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Another Defective IMF study on Inequality and Redistribution

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March 18, 2014

"IMF Warns on the Dangers of Inequality," screams the headline of a story by Ian Talley in the *Wall Street Journal*. The IMF – which Talley dubs "the world's top economic institution"– is said to be "warning that rising income inequality is weighing on global economic growth and fueling political instability."

This has been a familiar chorus from the White House/IMF songbook since late 2011, when President Obama's Special Assistant David Lipton became Deputy Managing Director of the IMF. It echoes a December 2012 *New York Times* piece, "Income Inequality May Take Toll on Growth," and a January 14, *Financial Times* feature, "IMF warns on threat of income inequality." This isn't news.

Talley writes, "The IMF … says advanced and developing economies need to raise more revenues through taxes, focusing on progressive taxation that moves more of the burden for social security, health care and other state benefits to the high-income earners." That isn't news either. The IMF has an ugly history of advising countries to raise tax rates, with disastrous results. The inequality crusade is just a new pretext for old mistakes.

The only news in the *Journal* article is "a 67-page paper detailing how the IMF's 188 member countries can use tax policy and targeted public spending to stem a rising disparity between haves and have-nots." That paper is just one of many "staff discussion notes" which "should be attributed to the authors and not to the IMF." The main "warning" from those authors (Jonathan Ostry, Andrew Berg, and Charalambos Tsangarides) is that "the data are particularly scarce and unreliable for redistribution, even more so than for inequality." Despite unreliable data, the IMF economists nevertheless claim that" higher inequality seems to lower growth. Redistribution, in contrast, has a tiny and statistically insignificant (slightly negative) effect."

This IMF discussion draft relies on "a recently-compiled cross-country dataset (Solt 2009) that carefully distinguishes net from market inequality and allows us to calculate redistributive transfers—defined as the difference between the Gini coefficient for market and for net

inequality." Frederick Solt of Southern Illinois University reconstructed the usual pretax, pre-transfer Gini indexes to estimate a "net" Gini – adjusted for direct taxes and cash transfers, but not sales taxes or in-kind transfers.

The Solt Gini index is scaled from zero to 100, where zero would be total equality (everyone has the same income) and 100 would be total inequality (one person has all the income). The U.S., for example, had a pretax, pre-transfer Gini of 46.5 in 2011, but a much lower *net* Gini of 37.2 after adding cash transfers and subtracting taxes. The net Gini would be much lower if the data accounted for America's unique reliance on refundable tax credits and in-kind benefits (which makes U.S. inequality *appear* higher than in countries that pay transfers in cash).

According to *The Wall Street Journal,* "Inequality in several advanced economies, including the U.S., has returned to levels not seen since before the Great Depression, the fund said." Irrelevant nonsense. The IMF study's data only go back to *1960*. The authors once rehashed rhetorical comparisons to 1928 in a blog, but that is a stale *fallacy* repeated uncritically from Thomas Piketty and Emmanuel Saez. It wrongly compares prewar data based shares of *personal income* with incompatible postwar data based on shares of a much narrower measure of income reported on individual tax returns after subtracting all transfer payments.

Getting back to the Solt list of 153 countries, inequality is lowest in countries with a net Gini around 30 and highest with a Gini over 45. Yet most countries The *Wall Street Journal* singles out as suffering from high inequality actually have *low* inequality.

"For the fund," says the *Journal*, "protests in Athens, Lisbon, Caracas and Tripoli … are manifestations of the broader underlying reality of income inequality." That might work for Lebanon, but not the others. The latest net Gini is a low 33.1 for Greece, 33.2 for Portugal, and 35.6 in Venezuela. The *Journal* also claims income inequality "helped propel widespread unrest" in Egypt and Ukraine, but the latest Gini was a super-low 30.9 in Egypt and an amazing 25.6 in Ukraine (much lower than even the USSR in 1992). Mr. Tally may mean these egalitarian governments went broke trying to redistribute too much, but that would contradict the IMF paper's *other* claim – that redistribution is innocuous.

Contrast the very low inequality numbers from countries like Greece and Ukraine with the much higher Gini estimates for all the rapidly-expanding BRIC countries. The latest net Gini is 46.4 for Brazil, 49.9 for Russia, 49.7 for India and 47.4 for China. Among these fastest-growing economies the Gini is virtually the same with or without taxes and transfers, suggesting no redistribution. Minimal redistribution just lowers the Gini from 47.9 to 47.4 in China and from 50.6 to 49.7 in India.

Unfortunately, countries begging for IMF loans may have to swallow IMF advice to push their highest tax rates even higher, and redistribute the added revenue (if any) to appreciative political supporters. Such loans may shore up unworthy governments, but the attached strings will surely strangle the nascent private economy.

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