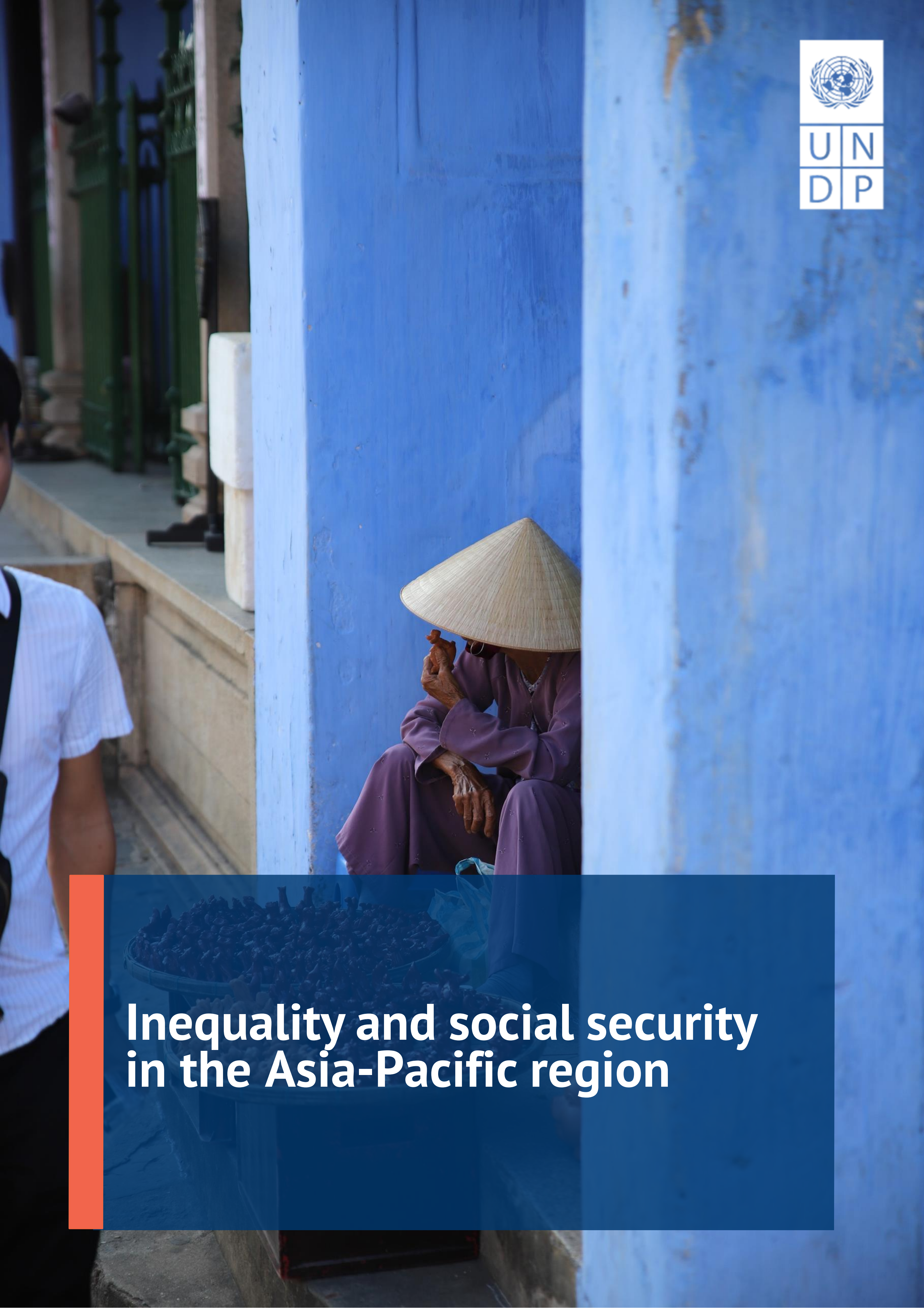

Inequality and social security in the Asia-Pacific region

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Executive summary

High income inequality can engender a wide range of negative impacts. It can harm child development, increase ill-health and mortality, limit the status of women, generate distrust in government, exacerbate levels of violence and social unrest, slow the pace of poverty reduction and hinder economic growth. Therefore, it is imperative that countries take action to tackle high inequality and create fairer and more decent societies.

The Asia-Pacific region is characterised by high levels of income inequality. While there is greater equality in Central Asia and the Pacific, the most unequal sub-regions are South Asia and East Asia. Income inequality varies greatly between countries, ranging from a Gini coefficient of 19 in Azerbaijan to 52 in India. Further, income inequality is likely underestimated across the region while wealth inequality appears to be much greater than inequality in incomes.

Investments in social security are one of the most effective means of tackling inequality. Nonetheless, countries need to do more than rely only on social security to tackle inequality and should take forward other policy measures that are effective in reducing inequality, such as investments in other public services and labour market interventions to deliver decent work and fair wages. Through both transfers and tax, international experience has demonstrated that well-designed social security systems transfer income from the better-off to the less well-off with the aim of building more equal and fair societies and, in doing so, strengthen human capital and contribute to economic growth. Across high income countries, social security has proven to be an effective tool for reducing inequality. For example, direct transfers and taxes have reduced income inequality by over a third across high-income countries and, globally, there is a clear correlation between levels of investment in social security and reductions in inequality.

While it is often believed that the best means of tackling inequality is by targeting social security transfers at the poorest members of society, this assumption, while intuitive, is not supported by the global evidence. Instead, the highest reductions in inequality have been achieved by countries that invest in universal social security. This ‘paradox of redistribution’ is, to a large extent, the result of the higher expenditures generated by universal schemes, which demand higher levels of taxation from the wealthier members of society, which is then redistributed across the population. These higher expenditures are, to a large extent, driven by the popularity of universal schemes and the fact that the main taxpayers are included as recipients. As a result, they are more willing to accept higher levels of taxation.

Most countries in the Asia-Pacific region have not yet established modern universal social security systems. Instead, they have bifurcated systems in which public service pensions and social insurance schemes are offered to those in the formal economy – where the better-off members of society tend to be over-represented – while small social assistance programmes are provided to the poorest members of society. This results in the exclusion of a large proportion of the population from the social security system, often referred to as the ‘missing middle.’ Such a system will be less effective in tackling inequality than the type of modern, universal lifecycle social security systems found in high-income countries. Nonetheless, there are some countries in the Asia-Pacific region that have begun to make the transition towards these more modern systems.

Across the Asia-Pacific region as a whole, the evidence is unclear on whether current social security systems reduce inequality. While some studies have shown a positive impact, others have found the opposite. This should not, however, be surprising given the prevailing social security model in many countries. In those countries where social security mainly benefits the better-off in the formal economy, it may well exacerbate inequality. However, when individual countries are examined, there is good evidence that social security has reduced inequality. Further, in line with international evidence, in countries with more universal systems and higher levels of spending, the impacts on inequality have been much greater than in countries where poverty targeting has been prioritised.

If Asia-Pacific countries wish to tackle inequality effectively, there will need to be a fundamental shift away from the prevailing bifurcated system towards modern, multi-tiered, universal social security systems. The analysis in this paper shows that, if countries make this shift – based, initially, on establishing universal child, disability and old age benefits – the impacts on inequality could be significant. In simulations across four countries, the paper shows that a recurrent investment of one percent of GDP in a modern, inclusive lifecycle system would bring about a reduction in the Gini coefficient of between 4.9 and 7 percent.[1] With an investment of 2 percent of GDP, the impact would be between 9.8 and 13.6 percent of GDP. The impact continues to increase as investment grows so that, at 3 percent of GDP, the fall in inequality would be between 14.5 and 19 percent. If countries were to introduce other policy measures that help tackle inequality alongside an expansion in their social security systems, the reductions in inequality would be even higher.

There would, of course, be winners and losers from this investment once tax is accounted for. Across the four countries, between 62 and 70 percent of households would, on average, experience a net increase in consumption, with between 30 and 38 percent paying, on average, more in tax than they would receive in benefits. Those experiencing the highest increases in consumption would be the poorest members of society, demonstrating that a truly universal social security system can be very pro-poor. Redistribution would be effective and fair and would result in more equal societies. In fact, given the likely positive impacts on individual and national wellbeing including greater economic growth, everyone would end up as a winner by enjoying the broader societal benefits of greater equality such as better health, greater economic growth, social cohesion and more peaceful societies. Further, given that lower inequality contributes to economic growth, those paying the highest taxes may, in the long run, end up with higher incomes compared to those they would have had if their countries had not tackled inequality.

If countries in the Asia-Pacific region are to tackle inequality through social security, it will be necessary to find the fiscal space. The main means for governments to generate additional revenues will be through strengthening national social contracts. By investing in universal social security, countries could build a virtuous circle of greater trust in government, a stronger social contract, higher revenues from taxation and, therefore, further investment in good quality, universal public services.

Nonetheless, to begin this virtuous circle, countries will need to find resources that will enable them to fund the initial expansion of their social security systems. A range of options exist but a basic principle should be increased solidarity across society, with the wealthier members of society – who can afford to pay more tax – taking on the greatest responsibility. This could involve higher income tax rates for the rich as well as wealth taxes and taxes on income from capital, such as interest, dividends and capital gains. Such taxes would be progressive since income from capital is skewed toward the rich. Other options could include an expansion of sin taxes on alcohol, tobacco and gambling and green taxes on fossil fuels. The international community should consider further measures to reduce the debt burden on poorer countries in the Asia-Pacific region while there needs to be greater international cooperation to reduce illicit financial flows out of countries and build a fairer global tax system, as is currently happening with corporation tax. Further, tax collection needs

[1] The term investment is used because social security enables societies to build human capital, generates higher economic growth and contributes to peace and stability.

to be enforced and more people need to be brought into national tax systems. Universal social security schemes themselves could also be used to bring more people into the tax system.

If countries in the Asia-Pacific region make the move to more modern, universal lifecycle systems, this report has shown that the impacts on inequality would be impressive. And, the more they invest, the higher will be the impacts. Countries would also be likely to see increases in human capital, a more dynamic and productive workforce, more effective poverty reduction, greater economic growth and stronger social contracts. The politicians responsible for these investments would enjoy the political rewards that derive from implementing popular policies.

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