Forum: United Nations Development Programme (UNDP)

Issue #12-02 : Measures to Reduce Income inequality

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Introduction

Income inequality is the extent to which there is an uneven distribution of wealth in a society. Income inequality is commonly measured by using the Gini Index (see key terms). The range of income inequality is extremely vast as in Nordic countries there is little income inequality compared to countries with extremely high-income inequality such as South Africa and Namibia. As income inequality basically is the unequal distribution of income in a country, it has a deep effect on a country's economy thus affects all sectors of society. Depending on the income inequality of a country, wealth distribution and income mobility are both affected either for the better or worse. There are many causes as to why there is a higher amount of income inequality in one country in comparison to others. Racial and ethnic discrimination has a big say as to how income is distributed in a country. Gender also affects income distribution as women are generally paid less than men. A country's tax policies can also help decrease or increase income inequality. Income inequality can have immense ramifications on society such as the decrease of consumption, less tax collection, inflation and more.

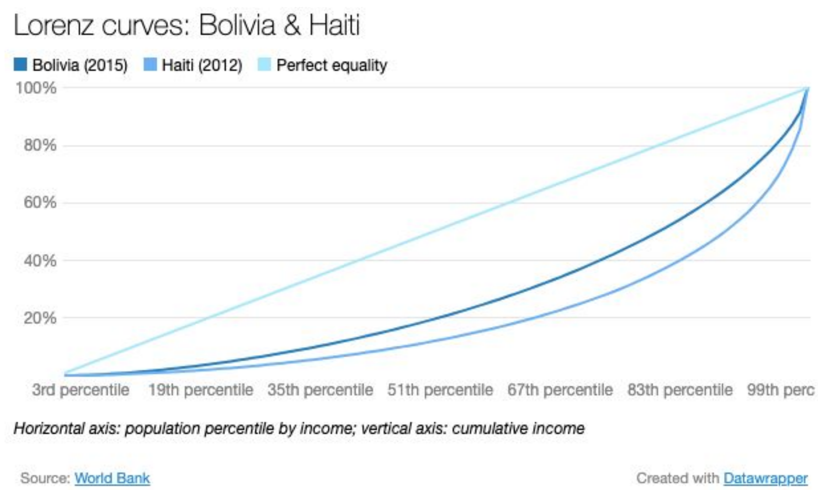
Definition of Key Terms

Income Inequality

The extreme concentration of income in the hands of a small percentage of the population. It is the gap between the poor and wealthy.

Gini Index

Measures economic inequality, including income and wealth distribution, of a population. The index ranges from 0 to 1. 0 being perfect, or a population with no economic inequality. This would mean that every member of a population has the same income. A Gini Index 1 means that only one member of a population earns all the income, and the rest earn nothing. The greater the coefficient, the more economic inequality there is. The more a Lorenz curve of a population deviates from the Gini ratio, the higher income inequality there is.



OECD Countries

The Organization for Economic Cooperation and Development is an economic intergovernmental organization that seeks economic and trade growth. The OECD has a total of 36 members which includes countries from North and South America, Europe, and Asia-Pacific.

Regressive Tax

A tax that takes a larger percentage of income from lower-income households than from higher-income households. This is because a regressive tax is uniformly applied to the entire population. The entire population pays the same rate which to lower-income households is a larger strain than higher-income ones. A very common type of regressive taxation is sales tax, which is a tariff applied by percentage when purchasing a product.

Progressive Tax

A tax that imposes a lower tax rate on lower-income households in comparison to higher-income households. The imposed tax is dependent on the taxpayer's ability to pay, and because of this it collects more funds from higher-income households.

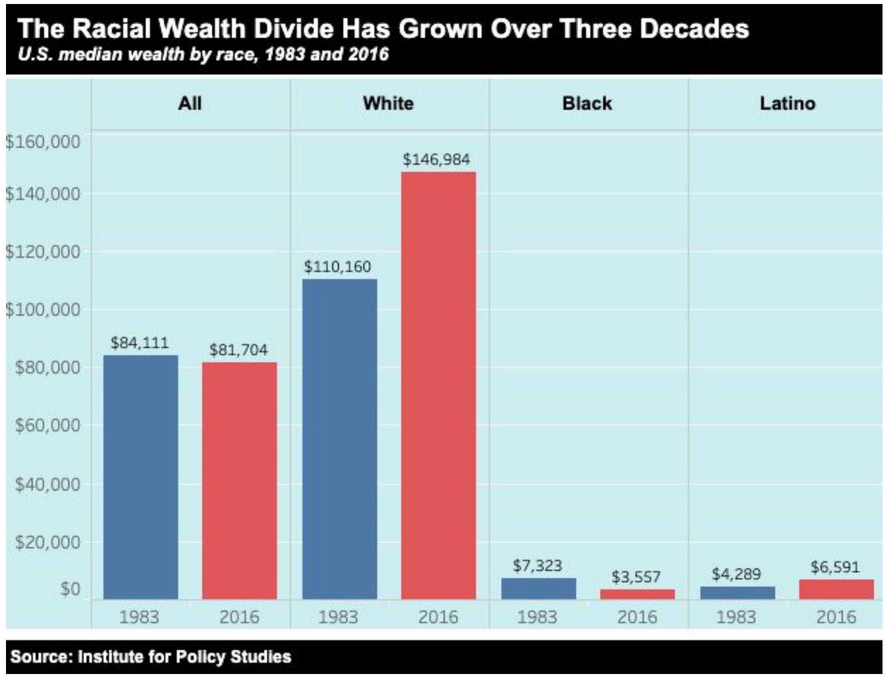
Value Added Tax (VAT)

A consumption tax added on a product, the value of the tax depends on the value of the product. More than 160 countries have implemented VAT in their taxation system and its very common in the European Union. Type of regressive tax.

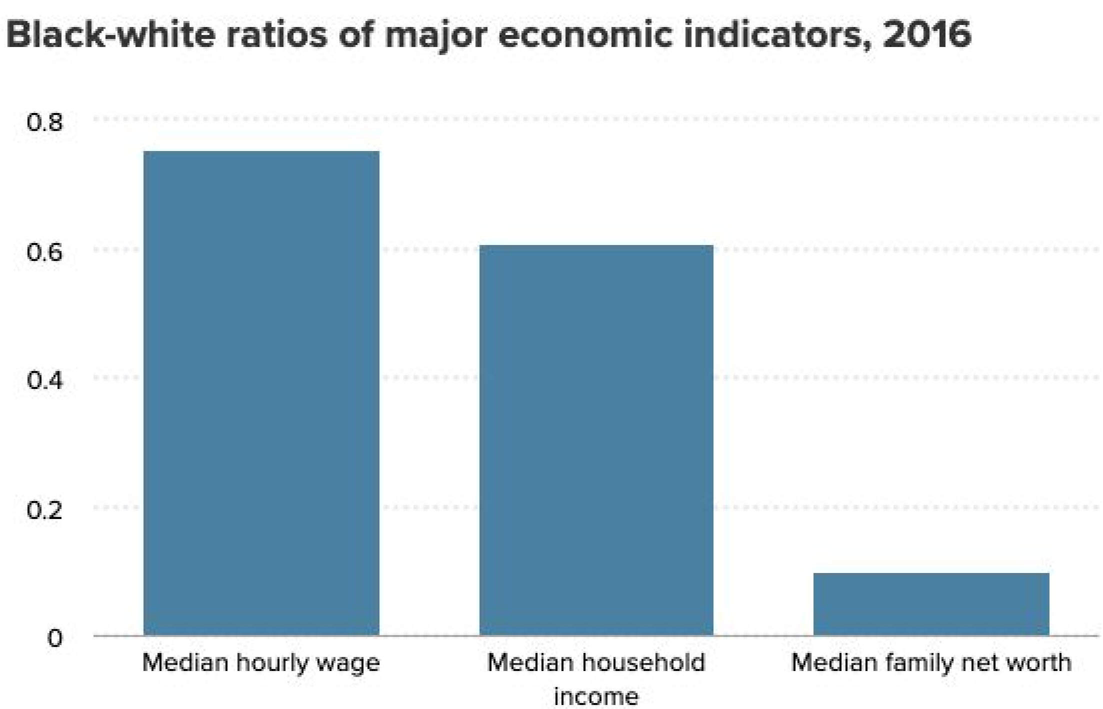
General Overview

Social Effects on Income Inequality

Ethnicity or race and gender, among others, have a lasting impact on a country's income inequality. Even though racial inequality has been significantly reduced over the last century, the inequality of income between races is very noticeable. In the year 2000, Caucasian individuals made up 90% of the wealthiest 10% in the United States. This statistic demonstrates the inequality of races as Caucasian individuals made up 75% of that same year's labor force. There is a 15% deviation between the figures which shows that Caucasian individuals tend to be wealthier than the other races. If there were equal income distribution, then 90% of the labor force would be made up by Caucasian individuals, which is not the case. Since then, Asians have become the highest earning racial group in the United States, but income inequality among Asians has doubled. Below, a bar graph demonstrates the income inequality in the United States by race:

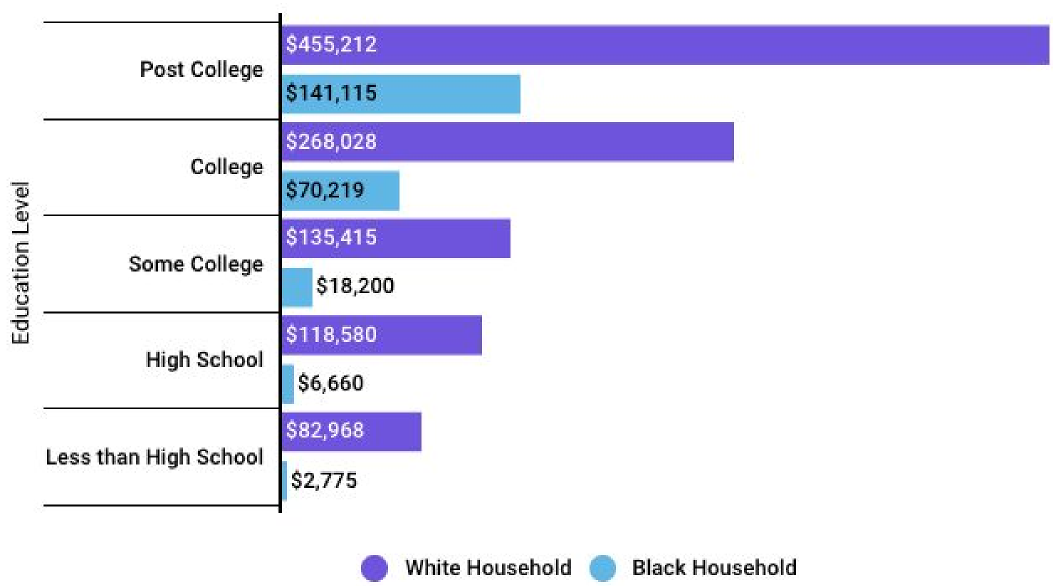


The Economic Policy Institute carried out an investigation in 2016 to find the black to white income ratio. Their findings are very alarming and can be seen in the graphic below:



As can be clearly seen, there is income inequality between the two races as black individuals gain only a fraction in comparison to white individuals. According to the Pacific Standard, in the United States, 21.8% of black people are in poverty compared to 8.8% of white people. It is also 6.4 times more likely for a black American to be incarcerated than a white American. All of these statistics prove that there still is racial inequality in the United States, even though it has been a steady decline for several decades.

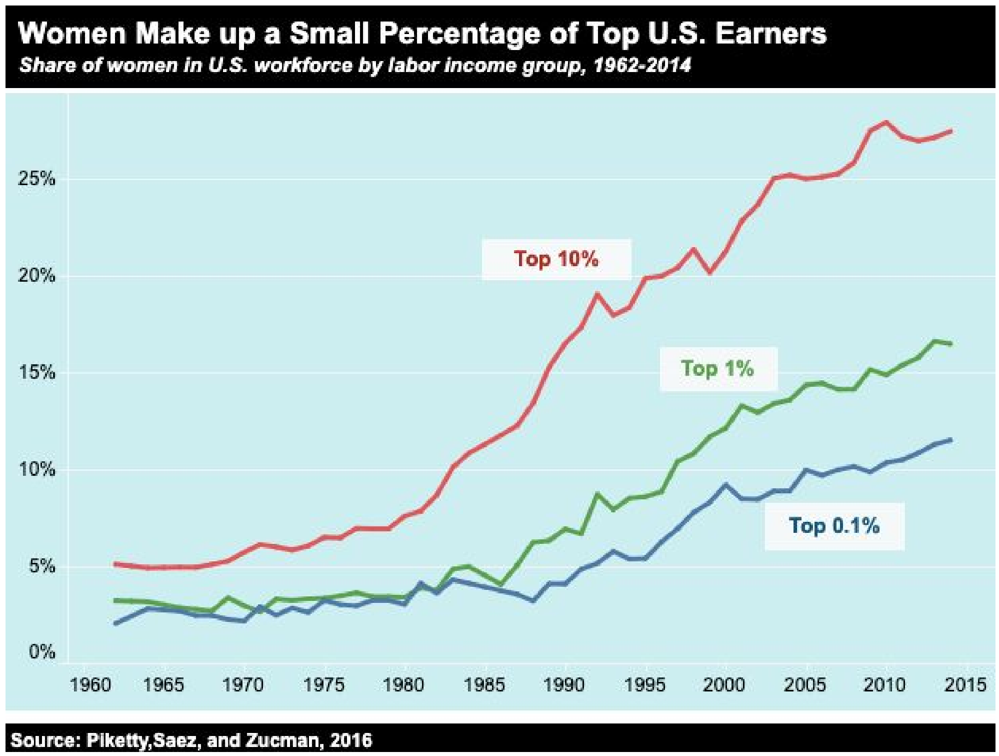
There are many factors that have caused this divide of income between blacks and whites. There have been countless studies conducted that have proved that, on average, white people receive a better education than black people. Black people also have a higher unemployment rate and lower homeownership rate than white people.

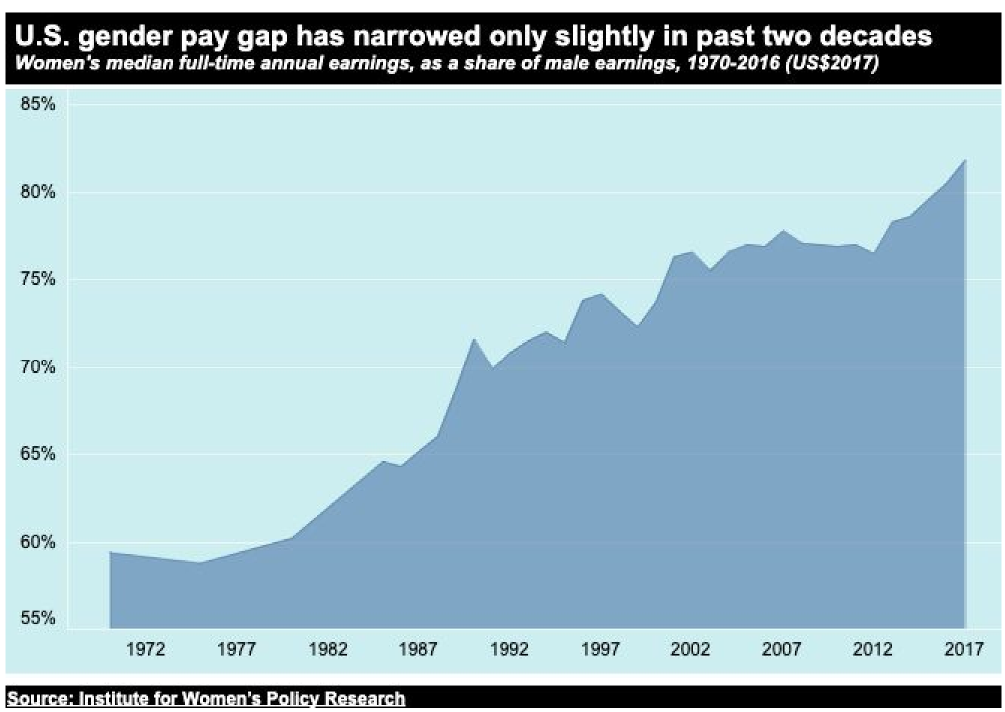


(Chart: Duke University; Author calculations from Survey on Income and Program Participation)

Discrimination also plays a major role in racial income inequality as it affects the hiring and promotions of individuals. A possible reason why white individuals hold most of the wealth in the United States is that extreme wealth has always been concentrated in the hands of a few white American families. This wealth is then passed down from generation to generation and stays in their hands.

Gender inequality is another persistent issue that must be solved. Even though gender inequality has been in decline over the last decades, women still earn considerably less than men.

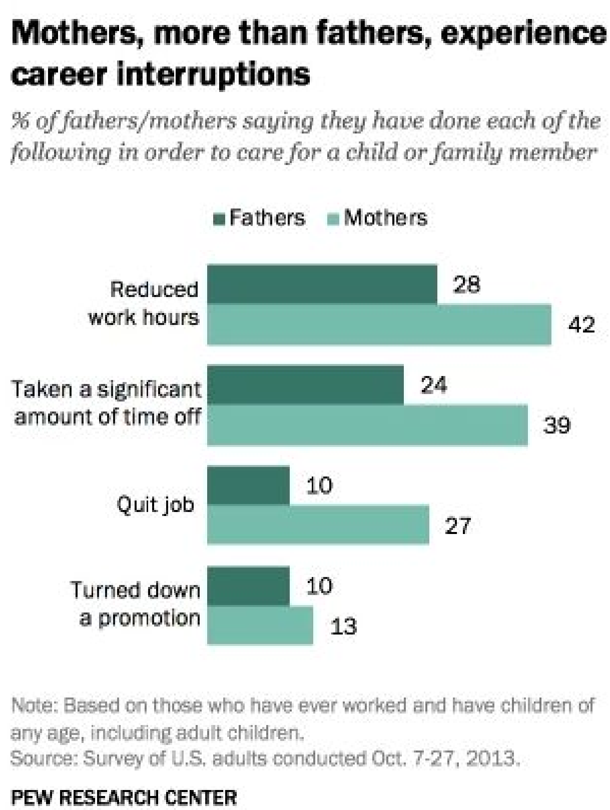




In a study of United States full-time workers in 2016, women earned about 81 cents for every dollar men earned. In management positions, men, on average, earned a salary of $81,000 while women earned $55,000.

Even though the United States appears to be incredibly unequal in terms of gender income, South Korea has the most gender income inequality as women earn 37% less than their male counterparts. The narrowest wage gap in OECD countries is in Luxembourg, where women earn 3.4% less than men. A factor for this income gap could be that women do considerably more unpaid work such as caring for the elderly and housekeeping.

Other factors causing this wage gap include but are not limited to: education, occupational segregation, work experience, gender discrimination and motherhood. Motherhood, specifically, creates interruptions in the careers of women and can affect the salary of women.



Tax Policies

Wealth distribution is highly reliant on taxation. In the last fifty years, there have been several worldwide attempts to reduce income inequality. Many of those attempts involved tax policies that, ideally, would help diminish the gap between the rich and the poor. The minimum wage is a highly debated topic around the world and a major issue in the United States. One would imagine that by increasing the minimum wage income inequality would be greatly lessened and that the economy would thrive because of the change. The increment of the minimum wage would result in higher income per capita and higher consumer expenditure. A higher expenditure would be beneficial to the entire economy as the population would be spending a higher percentage of their money, therefore boosting economic growth. Even though there are several benefits to raising the minimum wage, there are also some negatives. The risk of increasing the minimum wage is the danger of causing higher unemployment, thus negatively affecting the economy as a whole. The economic growth from higher expenditure is annulled if a higher percentage of people are unemployed, as unemployment leads to people spending less of their money, which would, in turn, lead to less demand. By increasing the minimum wage, all other wages would be affected and, therefore, increased as well. The increment of wages across the board would also increase the cost of the production of goods. Therefore, the price of said goods will also increase because of the heightened cost of production. In the short term, higher priced goods in a country would cause a higher rate of imports. Because of the imports, local industries are greatly affected which could cause an economic crisis and a higher unemployment rate. In the long term, inflation would occur which means that the local currency will lose its value which would reduce the population's purchasing power, hitting the hardest the poorest part of the population.

A common misconception is that economic growth generates economic prosperity for everyone. However, if wealth is poorly distributed among a population, then it does not matter if the economy is in a state of growth. Prior to the economic crisis of 2008, most economies around the world were enjoying a period of prosperity. OECD countries are among the leading economies of the world. The economic crisis of 2008 hit them the hardest, which has left many still recuperating from the crisis. Unlike the OECD, emerging economies kept on expanding and millions of people have been lifted from poverty. Nonetheless, the distribution of income became even more unequal than it was previously. Political debates have entertained the question of what distribution of wealth is "fair". But this issue goes beyond fairness because if the gap between the rich and the poor keeps on increasing, then all economic growth will cease. This is why it is of paramount importance for this issue to be addressed, and it can be done through proper taxation.

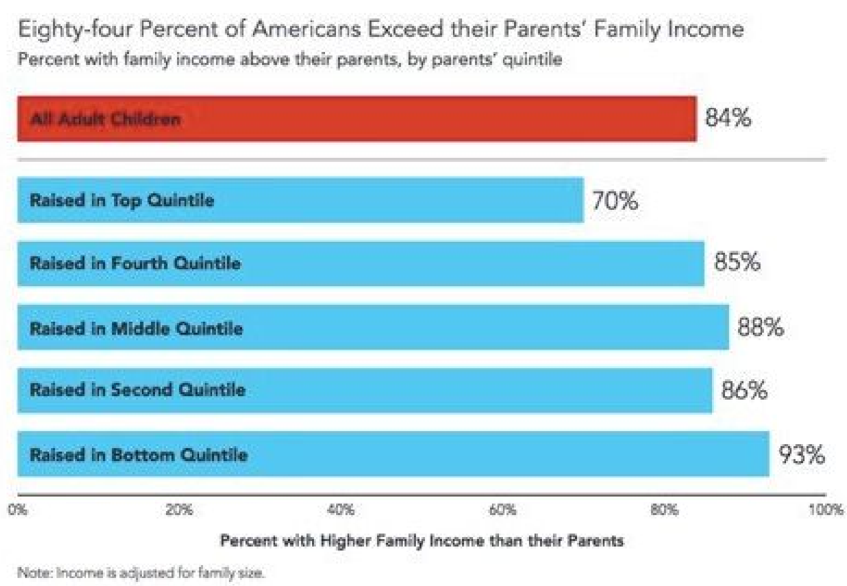
In some developed countries, the annual tax income of the government is around 35% of its total revenue. This permits those developed countries to aid those in need as they can invest more money primarily into health, education, infrastructure, sanitation, and social services. Because of greater investment into the public sector, income inequality is reduced as governments are giving back to low-income households through their investment. This not only reduces income inequality but also seeks to create equal opportunities for everyone. In OECD countries, there generally is a more efficient tax collection and a better distribution of income, which is the reason why those countries are less likely to have income inequality. Most Latin American countries have an annual tax income that makes up only 10% to 20% of their total revenue. Because of this, income inequality tends to be more pronounced than in developed countries.

Taxes have to be handled very carefully as they can have an enormous impact on income distribution. If all taxes were to be increased, then it would be more likely that income inequality will, as an effect, reduce. But this would also cause a major issue. Companies would start to lower investments in countries with higher tax rates as it is not in their best interest to pay large amounts of tax. This would lead to companies investing in countries with lower tax rates and discontinuing investment in those with high tax rates. This would generate lower economic growth and a higher unemployment rate in such countries. If tax rates are too low, then the revenue of tax collection would be considerably lower which would affect the government's capability to invest in poorer sectors. The consequence of this would be an increase in income inequality. This demonstrates the difficulty in addressing tax rates as going too low or too high can have negative effects.

Raising regressive taxes, even though it could increase tax collection, would have unwanted side effects that include the increment of all products and the decrease of consumption. Raising VAT would prevent the poorer demographic of the population from purchasing goods. A current doubt is that if taxes are drastically raised, then it would cause tax evasion. In contrast, a common belief is that if taxes are lower, more people would tend to pay their taxes. Many believe that income inequality could be solved by imposing greater taxes on the richer demographic but this brings problems of its own. The richer demographic will try to evade the taxes and invest less to stint their businesses from economic growth and not have to pay more taxes because of it.

Income Mobility

Income mobility is the ability of a subject to improve their economic status, which is measured in the facility of moving between income quintiles. Income mobility is created by an individual's will to work hard and discipline as long as the individual receives the proper opportunities and education. For the state to guarantee that, they need to invest in both aspects. This is why an efficient tax collection system must be in place in order for sufficient funds to be invested. "Evidence supporting this theory includes a 2008 report by the United States Treasury on income mobility that found that between 1996 and 2005 more than half of all U.S. taxpayers moved into a higher income quintile (or category). Roughly half who started in the lowest quintile in 1996 moved into a higher quintile by 2005, in only nine years." This demonstrates that correct wealth distribution increases the probability of moving up in terms of income quintiles.



Major Parties Involved and Their Views

The United States

Since the 1980s, income inequality in the United States has been on a steady increase and has now reached figures similar to those during the Great Depression (1929-1939). In 2016, the top 1% held 40% of the wealth. This is alarming as in the 1980s the top 1% held approximately 25% of the total wealth. The way to approach the question of income inequality varies between the country's political parties. Democrats firmly believe that economic growth will result in economic prosperity for all. Republicans, on the other hand, stay away from government involvement in wealth generation. The expansion of resources available to children, affordable higher education, and business ownership among others have been debated as ways to decrease the income inequality in the United States.

China

Similarly to the United States, China's income inequality has increased dramatically since the 20th century. In 1978, the Gini Index measured China's income distribution at 0.16, a figure that tells us that the distribution of income was highly equal. Since then, the figure has almost tripled, as in 2012 it measured at 0.47. In 2013, the State Council published a plan to restructure the income distribution system. The plan includes fiscal and legislative reforms to try to narrow the wage gap.

South Africa

South Africa, with a Gini coefficient 0.63, is officially the most unequal country in the world income-wise. South Africa suffered from the apartheid system until 1994, where race dictated the way of life. One of the causes of this tremendous income inequality is the huge wage gap. Some workers earn less than $50 per month while many live the life of European millionaires.

Saudi Arabia

The Saudi Family, which governs Saudi Arabia, is worth around $1.4 trillion. Saudi Arabia's annual revenue from oil is approximately $200 billion. Still, 20% of the Saudi population lives in poverty. 80% of the revenue from oil goes to the Saudi Family which is a problem, as this money could be invested in the country to produce great changes. Saudi Arabia has a Gini Coefficient of 0.45 which demonstrates its extreme income inequality. Some of the main factors for this is the high unemployment rate in the country and poor education.

Russia

Russia is in a similar economic situation as the United States. The richest 3% in Russia hold 90% of the country's total wealth. In stark contrast, the poorest 20% only holds 6% of the country's wealth. Income inequality in Russia has been on the rise since the 1980s. Back then the richest 10% took 21% of the country's total income. In 2015, the richest 10% took 46% of the country's income. This drastic change in income distribution is one of the many consequences of the Soviet Union's dissolution in 1991.

UN involvement, Relevant Resolutions, Treaties and Events

- United Nations' Sustainable Development Goal 10: Reduce inequality within and among countries. The targets of Goal 10 includes ensuring equal opportunities to everyone, adopting policies to obtain more equality, greater foreign investment, and reducing the transaction costs of migrant remittances.
- Council of Europe: Resolution 2158 (2017). This resolution acknowledges the steady increase in income inequality in the last 30 years across Europe and the rest of the world. The Assembly calls upon the Member States to "make the fight against income inequality a political priority and develop comprehensive and effective national strategies, including setting or promoting measurable targets in terms of reducing overall levels of inequality, gender pay gaps and ratios between the lowest and highest salaries;" regarding employment and wage-setting policies, tax policies and systems and labor market institutions.

Evaluation of Previous Attempts to Resolve the Issue

As seen in the previous section, the United Nations among other organizations are aware of the forever pressing issue of income inequality and its ramifications on society. The United Nations's Sustainable Development Goals, created in 2015 and sought to be achieved by 2030, includes Goal 10 which seeks to ensure equal opportunities for society. This attempt is an efficient one as the United Nations' Sustainable Development Goals are highly regarded within the United Nations, thus have a good possibility of being accomplished. The Council of Europe's Resolution 2158 (2017) acknowledges the increase of income inequality and calls upon members of the Council to fight income inequality. The acknowledgment of the rise of income inequality and its call to action by this resolution has proven to be effective within the member countries of the Council of Europe.

Possible Solutions

There are various ways to address the issue of income inequality through government intervention, in the form of tax policies. These policies enable governments to have a greater investment capacity to reduce income inequality through diverse actions. In the short term, governmental bodies can channel their funds directly to the less privileged population to reduce the gap between the rich and the poor, and increase their spending capability. In the long term, education has proven to be one of the most influential factors that affect a subject's income. With a higher collection rate, the government is able to invest a greater amount into the educational sector in order to improve the population's ability to get better and stable jobs, thus reducing income inequality. An effective governmental tax collection system is fundamental to increase the government's capacity to invest in less privileged sectors, hence reducing income inequality. This issue must be solved through resolutions that are legally plausible and practical.

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