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## REPORT SAYS REDUCING INEQUALITY THROUGH FISCAL AND INCOMES POLICIES IS KEY FOR GROWTH AND DEVELOPMENT

### Trade and Development Report 2012 says governments can employ progressive taxation, social spending and encourage wage increases in line with productivity growth

*Geneva, 12 September 2012* – The prevailing belief since the 1980s that governments, in pursuing greater economic efficiency, have to tolerate greater inequality is not true, a new UNCTAD report says – and it recommends steps that can be taken to reduce income disparities while boosting economic growth.

The **Trade and Development Report 2012**[1], subtitled "**Policies for inclusive and balanced growth**", was released today.

It says policies that preserve the share of workers in national income and redistribute income through progressive taxation and public spending would improve equality as well as economic efficiency and growth.

For years, the dominant approach to fiscal policy has sought to minimize State intervention and eliminate the alleged distortion of progressive taxation. In labour markets, policy was reoriented towards more flexibility in wage formation and at less job protection, which in this view discourages hiring. These structural reforms contributed to rising income inequality without leading to better social services, higher investment, stronger employment creation and growth, the report says.

Beginning in the 1980s and 1990s, fiscal policies also tended to reduce the share of direct income taxes in government revenues while increasing the share of indirect taxes such as value added tax. In several countries, policies also sought to reduce the "size of the State" in terms of primary expenditure as a percentage of gross domestic product. However, lower taxation of high-income groups and public

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[1] The Report (Sales No. E.12.II.D.6, ISBN-13: 978-92-1-112846-8) may be obtained from United Publications Sales and Marketing Office at the address mentioned below or from United Nations sales agents throughout the world. Price: US$ 55 (50% discount for residents of developing countries, and 75% discount for residents of least developed countries). Customers may send orders or inquiries to: United Publications Sales and Marketing Office, 300 E 42nd Street, 9th Floor, IN-919J New York, NY 10017, United States. tel.: +1 212 963 8302, fax: +1 212 963 3489, e-mail: publications@un.org, https://unp.un.org.

spending restraint did not generally result in greater investment, either public or private, the report notes.

Recent experience, especially in Latin America and other developing countries, suggests that progressive taxation and rising public spending, including social transfers and the provision of essential goods and services to low-income groups, can strongly contribute to the process of inclusive growth, the report says. It adds that this approach would reduce income inequality and provide at the same time the prospect of expanding demand that is needed for firms to increase investment.

It is possible to improve tax collection and make it more progressive without negatively affecting economic incentives, the report notes. For example, taxation could be increased on top incomes resulting from rent-seeking activities – that is, activities directed more at increasing the share of the pie a few people at key positions get -- as compared with profits from entrepreneurial activity and productive work that increase the size of the pie itself.

In resource-rich developing countries, governments should appropriate a fair share of commodity rents and ensure that they benefit the entire population and not just a few domestic and foreign actors, the report recommends.

By enlarging fiscal space, governments can apply countercyclical policies – such as are needed to increase demand during the current economic downturn – as well as redistribute income and finance investment for more sustainable and inclusive growth, the report says.

The **Trade and Development Report 2012** also argues that the paradigm of labour-market flexibility has not only failed to reduce unemployment, but tends to exacerbate it. By relying on wage compression as the main tool for expanding employment, such labour market reforms dismiss the important contribution of income distribution to demand growth and employment creation. If overall productivity grows without a commensurate increase in wages, demand will eventually fall short of the production potential, thereby reducing capacity utilization, profits and investment, the report says.

In addition, by promoting wage differentiation at the firm level – in other words, determining wages at each individual business, rather than by collective bargaining or setting broader standards –- these reforms would undermine the incentives for investment, innovation and productive gains by businesses, the report says. Indeed, if less efficient firms can compensate for their lower profits by cutting wages, they are not forced to increase their productivity to survive.

Collective bargaining, complemented by government recommendations or general guidelines, should prevent the wage share in national income from falling, as has occurred in many countries in recent years (see UNCTAD/PRESS/PR/2012/31). Instead, wages could increase in line with overall productivity growth and inflation targets. Such an approach also would prevent the emergence of large differences in wages for similar occupations, the report says.

Other instruments may be used to correct market outcomes in favour of those with weak negotiating power, or those excluded from the formal sector. Such instruments include legal minimum wages, enhanced public employment and measures to increase the income of the informally employed and the self-employed, the report says.

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