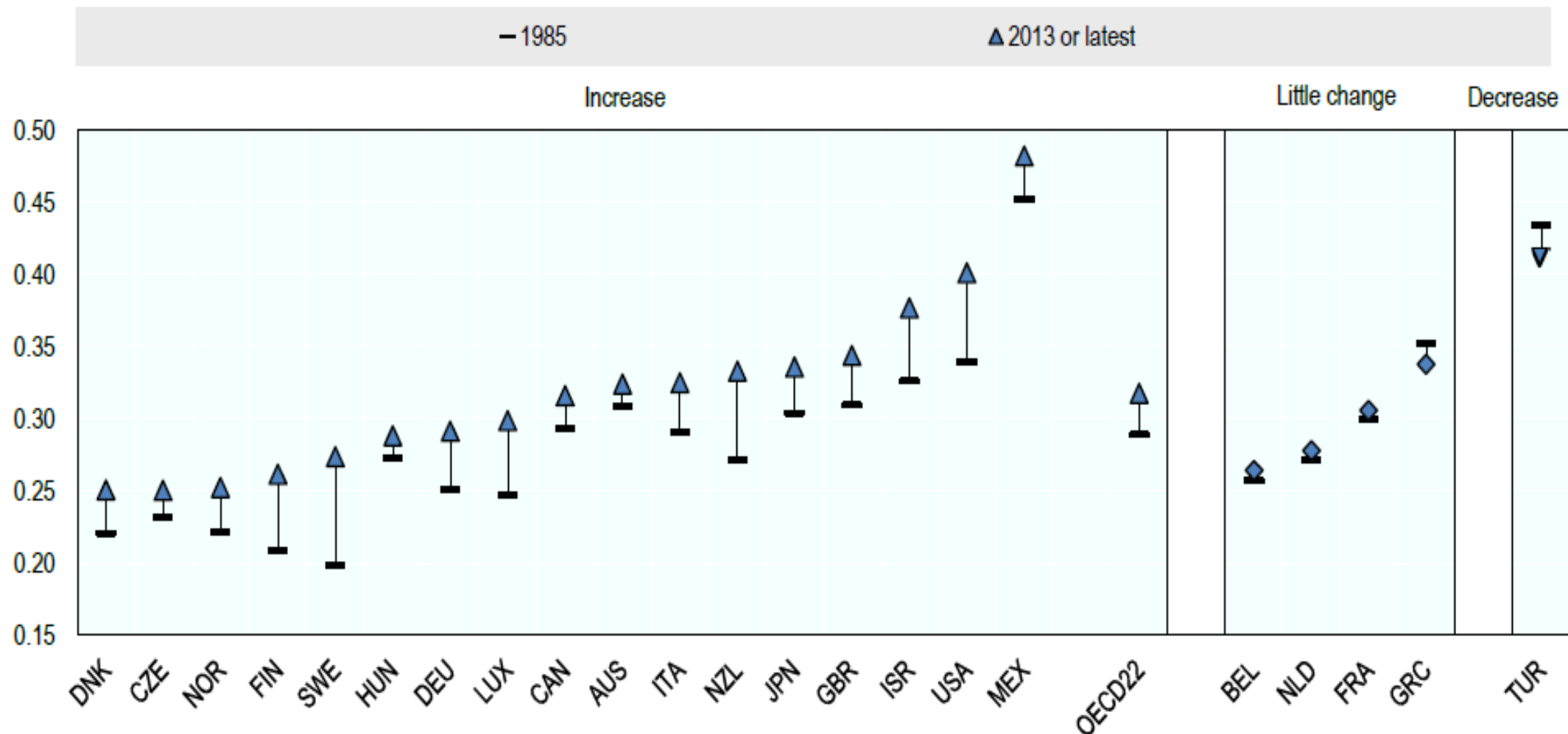
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Inequality in developed countries

- We have seen increased inequality in developed countries
- How do we combat this increasing inequality?
 - Typically a trade-off between efficiency and equality
- How can we design policies to reduce inequality –
 - Experiences from the Nordic countries

INCREASED INEQUALITY

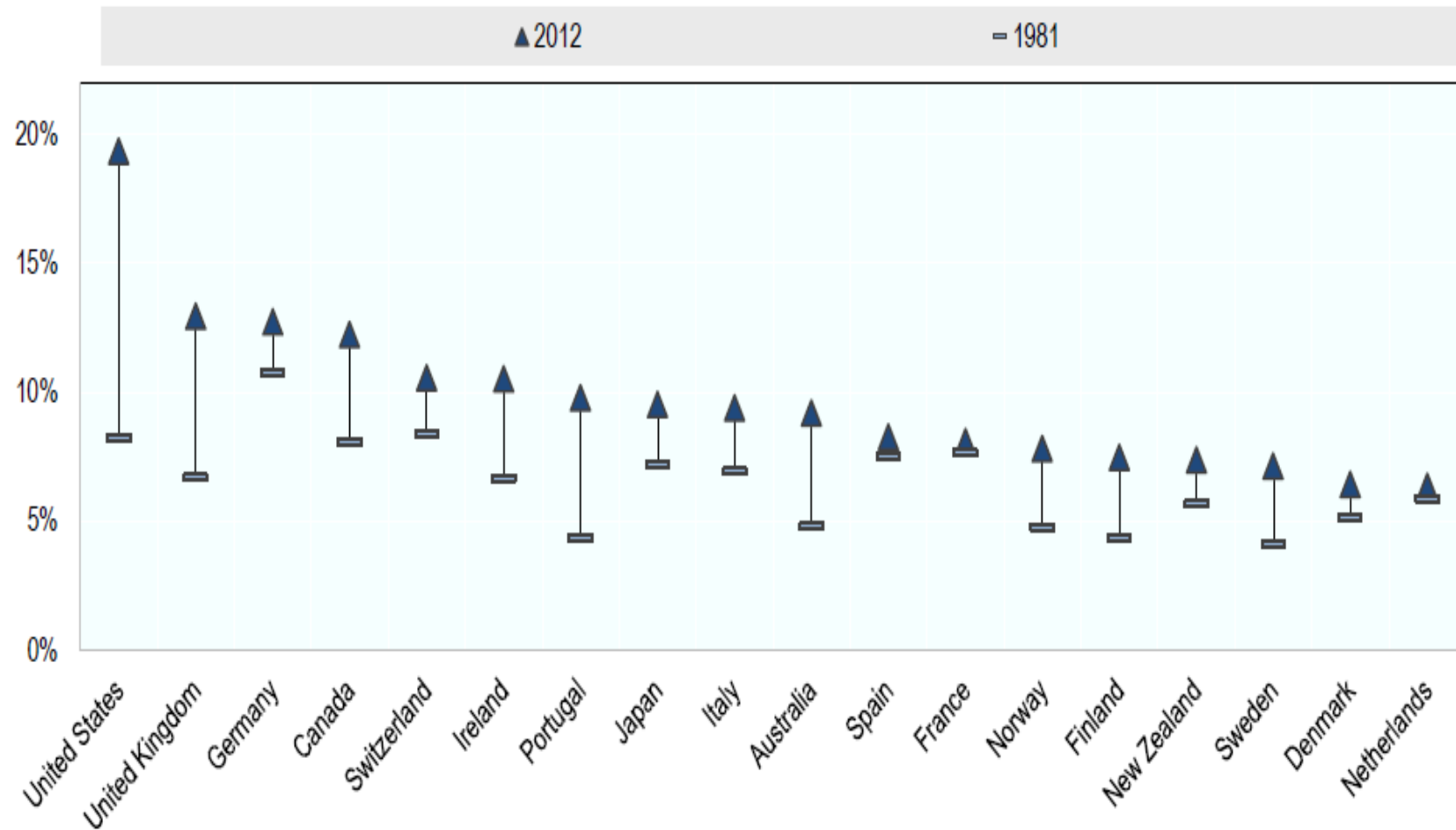
Figure 1. Disposable income Gini coefficients, mid-1980s and 2013 (or latest available data)



Source: *In It Together* (OECD, 2015b)

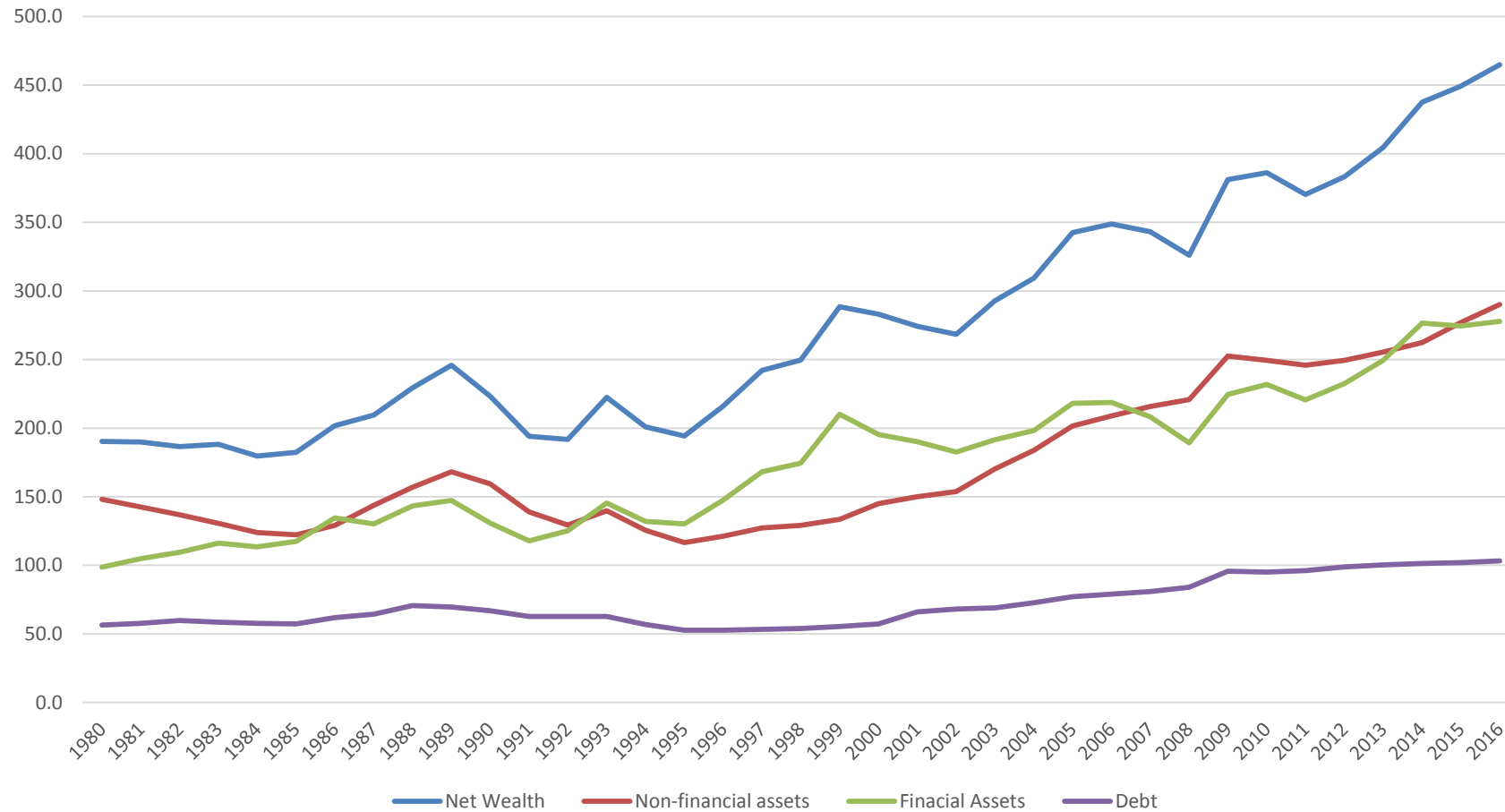
Note: "Little change" in inequality refers to changes of less than 1.5 percentage points

Figure 2. Share of top 1% incomes in total pre-tax income, 1981-2012 (or closest)

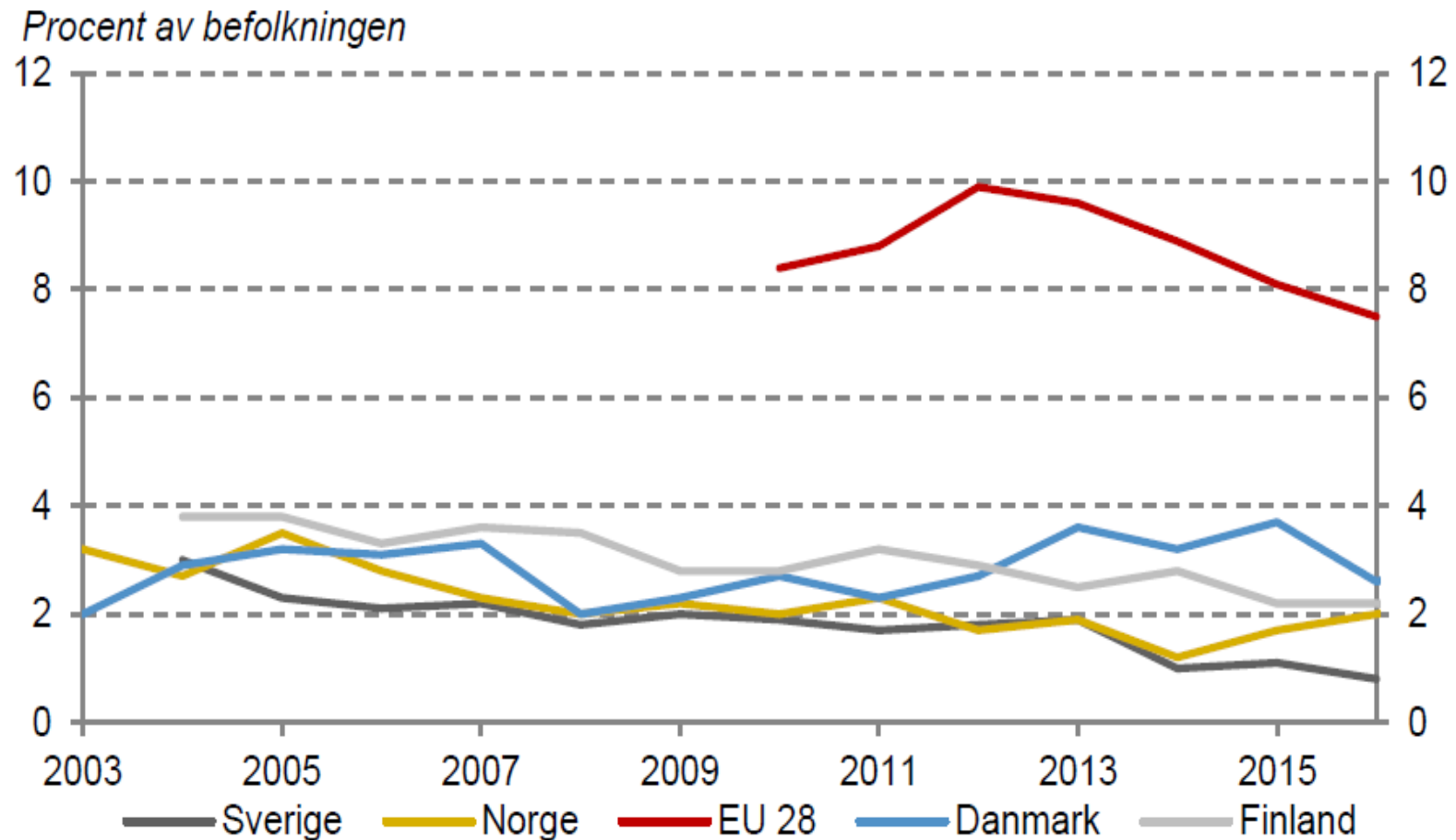


Source: OECD (2015b), OECD calculations based on the World Top Income Database

Wealth in Sweden, percent of national income



Share of population with very low material standard



Källa: Eurostat och Macrobond.

Increased inequality

- Gini-coefficients have increased (not least in Sweden)
 - Top-income individuals earn a larger share of total income
 - Poverty has increased (head-count) and primarily among young people (before primarily among the elderly)
- Wealth
 - Non-financial wealth constitutes 70-90 % of households total wealth
 - In the very top, financial wealth constitutes a major part of total wealth
- Research on inequality and economic growth
 - No consensus on the relationship, but inequality at the bottom seem to be more harmful to economic growth than inequality at the top (Biswas et al. 2015)

HOW TO COMBAT INCREASED INEQUALITY

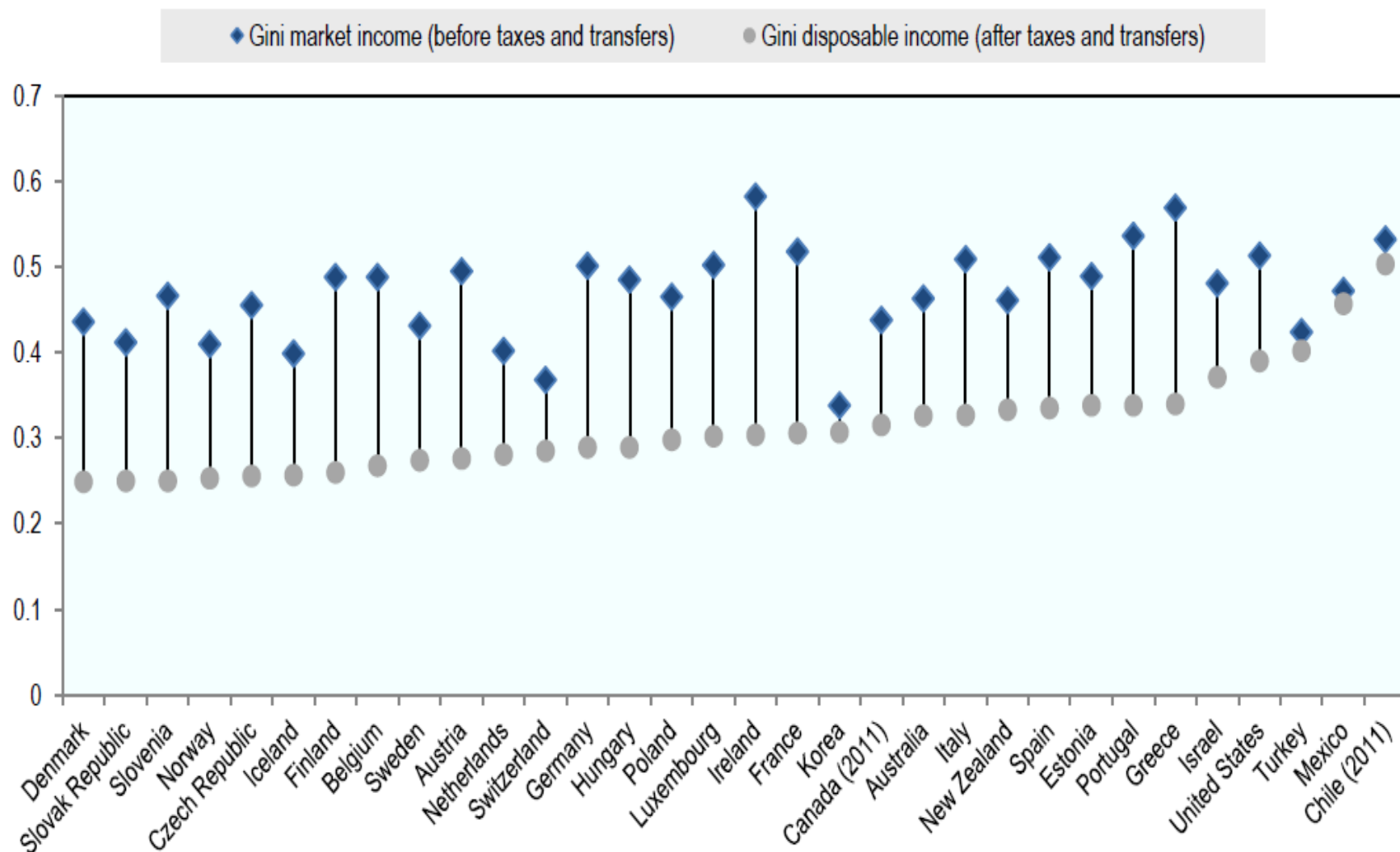
How to combat inequality?

- What can the government do to decrease inequality?
- Typically a trade-off between efficiency and equality
 - Redistribution decreases inequality but may also harm incentives to take effort
 - How do you design policies that reduce inequality and do not harm incentives?
 - Government expenditures (transfers, spending on education, health etc)
 - Taxes

Taxes and transfers impact the distribution

- Taxes generate tax revenues that are used to decrease income- and wealth differences
- Taxes reduce differences in disposable income and wealth (progressive income tax, broaden tax bases, reduce tax avoidance and evasion, wealth and gift and inheritance taxes)
- The tax system can affect differences in market income (influence incentives to work, EITC)
- Important to remember that in the long-run the tax/transfer system has a lower impact on redistribution than in the short-run

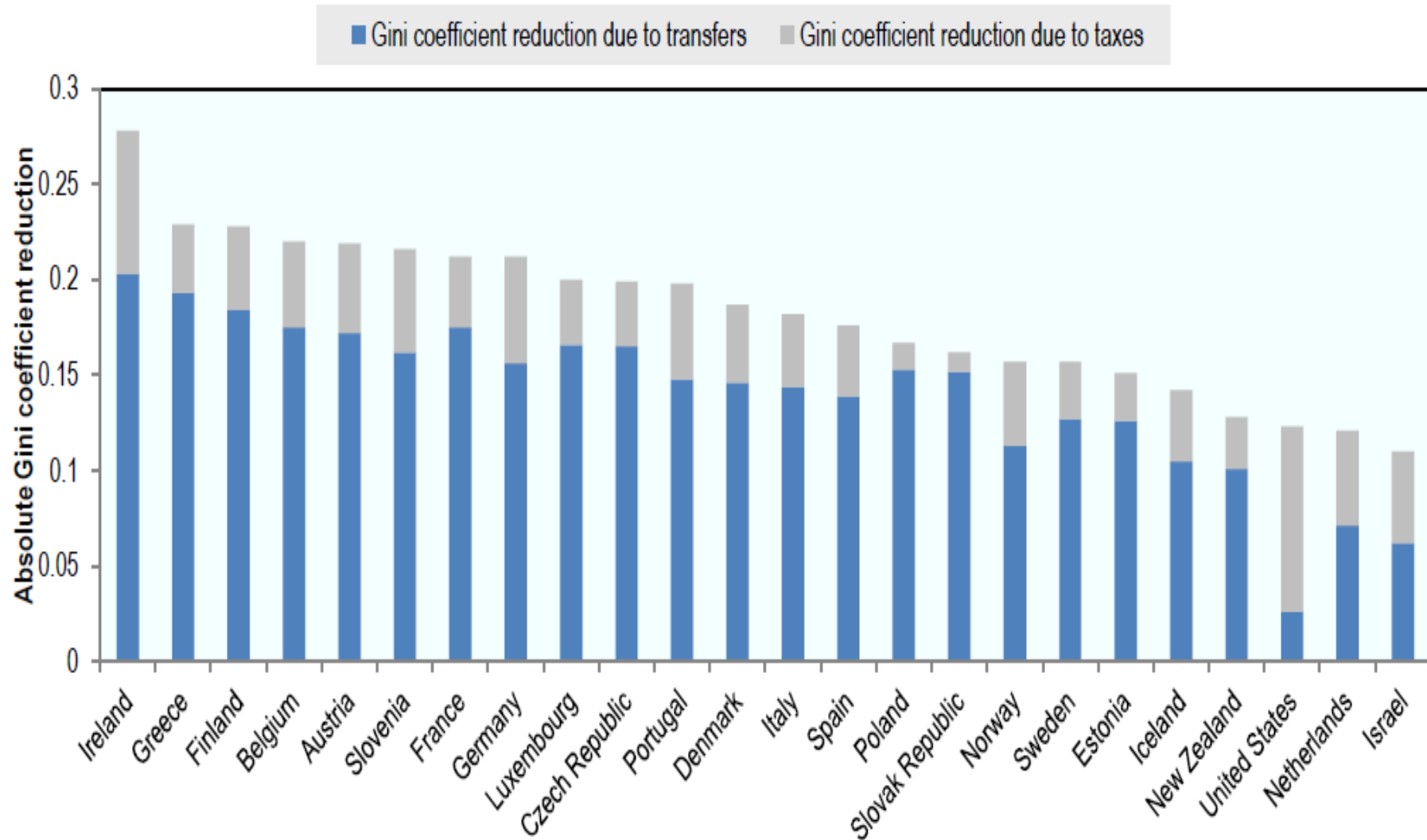
Figure 4. Gini coefficients before and after taxes and transfers in OECD countries, 2012



Source: OECD Income Distribution Database

Note: Data from 2011 for Canada and Chile

Figure 5. Redistributive impact of taxes versus cash transfers in OECD countries, 2012



Source: OECD Income Distribution Database – N.B.: no data for Australia and Switzerland

How to reduce inequality

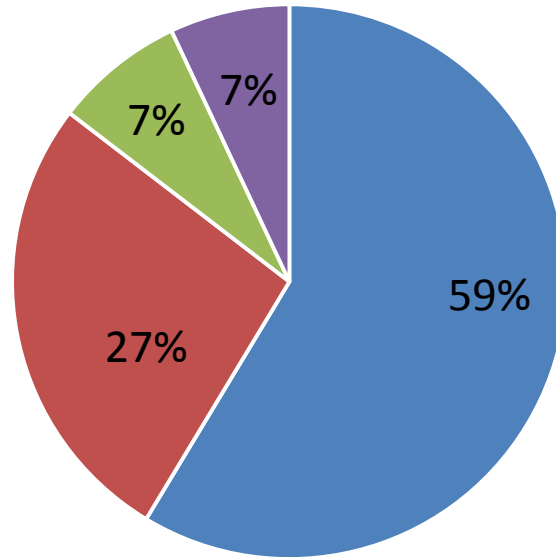
- Taxes are not the primary mean to reduce income inequality. Government expenditures do more to reduce income inequality (cash transfers)
- How to reduce income and wealth inequality
 - Wealth tax?
 - Inheritance and gift tax?
 - Property tax?
 - Progressive income taxes?

The Nordic Welfare State Model

- The Nordic countries are known to redistribute and spend large amounts on social expenditures (the Welfare State)
- However, it is important to note that the majority of the redistribution is life-cycle redistribution, not redistribution from rich to poor
 - It is the low- and middle-class that are taxed and also those that receive most transfers
 - Not primarily redistribution from rich to poor
- The tax system in the Nordic countries have an insurance effect
 - This insurance mechanism decreases the distortionary effect of taxes and have been used to explain why taxes do not harm economic growth more in the Nordic countries. How well this insurance mechanism works depend on the quality of what the welfare state offers and degree of free-rising
- Redistributing from rich to poor creates negative incentive effects

Inequality has gone up in Sweden

- Wealth and capital related taxes have gone down
- Lion's part of taxation comes from taxation of labor



■ Tax on labor

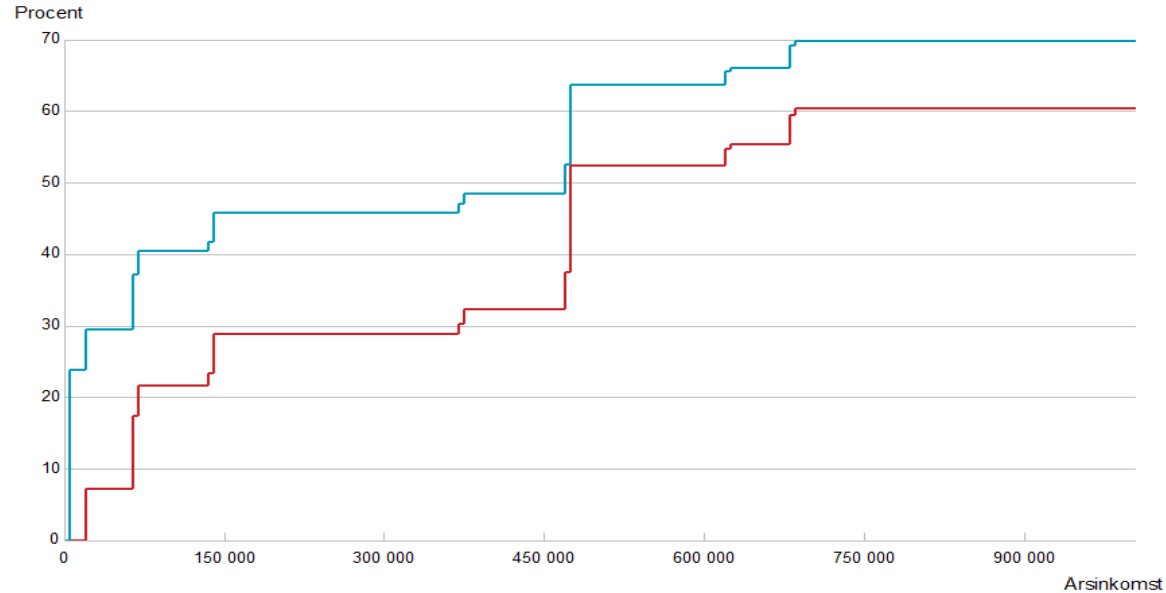
■ Tax on consumption

■ Tax on corporations

■ Tax on capital individuals

Sweden a high tax country on labor income – but wealth and capital is taxed at relatively low rates

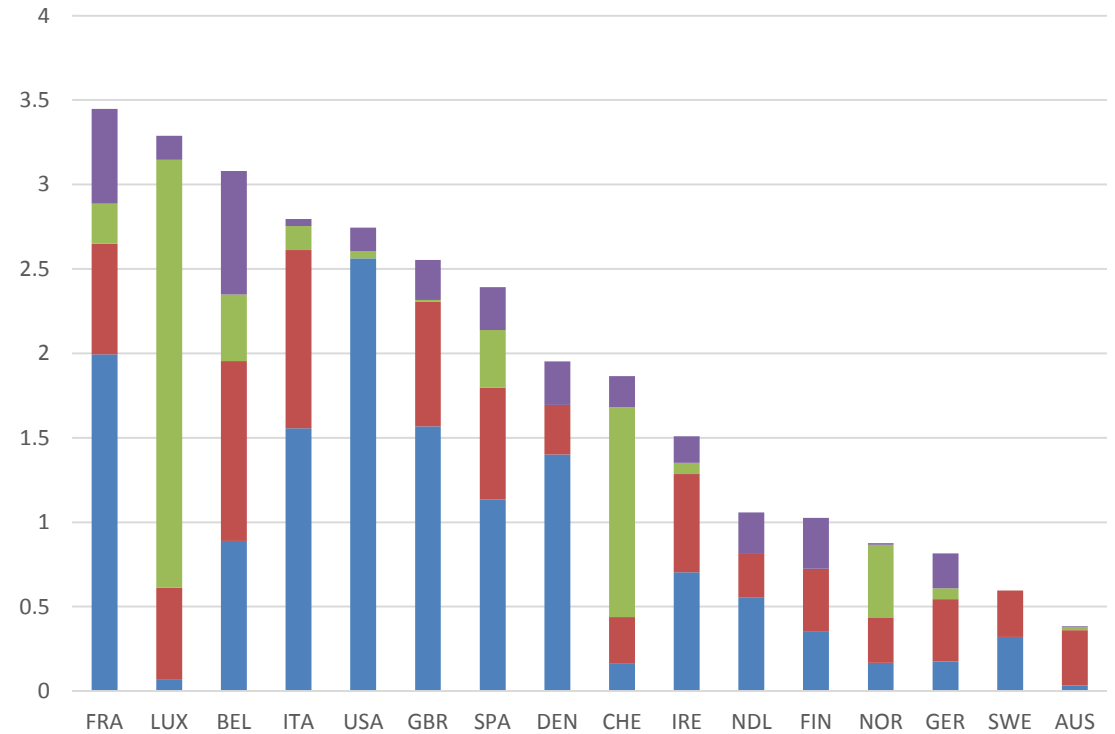
Marginalskatt, arbetstagare, år 2018



Källa: Finansdepartementet samt beräkningar av Ekonomifakta
 Beräkningarna baseras på en genomsnittlig kommunalskattesats på 32,12 procent samt en begravningsavgift på 0,22 procent. Av diagramtekniska skäl har vissa mindre variationer i marginalsikten utjämnats. Dessa små variationer uppkommer bland annat på grund av grundavdragets avtrappning.
 Hämtat: 2018-05-28 11:15

ekonomifakta

■ Marginalskatt ■ Marginalskatt, inkl arbetsgivaravgift



■ Property tax ■ Transaction tax
 ■ Wealth tax ■ Inheritance tax

Wealth related taxes

- **Wealth tax:**
 - Distortionary, easy to avoid
 - Hard to measure wealth and the tax is associated with high administrative costs
 - A tax on capital income is preferable
- **Inheritance and gift taxes:**
 - Lower distortionary costs than a wealth tax, harder to avoid
 - Efficient mean to increase equality in life opportunity
- **Property tax:**
 - The least harmful tax to economic growth
 - Progressive in nature as rich individuals tend to live in higher valued properties
- **Progressive income taxes:**
 - High marginal tax rates harmful for incentives
 - But most countries employ progressive income taxes
 - Marginal taxes should be U-shaped according to optimal taxation

Has demand for equality decreased in Sweden?

- Last election a majority voted for lower taxes
- Sweden today is more heterogeneous than before
 - Research shows a correlation between a homogenous population and degree of redistribution (government size)
- But inequality has increased – especially among those that own (property or stocks) and those that do not own and between those that work and those that do not work
- Talk about a new large overall tax reform

Tax design for increased inequality

- 1. Broaden the tax base (remove tax expenditures)
- 2. Improve the progressivity
 - Tax capital, capital income taxes
 - Inheritance and gift tax is efficient in achieving more equal life opportunities
 - Tax property
 - Improve link between payment and benefit

Tax design for increased inequality

- 3. Encourage effort
 - Reduce black market activities
 - Earned income tax credit
- 4. Fight tax avoidance and tax evasion

Not primarily taxing rich and redistribute to poor!

THANK YOU FOR YOUR TIME!