Introduction

Finn Tarp, Director of UNU-WIDER
Is Social Protection effective in tackling inequality in developing countries?

Miguel Niño-Zarazúa
The concern of inequality

• The concern of inequality is a critical factor in the success of development strategies in developing countries.

• **High inequality reduces the efficacy of economic growth to poverty reduction** (Ravallion 2011).

• Inequality also affects a country’s potential of economic growth, by impacting negatively on consumer demand, national savings and human capital formation.

• Negative implications of high levels of inequality, in terms of social cohesion and crime, (Kelly, 2000), conflict and political instability (Alesina and Perotti, 1996) and corruption and governance (You and Khagram, 2005) are widely acknowledged.
The concern of inequality

- The report of the UN System Task Team (2012) to support the preparation of the Post 2015 UN Development Agenda points out that the inequality is a ‘key concern, not just from the perspective of a future in which a decent and secure wellbeing is a prerogative of all citizens, but sustained development itself is impeded by high inequalities. Hence, redressing these trends will be a major challenge in the decades ahead’
What are the recent trends in global inequality?

- Global Inequality has fallen steadily between 1975 and 2005, and then with a more pronounced decline after the 2008 financial crisis.
- Gini coefficients fell from 0.739 in 1975 to 0.621 in 2010.
- Theil L (MLD) index fell from 1.349 in 1975 to 0.763 in 2010.

Source: Niño-Zarazúa, Roope and Tarp (2013)
Regional Inequality

- We observe considerable variation in within-country inequality trends across regions: For example, whereas within-country inequality in LA, EA, SA has declined, it has increased in North America and SSA.
What happened in India and China?

- India experienced an increase in within inequality from 29.7 in 1990 to 36.8 in 2004 and has remained at that level throughout 2009.

- China experienced a consistent increase in inequality until 2009 and then a steady decline in inequality.
What does explain the fall in inequality China?

Possible explanations

1. Domestic policies introduced since the 2000s seem to have played a role (Li and Sicular 2014)
   - Minimum wage increases
   - Extension of social protection and antipoverty policies (e.g. DiBao)
   - Agricultural support policies
   - Targeted tax reductions

2. A major stimulus package of 4 trillion yuan
   - Increase investment in infrastructure
   - Tax cuts
   - Increase in social spending (education and health)
The emergence of Social Protection

- A new paradigm in the fight against poverty and vulnerability
- Tax-financed (and/or aid-supported) policies that moved antipoverty approaches:
  - From food-aid and subsidies to regular, reliable and predictable income transfers
  - Emerging consensus that eradicating poverty requires economic growth, basic service provision and social protection
  - A shift from poverty as a lack of income to poverty as a multidimensional phenomenon
- Over 30 developing countries have large scale social transfer programmes
- Pilot schemes being introduced in Kenya, Malawi, Ghana and Zambia; and at implementation in Nigeria, Liberia, Uganda, and Tanzania
- Nearly 900 million people currently benefit from social protection, making it the most important policy instrument against poverty at the present time
What is the impact of transfers programmes on inequality in LA?

<table>
<thead>
<tr>
<th></th>
<th>Brazil</th>
<th>Chile</th>
<th>Mexico</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1995</td>
<td>2004</td>
<td>Δ value (%)</td>
</tr>
<tr>
<td>Gini</td>
<td>0.598</td>
<td>0.571</td>
<td>-0.027 100</td>
</tr>
<tr>
<td><strong>Contribution to inequality reduction</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labour</td>
<td>-0.023</td>
<td></td>
<td>85.2</td>
</tr>
<tr>
<td>Social Security</td>
<td>0.006</td>
<td></td>
<td>-21.8</td>
</tr>
<tr>
<td>Other</td>
<td>-0.004</td>
<td></td>
<td>15.8</td>
</tr>
<tr>
<td>CCT</td>
<td>-0.0057</td>
<td></td>
<td>20.8</td>
</tr>
<tr>
<td><strong>Weight in total income</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labour</td>
<td>0.820</td>
<td>0.726</td>
<td></td>
</tr>
<tr>
<td>Social Security</td>
<td>0.142</td>
<td>0.227</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>0.037</td>
<td>0.042</td>
<td></td>
</tr>
<tr>
<td>CCT</td>
<td>0.0051</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Soares et al (2009)
What is the impact of transfers programmes on inequality in Namibia?

- Poverty is more pervasive in rural areas
- Female-headed households are poorer than male-headed
- Poverty in rural areas is less sensitive to changes in per capita consumption expenditure

<table>
<thead>
<tr>
<th></th>
<th>Poverty Headcount Rate (P0)</th>
<th>Poverty Gap (P1)</th>
<th>Squared Poverty Gap (P2)</th>
<th>Headcount elasticity</th>
<th>Gini Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban</td>
<td>14.6</td>
<td>4.4</td>
<td>2.0</td>
<td>-1.94</td>
<td>58.1</td>
</tr>
<tr>
<td>Rural</td>
<td>37.5</td>
<td>11.6</td>
<td>5.0</td>
<td>-1.68</td>
<td>48.3</td>
</tr>
<tr>
<td>Total</td>
<td>28.8</td>
<td>8.9</td>
<td>3.9</td>
<td>-1.73</td>
<td>59.4</td>
</tr>
</tbody>
</table>

Source: Chiripanhura and Niño-Zarazúa (2014)
What is the impact of transfers programmes on inequality in Namibia?

- Inequality decompositions show that labour income is the main contributing factor to high inequality levels in Namibia: a 1% increase in labour income increases the Gini coefficient by 3%.

- Non-contributory social assistance programmes (Old Age Pension, Disability Grant, Foster Parent Allowance) are the main sources of redistribution, followed by remittances, despite their small share in total income.

<table>
<thead>
<tr>
<th>Income source</th>
<th>Share of each income source in total income</th>
<th>Gini correlation of income sources</th>
<th>Gini correlation of income sources with distribution of total income</th>
<th>Share of each income source in total inequality</th>
<th>% change in Inequality from income source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labour income</td>
<td>0.916</td>
<td>0.799</td>
<td>0.972</td>
<td>0.946</td>
<td>0.03</td>
</tr>
<tr>
<td>Social security</td>
<td>0.015</td>
<td>0.995</td>
<td>0.732</td>
<td>0.014</td>
<td>-0.0005</td>
</tr>
<tr>
<td>Social assistance</td>
<td>0.038</td>
<td>0.937</td>
<td>0.271</td>
<td>0.013</td>
<td>-0.025</td>
</tr>
<tr>
<td>Remittances</td>
<td>0.013</td>
<td>0.985</td>
<td>0.375</td>
<td>0.006</td>
<td>-0.007</td>
</tr>
<tr>
<td>Assets</td>
<td>0.013</td>
<td>0.999</td>
<td>0.854</td>
<td>0.015</td>
<td>0.002</td>
</tr>
<tr>
<td>Other income</td>
<td>0.005</td>
<td>0.998</td>
<td>0.732</td>
<td>0.005</td>
<td>-0.0001</td>
</tr>
</tbody>
</table>

Source: Chiripanhura and Niño-Zarazúa (2014)
Wider functionings of Social Protection: automatic stabilizers

• In Indonesia, the Jaring Pengaman Sosial was launched in 1998 to help poor households to mitigate the impact of the 1997-1998 Asian financial crisis.

• In Argentina, Plan Jefes y Jefas de Hogar Desocupados was introduced in the aftermath of the 2001-2002 Argentinean peso crisis to support unemployed parents with children.

• In the Aftermath of the 2008 financial crisis

  — South Africa extended the Child Support Grant to cover children up to age 17, from the previous age limit of 15.

  — In Brazil, the scope of Bolsa Familia was expanded to include an additional 1.3 million households.

  — In Mexico, Oportunidades was expanded in 2010 to cover an additional 600,000 households mostly in urban areas.
What are the costs and sources of financing Social Protection in Developing Countries?
The Cost of Social Protection

- MICs spend less than 1% of GDP on Social Transfers  
- LICs African countries: 3-5% GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Old age pension as % GDP</th>
<th>Child benefit as % GDP</th>
<th>Unemployment scheme as % GDP</th>
<th>Transfer package as % GDP</th>
<th>Revenue – grants as % GDP</th>
<th>Transfer package as % Revenue - grants</th>
<th>Net ODA/ as % GDP</th>
<th>Transfer package as % net ODA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guinea</td>
<td>0,6</td>
<td>1,5</td>
<td>0,3</td>
<td><strong>2,8</strong></td>
<td>15,6</td>
<td><strong>17,7</strong></td>
<td>7,5</td>
<td>36,9</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>1,1</td>
<td>2,8</td>
<td>0,6</td>
<td><strong>5,2</strong></td>
<td>13,1</td>
<td><strong>39,5</strong></td>
<td>12,5</td>
<td>41,3</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>1,0</td>
<td>2,8</td>
<td>0,6</td>
<td><strong>5,1</strong></td>
<td>12,0</td>
<td><strong>42,2</strong></td>
<td>12,6</td>
<td>40,3</td>
</tr>
<tr>
<td>Tanzania</td>
<td>1,1</td>
<td>3,1</td>
<td>0,6</td>
<td><strong>5,5</strong></td>
<td>17,3</td>
<td><strong>31,9</strong></td>
<td>11,4</td>
<td>48,5</td>
</tr>
<tr>
<td>Senegal</td>
<td>1,1</td>
<td>2,0</td>
<td>0,5</td>
<td><strong>4,1</strong></td>
<td>19,6</td>
<td><strong>21,1</strong></td>
<td>8,0</td>
<td>51,7</td>
</tr>
<tr>
<td>Kenya</td>
<td>0,9</td>
<td>3,0</td>
<td>0,6</td>
<td><strong>5,2</strong></td>
<td>20,8</td>
<td><strong>24,9</strong></td>
<td>3,9</td>
<td>131,3</td>
</tr>
<tr>
<td>Cameroon</td>
<td>0,8</td>
<td>1,8</td>
<td>0,4</td>
<td><strong>3,5</strong></td>
<td>20,0</td>
<td><strong>17,3</strong></td>
<td>2,2</td>
<td>154,0</td>
</tr>
</tbody>
</table>

ILO (2008)
Sources to Finance Social Protection

- Tax revenues as a share of GDP have grown modestly in the sub-Saharan region; from 13.5% in the 1980s to 18% in the 2000s

- Constraints associated with:
  - The structure of the economy – the rural subsistence economy and the informal sector are difficult to tax
  - Administrative capacity of revenue authorities
  - Political economy factors

- What are the options for financing social protection in developing countries?
What about redistribution?


Marginal Income tax rate on the ‘rich’ needed to eliminate the normalised poverty gap
What about resource mobilisation?

- Revenues from Natural resources. Potential for Angola, Botswana, Cameroon, Chad, Côte d'Ivoire, Gabon, Equatorial Guinea, Ghana Namibia, Nigeria, Republic of Congo, Sierra Leone, Togo, Uganda and Zambia
  - Immediate challenges in terms of efficiency and equity

- Renegotiation of contracts with companies involved in the exploitation of natural resources: Bolivia’s Bono Juancito Pinto and Programa (PAN)

- Subsidies in developing countries are very regressive - amounted around $54 billion in 2010, roughly, 1/3 of ODA (170.6 billion USD)

- Rises in VAT earmarked for expenditures on Social Protection. VAT on ‘sin’ products (e.g. cigarettes/alcohol) could rise revenues in India and Vietnam equivalent to 0.3 and 0.4 % of GDP, respectively.

- Anti tax-evasion policies – Chile was able to reduce VAT evasion from 20% in the 1990s to less than 10% in 2009
Concluding Remarks

• Inequality remains a major challenge when analysing trends in within-country inequalities

• Concerns about the negative implications of inequality, in terms of social cohesion, crime, conflict and political instability

• Recent encouraging trends in Latin America and some Asian countries, where inequality has been falling due to:
  – A decline in the premium to skills after an educational upgrading
  – Progressive fiscal and social policies, including social protection

• Recent although scant evidence from Latin America (LA) and Southern Africa (SA) suggests that social transfers have contributed to the reduction in inequality in the order of 15% to 20% in LA, and 3% in SA

• Potential sources to finance social protection vary from country to country. However, the expansion of social protection in developing countries are equally constrained by political economy factors
Thank you!
The Role of Taxation

Jukka Pirttilä
Outline

• Characteristics of a good, redistributive, tax system
  – Generally
  – When applied to developing countries
• Two specific topics
  – Full incidence of tax and spending policies
  – The role of price subsidies vs direct income support
• Thoughts on linkages between tax policy research and practice in developing countries
Characteristics of a good tax system

• Based on the Mirrlees Review
  – A comprehensive treatment of what can be said about the design of tax systems based on the theory and evidence of decades of tax research
  – Put together by the Institute for Fiscal Studies in London
  – Specific focus on small, open, developed, economies
  – But broad principles highly relevant for developing countries as well
The Mirrlees Review: key principles

• A progressive neutral tax system: each part of this is important

• Progressive
  – Trade-off between redistribution and efficiency is key in tax design
  – Redistribute in a way that minimises efficiency costs

• Neutral
  – Do not discriminate between different activities unless good reason to (e.g. different types of goods, different forms of remuneration)
  – Non-neutralities often lead to inefficiency, complexity and opportunities for tax evasion

• System
  – Important to think how system works as a whole (and with benefits)
  – Consider role of each tax – e.g. not all need to be progressive
More on tax systems

• Economics has traditionally devoted a lot of attention on getting the tax rates right
  – For this, evidence is needed on how responsive are tax bases (e.g. taxable income) to changes in the tax rates
  – i.e. how distortive taxes are

• Much more limited attention on tax collection, avoidance, evasion and tax administration

• The extent of tax distortions depends crucially on how the entire tax system is build
  – The wider the tax base, the smaller is the scope for evasion, and the smaller are the distortions of generating tax revenues and achieving redistribution
Taxes, poverty and inequality

• The role of taxes in affecting poverty is limited -- those living in absolute poverty do not pay taxes
• The role of taxes in poverty alleviation is indirect via their role in generating income for public services and transfers
• The role of taxes in restraining inequality is stronger
  – But the extent on desirable inequality reduction depends on values
  – The scope of inequality reduction via taxes in developing countries limited because of the low importance of direct labour income taxes and the administrative burden of levying effective capital income taxes
Example of taxation and redistribution

Full incidence analysis – **Commitment to Equity Project**

- Study that calculates the total effect of taxes, transfers and public provision for selected countries
- Ready for many Latin American countries, in progress for many African countries
- Calculates redistribution: the reduction of market income inequality and household final income inequality
Income concepts

- Market income: labour income, capital income
- Net market income: Market income – direct taxes
- Disposable income: Net market income + direct transfers
- Post-fiscal income: Disposable income – indirect taxes + indirect subsidies
- Final income: Post-fiscal income + in-kind transfers (value of public services) – user fees
Results for Latin America

FIGURE 1. GINI COEFFICIENT FOR EACH INCOME CONCEPT
Results on Brazil in a nutshell

- Direct taxes have a very limited role: while they are progressive, their share of overall revenue is small.
- And since indirect taxes are regressive, the tax part as a whole is not much progressive.
- Transfers are redistributive.
- What really makes a difference is the value of publicly provided services.
- This finding reflects the relative size of public provision vs cash transfers.
Redistribution using indirect taxes (price subsidies) vs direct transfers?

Based on the presentation by Michael Keen (IMF) at the UNU-WIDER conference

- Generalized price support can be a very badly targeted way to support the poor
- Because although the poor may spend a larger proportion of their income on, say, food or fuel, the rich spend absolutely more
  - so most of the dollar benefit (revenue foregone) goes to them
- An example from Mexico
An example: reduced VAT rates

- Zero rating of food in Mexico
But the question is:

- Maybe these heavy costs are a price we have to pay for equity objectives? Real issue is:

- Are there better targeted ways to support the poor?

- Benefit to poor from subsidies can be sizable:
  - E.g. $0.25 per liter increase in fuel prices can reduce real consumption of poorest 20 percent by 5.5 percent
The answer?

• In developed countries, the answer is yes. One can remove the differentiated VAT rates and compensate those at the bottom of the distribution by increasing direct transfer, yet saving net tax revenues

• But in developing countries, only blunter spending instruments available, so policy case for rate differentiation stronger—but how strong?
Different ways of targeting

For a cash transfer, the condition is simply that consumption share lower than share in total cash benefits

• For a poll subsidy, this must be the case if their consumption is below the average
  – Iran
• And even more likely to be case if some element of pro-poor element in cash transfers
• Use new ICT techniques to improve targeting (smart cards in India)
Main messages

• We need to think taxes and transfers as a system
  – Not every policy the Finnish For Min supports needs to reduce inequality – but for the country as a whole the answer is different

• We also need more knowledge on the current stance of the redistributive systems for low-income countries

• Redistribution should be more efficient, probably via transfer and public provision rather than price subsidies
Ideas for policy-relevant research

• Try to obtain evidence on key measures of tax responsiveness
  – Explore the potential of tax register data
• Build capacity to understand the tax-benefit structure and needed reforms
  – Build microsimulation models
• Field experiments
  – Interact with tax authorities and experiment with methods targeted to improve tax collection