NARROWING DISPARITIES USING TAXATION AND OTHER ECONOMIC INCENTIVES AND DISINCENTIVES

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Summary

Along with the growth of the global economy during the 1990s, social and economic disparities have increased not only within many countries but also between developed and developing countries. Serious inequality in consumption has meant that over 10 billion people cannot meet even their most basic needs. Globalization, to some extent, is an important factor in effecting income distribution. Both the poor and the rich put

pressure on the environment. A society with serious social and economic disparities can never be sustainable. Although there are a number of obstacles for governments to overcome, economic policy makers have devoted greater attention to seeking to implement equity-oriented policies. Economic incentives and disincentives used for narrowing disparities concern the taxation system, social expenditure, labor market policy, monetary and macroeconomic policy, and institutional systems. The World Bank's strategic shifts represent the global efforts of the international community on poverty reduction. In the final section of this article, the microcredit program is taken as an example of how economic incentives help in poverty reduction worldwide.

1. Increasing Economic and Social Disparity

Since the early 1990s, gross world product (GWP) has grown by more than 3% a year and inflation has slowed in most regions. Unfortunately, the fruits of global economic growth have not been shared equally. Social and economic disparities have increased in many countries, developed as well as developing.

The Gini coefficient is the most commonly used indicator of income inequality. In Latin America, the region of the greatest income inequality, the average Gini coefficient is nearly 0.5. In the economies of transition (from planning- to market-oriented systems), the average Gini coefficient was about 0.25 until the late 1980s and rose to more than 0.30 by the mid 1990s. Since the early 1980s, with the policies of reform and opening up in China, social and economic disparities are also widening between the interior and the export-oriented provinces of the coast. In industrialized Organisation for Economic Co-operation and Development (OECD) countries, and especially Sweden, the United Kingdom, and the United States, inequality also apparently increased after the 1980s.

While inequality within many developing and developed countries has increased, inequality between countries has also increased. According to statistical data from the United Nations Development Programme's (UNDP) *Human Development Report 1999*, the income gap between the one-fifth of the world's people living in the richest countries and the one-fifth in the poorest was 74 to 1 in 1997, up from 60 to 1 in 1990 and 30 to 1 in 1960. Particularly astonishing was that the world's 200 richest people almost doubled their net worth in the four years to 1998, which went up to more than US$1 trillion. The assets of the top three billionaires were more than the sum of the gross national product (GNP) in all least developed countries and their 600 million people by the end of the twentieth century.

With the increase of wealth, global consumption has grown rapidly. The global consumption in product and services in 1998 was US$24 000 billion, six times that in 1976. However, the serious inequality in consumption means that over 10 billion people cannot meet even their most basic needs. Calculated on international prices in 1985, the living costs of around 1.3 billion people, a quarter of the world's population, was lower than US$1 per day. For 4.4 billion people in developing countries, almost three out of five live in communities lacking basic sanitation facilities, one out of three lacks safe drinking water, one-quarter lacks housing, and one-fifth of children cannot finish primary school. Almost the same ratio of children suffers from insufficient nutrition. In this sense, it can be said that in terms of human beings, our one planet can be divided into two worlds: the poor and the rich.

2. Globalization, Disparities, and Sustainability

Globalization has linked the labor, product, and capital markets of economies around the world and led to greater specialization in production and the dispersion of specialized production processes to geographically distant locations. Market expansion—opening national borders to trade, capital, and information—is now regarded as the main driving force of globalization. As barriers to trade are reduced and distribution of production is reallocated among sectors, globalization may lead to sharp short-term changes in the distribution of income. When exposed to international competition, developing countries may lose out because of their low development level and backward technologies. Competitive markets may be the best guarantee of efficiency, but not necessarily of equity. Some argue that globalization, to some extent, is to blame for growing income inequality in many countries as well as between developed and developing countries.

A society with serious social and economic disparities can never be sustainable. Having little choice, the poor put pressure on the environment so that they and their families can survive. Lacking adequate ability to manage the environment and high discount rates, the poor value short-term benefits far ahead of long-term losses. Also the rich put pressure on the environment by overexploiting and over consuming natural resources. The growing export markets for fish, shrimps, paper, and many other products mean depleted stocks, less biodiversity, and fewer forests. Most of the costs are borne by the poor, although it is the rich who benefit most. Both poverty and affluence hurt the sustainability of natural resources and environment. But environmental damage tends to affect the poor particularly severely for several reasons.

- They tend to rely heavily on fragile natural resources for their livelihood. Poor people have few assets. Much of their wealth, therefore, derives from their own labor and any natural capital that they have access to. Since they often have little education, their human capital tends to have a low return, making any natural capital all the more important. However, the poor often only have access to poor-quality and fragile natural resources.

- Poor people also tend to have fewer ways of responding to environmental problems. Polluted areas where land is cheap or free may be the only area they can afford to live in. They are also less likely to have the resources to buy bottled water when sewage and industrial waste are polluting the drinking water.

This is why the poor are often easily trapped into a vicious cycle of "poor—environmental problems—poorer," which means that poverty leads to environmental damage while environmental problems exacerbate poverty.

We have only one earth, for both the poor and the rich. Equity is not only the basis of but also an important target for sustainable development of human society. An unsustainable world of poverty will eventually affect the development of a world of affluence, leading to undesirable consequences for our common future. The trends of increasing disparity have heightened concern about the treatment of equity in the formulation of economic policy, which is one of the most pressing issues facing policy makers today.

Different societies have different perceptions of what is equitable, and these social and cultural norms shape the policies they will adopt to promote equity. Being aware of the importance of equity to sustainable development, economic policy makers are devoting greater attention to incorporating equity considerations into economic policy. This is exactly the theme of the Conference on Economic Policy and Equity organized by the International Monetary Fund (IMF) Fiscal Affairs Division and held on June 8–9, 1998. It has been widely recognized by economic policy makers that taxation and other economic incentives and disincentives are effective policy tools for narrowing disparities.

3. Overview of Economic Policies for Narrowing Disparities

The strategies countries have adopted to promote equity vary widely. Some countries have actively promoted the use of public resources to improve the situation of the bottom tier of income distribution. Others have focused on the top percentiles with highly progressive taxes. Yet others—concerned that policies targeting the poor may result in economic inefficiencies and distortions that retard growth—have taken an indirect approach, seeking to help low-income families by stimulating overall economic growth.

Before the financial crisis of 1997/98, East Asian countries had achieved record performance in growth and poverty reduction. The poor benefited from the boom along with the rich. However, the crisis affected different groups of people differently. Some lost, some lost less, and some gained. The poor and vulnerable suffered greatly because they were already at the margin and were ill equipped to deal with shocks. Countries should adopt policy response to protect them during crises. Since it is difficult to react effectively during a crisis, it is necessary for countries to include in their development strategies appropriate policies aimed at helping the poor and vulnerable groups likely to be hurt, before a crisis hits. This also needs to be considered for countries in transition. Such policies have included adapting social policy instruments to protect the poor and vulnerable groups, and erecting proper social safety nets, for example, targeted subsidies, cash compensation in lieu of subsidies, severance pay and retraining for retrenched public sector employees, and pubic works programs. However, the lack of budgetary resources may hamper implementation of these policies.

3.1. Taxation

In general, fiscal policy—taxation and spending—is a government's most direct tool for redistributing income, in both the short and the long run. Nevertheless, the effect of redistribution tax policies, especially in the face of globalization, has been small. Many observe that increasingly mobile capital and labor have limited the ability of governments to levy taxes and transfer them to those affected by globalization. It is widely accepted that policy makers should focus on developing a broadly based, efficient, and easily administered tax system with a moderate marginal rate. An important subsidiary issue is how to distribute the burden of taxation so the system is seen as fair and just. Achieving these various goals is naturally complex and politically sensitive.

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Biographical Sketch

Dr. Ying Chen was born in April 1969 and is now an associate researcher with the Institute of World Economics and Politics, Chinese Academy of Social Sciences. Dr. Chen graduated from the Chemical Engineering Department of Tsinghua University, Beijing, in July 1997 and she is now engaged in research of environmental and natural economics. Her areas of interest include global environmental problems, climate change economics, and sustainable development indicators.