I J A B E R, Vol. 12, No. 1, (2014): 131-136

INEQUALITY IN EMERGING ECONOMIES (EES)

PREMA PARANDE*

Abstract: Emerging countries are playing a growing role in the world economy. It is a role that is expected to be even greater in the future. It is important, therefore, that any comprehensive assessment of inequality trends worldwide considers the emerging economies. This Paper discusses inequality patterns and related issues in the emerging economies. Focus on the fight against corruption would also help improve tax collection. Over time, the pay-offs from these efforts would be visible both in terms of improved horizontal equality – individuals with the same gross income paying the same amount of tax – and vertical equality – as better-off individuals who are typically better able to evade taxation have to pay their fair share in taxes.

INTRODUCTION

Emerging countries are playing a growing role in the world economy. It is a role that is expected to be even greater in the future. It is important, therefore, that any comprehensive assessment of inequality trends worldwide considers the emerging economies.Iinequality patterns and key related policy challenges in Argentina, Brazil, China, India, Indonesia, the Russian Federation and South Africa. These countries form the group of the world's largest emerging economies.Henceforth collectively referred to as EEs, they total about one fifth of global GDP and close to half the world's population. At a time when restoring sustainable growth after the Great Recession is a key priority, they are playing a very crucial role in supporting the global economy. As active participants in the Group of Twenty (G20), the EEs are also actively engaged in shaping the post-crisis global governance architecture.

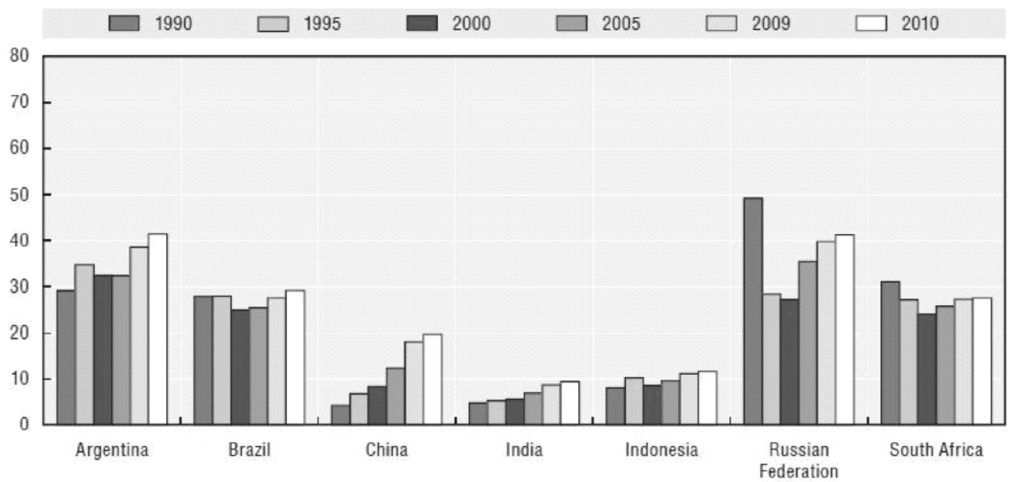
The emerging economies represent a highly heterogeneous group, in terms of conomic size, population, levels of per capita income and growth performance over the past decade. China and India, for example, are among the largest economies and the two most populous countries in the world, while Argentina and South Africa are considerably smaller economies. Moreover, the EEs have reached different stages of development, with the variation among their incomes being similar to that among the 34 OECD countries. Their long-term patterns of development also differ.

This paper focuses on within-country inequality in the EE countries. Its main findings and policy challenges are as follows:

- All EEs have levels of income inequality significantly higher than the OECD average.
- Brazil, Indonesia and, on some indicators, Argentina have recorded significant progress in reducing inequality over the past 20 years. By contrast, China, India, the

* Lecturer in Economics, BDE Society Women's College affiliated to KSWU Bijapur, Bijapur-586103, *E-mail: galaxybip_2005@yahoo.com*

Figure **GDP per capita**
Constant 2005 PPPs
Relative to the median of the upper half of OECD countries



Source: World Bank, International Comparison Program Database.

Russian Federation and South Africa have all become less equal over time and inequality levels in Argentina and Brazil do remain high. Inequality in South Africa and Russia has also reached high levels.

- While the challenge of tackling inequality is common to EEs and OECD countries, the underlying forces of inequality in the EEs are different from those in the OECD countries. Key sources of inequality include a large, persistent informal sector, widespread regional divides (e.g. urban-rural), gaps in access to education, and barriers to employment and career progression for women.

The benefit and tax systems in EEs play a lesser role than in the OECD countries in easing marketdriven inequality. The coverage and generosity of social protection systems is generally lower than in most OECD countries. Social spending is highest in Brazil and Russia, where it represents about three-quarters of the OECD average, while in China and India it is three to four times lower than the OECD average. At the same time, the tax system delivers only modest redistribution, reflecting such problems as tax evasion and administrative bottlenecks to collect taxes on personal income. The background is one of high levels of self-employment and sizeable informal sectors, which together limit the capacity of the tax authorities to verify taxpayers' declared income.

They combine income support with the requirement to maintain investment in human capital and child health means that they can be useful tools not only for tackling household poverty, but also for promoting school enrolment and improving healthcare for children. This approach will have longer-term beneficial effects on labour market outcomes in the EEs.

- Addressing inequalities in both access to, and quality of, education can also make an important contribution to lowering inequality in labour income.
- Enhancing the distributive capacity of the tax system would require an emphasis on improving revenue collection procedures and strengthening the extent to which taxpayers comply voluntarily with their obligations. A focus on the fight against corruption would also help improve tax collection.

Second, inequality trends show wide differences across EEs. At one extreme, strong output growth during the past decade went hand-to-hand with declining income inequality in two countries (Brazil and Indonesia). At the other extreme, four countries (China, India, the Russian Federation and South Africa) recorded steep increases in inequality levels during the same period, even though their economies were also expanding strongly. Argentina is the only country where inequality was broadly stable. 3

ECONOMIC FACTORS BEHIND INEQUALITY

The economic factors behind high and often growing income inequality in the EEs tend to differ from those at work in most OECD countries. Widespread informality, together with persistently large geographical differences in economic performances, plays a particularly important role in shaping income inequality in all EEs. Informality and geographical disparities are, in turn, closely intertwined with other key drivers of inequality, namely gender, ethnic disparities, alongside disparities in educational outcomes and in labour market conditions (contract type, productivity, and so on). This section reviews each of these drivers of inequality in turn.

Education

Education is of great intrinsic importance when assessing inequalities of opportunity. Educational institutions that give children from different backgrounds equal opportunities to benefit from quality education are generally associated with improved employment prospects and higher average earnings. Furthermore, education tends to be positively associated with well-being and social outcomes such as health status and willingness to participate and become socially active. By fostering social cohesion, the benefits of greater opportunities for education accrue to society as a whole.

School attainment rates have increased markedly in the EEs. With the exception of India and South Africa, primary attainment rates are today broadly similar to the average seen in the OECD for younger cohorts, although they remain lower for secondary and tertiary enrolments. Notwithstanding the improvements achieved, enrolment varies markedly, both geographically and between population groups – *i.e.* it is significantly lower in rural areas and is lower for girls than for boys. While in most EEs primary education is generally available in every local community, secondary education may require travelling or moving to larger urban areas, making attendance more difficult for children from disadvantaged households in rural areas, especially for girls still spending time working or helping with household duties. The lack of role models for girls and entrenched social roles still hamper the closing of the gender gap in education in several EEs.

Increasing attendance cannot be an end in itself. Rather, it should be a means to improving learning outcomes and the employability and competences of the workforce.

Impacts on Earnings

One country that has experienced a significant increase in earnings inequality over time is India, where the ratio between the top and the bottom deciles of the wage distribution has doubled since the early 1990s. The main driver has been an increase in wage inequality between regular wage earners – *i.e.* contractual employees hired over a period of time. By contrast, inequality in the casual wage sector – workers employed on a day-to-day basis– has remained more stable.

Unlike India, Brazil and South Africa underwent a marked compression of the ratio between the top and bottom deciles (D9/D1) of the earnings distribution, which was almost halved during the period between the early 1990s and late 2000s. The figures for South Africa, however, mask the fact that it had achieved most of the progress shown by the end of the 1990s. Thereafter, top earnings increased at a somewhat faster pace than those at the bottom of the distribution, which points to a partial erosion of earlier progress.Contributory social insurance programmes account for the bulk of public social expenditure in most EEs, particularly in China, India and Indonesia (OECD, 2010a). Eventhough programmes' coverage varies across countries, it is generally limited, and social expenditure is comparatively low. Most contributory social insurance tends to be in the form of pension schemes, covering workers chiefly in the formal sector and leaving the others unprotected. The share of the workforce contributing to a pension and/or health insurance plan ranges from about 10% India and Indonesia to 50-60% in Brazil and South Africa (OECD, 2011). To a large extent, low coverage reflects a high incidence of informality and self-employment.

How are Social Spending Requirements Financed?

However, EEs' tax revenues differ significantly from OECD countries' in that consumption taxes are the main source (Table 0.2). Most OECD countries tend to offset the regressive effects of consumption taxes through the progressivity of personal income tax (PIT) and insurance-based and income-related benefits or in-work tax credits. This redistribution through government budgets means that post-tax and benefit incomes are less unequally distributed than gross incomes.

Policy Challenges for Tackling Inequality While Creating more and Better Jobs

The broad challenge of gradually reducing inequality in the EEs over the long-term can be framed in the context of a multipronged approach that addresses four areas:

1. better incentives for more formal employment;
2. targeting social assistance to those in need;

3. spreading the rewards from education; and
4. preparing to finance higher social spending in the future.

The EEs can alter the distribution of incomes by adjusting their benefits and Government transfer systems and improving tax provisions. Such redistributive policies, once appropriately assessed to reflect domestic circumstances and priorities, can be powerful tools for reducing inequality. Indeed, one salient common denominator between the options for policies considered below is that they all help enhance equality, while acting as catalysts for better job creation.

Minimum Wage Policies

Minimum wages are useful tools for ensuring that fair wages are paid, thus helping to prevent poverty among workers, which includes supporting living standards for the lowskilled – many of whom are youth. Furthermore, redistributing income to workers at the low end of the pay scale decreases wage dispersion and is likely to boost aggregate demand through a multiplier effect. An advantage of minimum wages from an administrative perspective is that they require little monitoring. In addition to its low minimum wage ratio by international norms, India allows even lower rates to apply to youth in sectors such as agriculture and tea plantations. Good international practices, however, suggest that there may be stronger grounds for applying lower sub-minimum wages to young workers when the job requires investment in training. The rationale is that a more differentiated minimum wage setting offers the advantage of encouraging more firms to invest in hiring and training young workers, while enabling them to share the related cost burden with the young workers. OECD countries following this practice include Germany and the United Kingdom, where salaries and training allowances are initially set at relatively low levels to account for the lower labour productivity expected during the training period.

Preparing to Finance Higher Social Spending in the Future

The development of a comprehensive social protection system could put upward pressure on government spending. This suggests that one key challenge for the EEs is to meet the long-term need for greater additional revenue to finance social protection expenditure while sustaining growth. The question is how to do so in a way that promotes redistribution and does not hinder growth. Faced with high levels of informality, one important priority would be to widen the coverage of the formal sector in order to enhance the distributive capacity of the tax system. This would require special emphasis on improving revenue-collection procedures through measures to underpin the capacity of the tax administration to enforce compliance.10 There would also have to be initiatives to address tax simplification to encourage taxpayers' voluntary compliance with their obligations. Tax simplification is reported to have helped the significant expansion of formal jobs recorded in Brazil since the early 2000s (OECD-ILO, 2011d). Focus on the fight against corruption would also help improve tax collection. Over time, the pay-offs from these efforts would be visible both in terms of improved horizontal equality – individuals with the same gross income paying the same amount of tax – and vertical equality – as better-off individuals who are typically better able to evade taxation have to pay their fair share in taxes.

Broadening tax bases could also contribute to meeting efficiency, growth and distribution objectives. Broader tax bases would have to be supported by careful reassessments of tax relief systems. Tax relief and exemptions often exist because of the influence of the rich and powerful on the drafting of tax codes. Greater transparency, particularly as to the amounts of revenue forgone and the beneficiaries, is often a good first step in eliminating tax relief arrangements.

CONCLUSION

All in all, under current conditions of widespread informality and tax evasion, the role of taxes in income redistribution remains limited. Changing this situation is likely to take time,unless countries rapidly put in place ways and means to expand the tax base and reform thetax administration. Until then, reducing inequality is better addressed through well-targetedsocial welfare programmes and the recourse to mechanisms of in-work benefits. In-workbenefits may take the form of tax credits, wage-related transfers, or lump-sum payments. Where there are significant earnings or income disparities at the bottom of the distribution,they have been shown to reduce inequality and increase employment in OECD countries ifthey provide regular payments to low-income workers. As such,they could be an attractive additional policy option in emerging economies.

References

Alvaredo, F. and A.B. Atkinson (2010), "Colonial Rule, Apartheid and Natural Resources: Top Incomes in South Africa 1903-2005", *OxCarre Research Paper*, No. 46/201.

Banerjee, A. and T. Piketty (2005), "Top Indian Incomes, 1922-2000", *World Bank Economic Review*, No. 19, Washington, DC.

Barros, R. and C. H. Corseuil (2004), "The Impact of Regulations on Brazilian Labor Market Performance", *Law and Employment: Lessons from Latin American and the Caribbean*, NBER, University of Chicago Press, Chicago, pp. 273-350.

Brys, B., Matthews S. and J. Owens (2011), "Tax Reform Trends in OECD Countries", *OECD Taxation Working Papers*, No. 1, forthcoming.

Chakraborty, P. (2007), "Implementation of the National Rural Employment Guarantee Act in India: Spatial Dimensions and Fiscal Implications", *Economics Working Paper*, No. 505, Levy Economics Institute, New York.

Chen, J. and A. Barriento (2006), "Extending Social Assistance in China: Lessons from the Minimum Living Standard Scheme", *CPRC Working Paper*, No. 67, Chronic Poverty Research Centre, Manchester, November.

Chhibber, A., J. Ghosh and T. Palanivel (2009), *The Global Financial Crisis and the Asia-Pacific region: a Synthesis Study Incorporating Evidence from Country Case Studies*, UNDP Regional Centre for Asia and the Pacific.

Du, Y. (2010), "Improving Social Protection Systems in China: Key Trends and Policies", presentation at the OECD/EU Joint International Conference on Inequalities in Emerging Economie: "What Role for Labour Market and Social Policies?", OECD Publishing, Paris, May.