

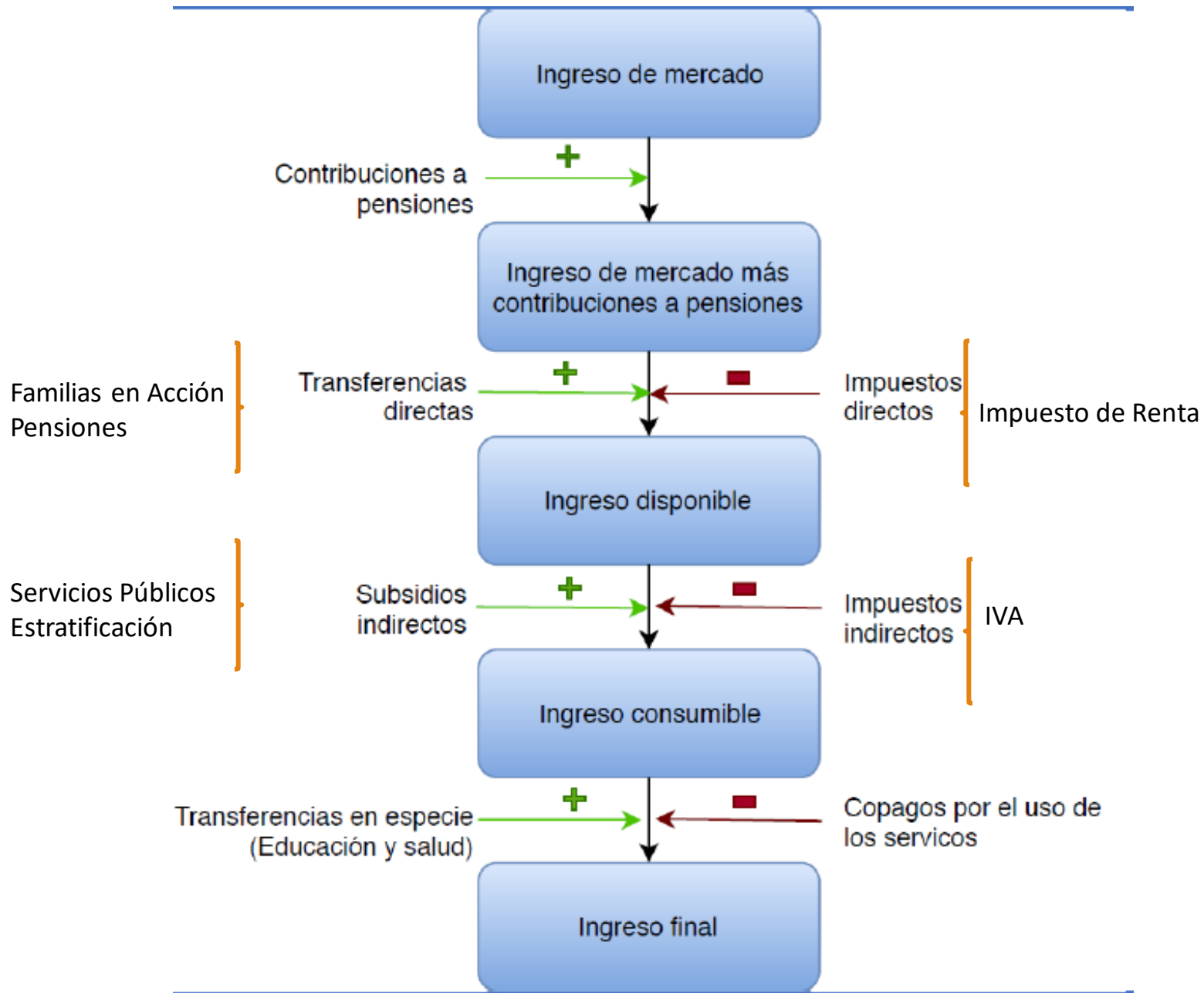
# The redistributive impact of taxes and social spending in Colombia

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# Introduction

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1. This paper has the objective of establishing the incidence of taxes and social spending on poverty and inequality in Colombia.
2. We use our own tools combined with those of the CEQ of Tulane University
3. The work we have done at Fedesarrollo, with the support of AFD, includes analyzes from 2017 to 2020
4. In summary, we find that the incidence of state redistribution mechanisms is important, but that after running a set of simulations there is enormous room for improvement.



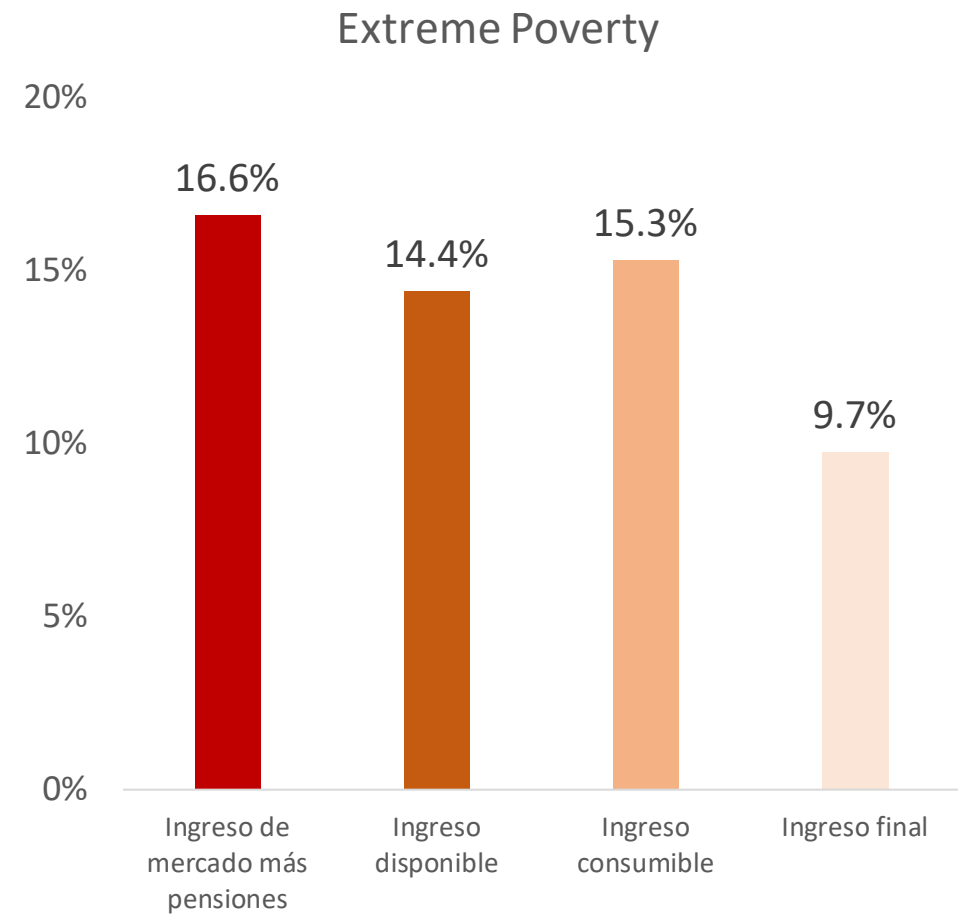
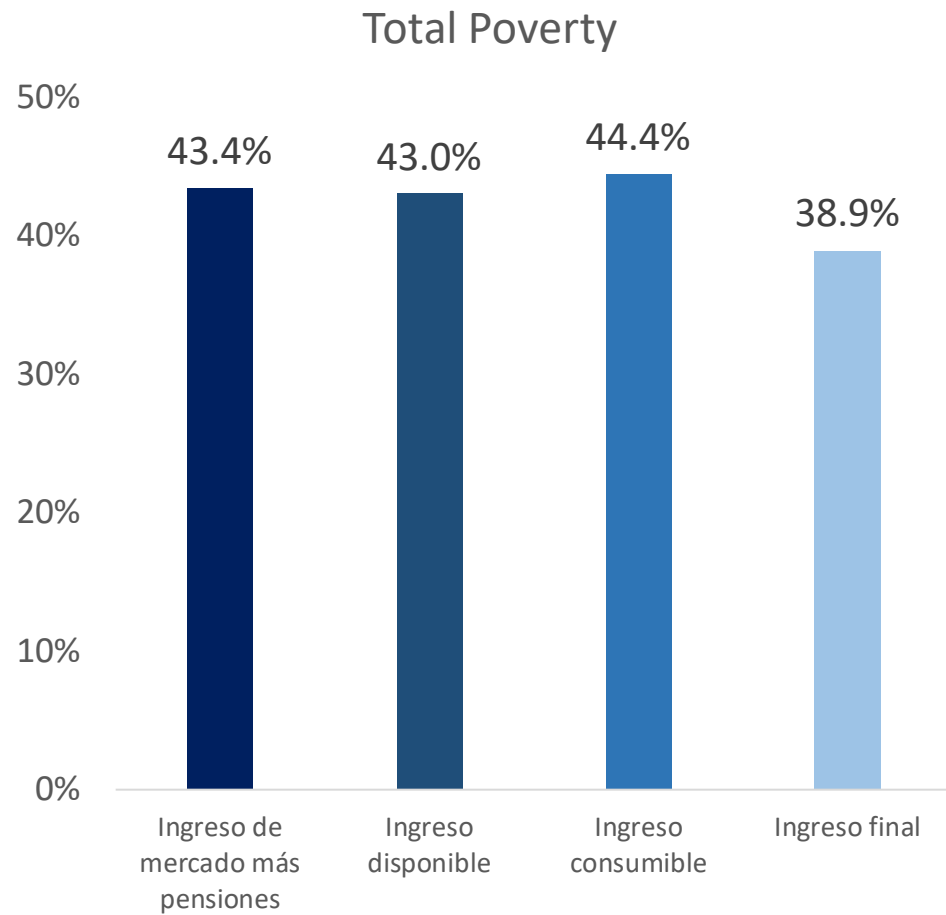
We start the analysis using market income from household surveys and adding pension contributions made by employers.

After this, we add direct cash transfers and subtract direct taxes (income tax) to get disposable income.

Next, we add indirect transfers (stratified public services) and subtract indirect taxes (VAT) to obtain consumable income.

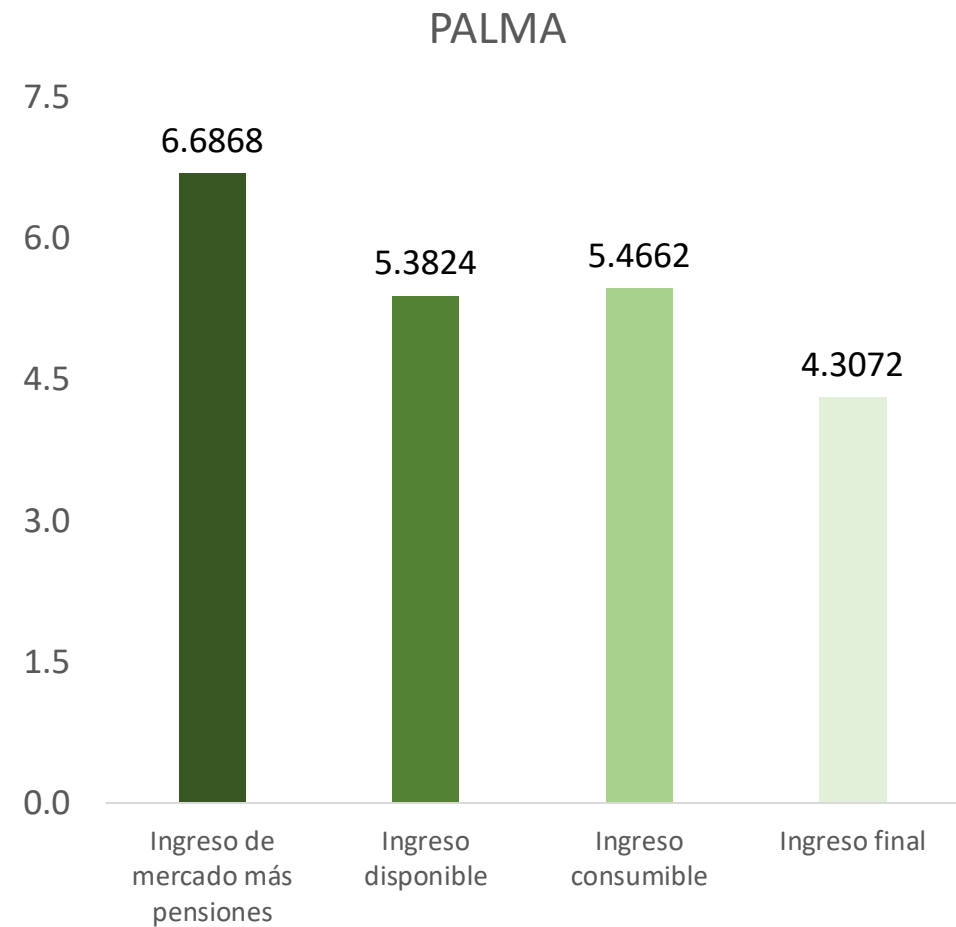
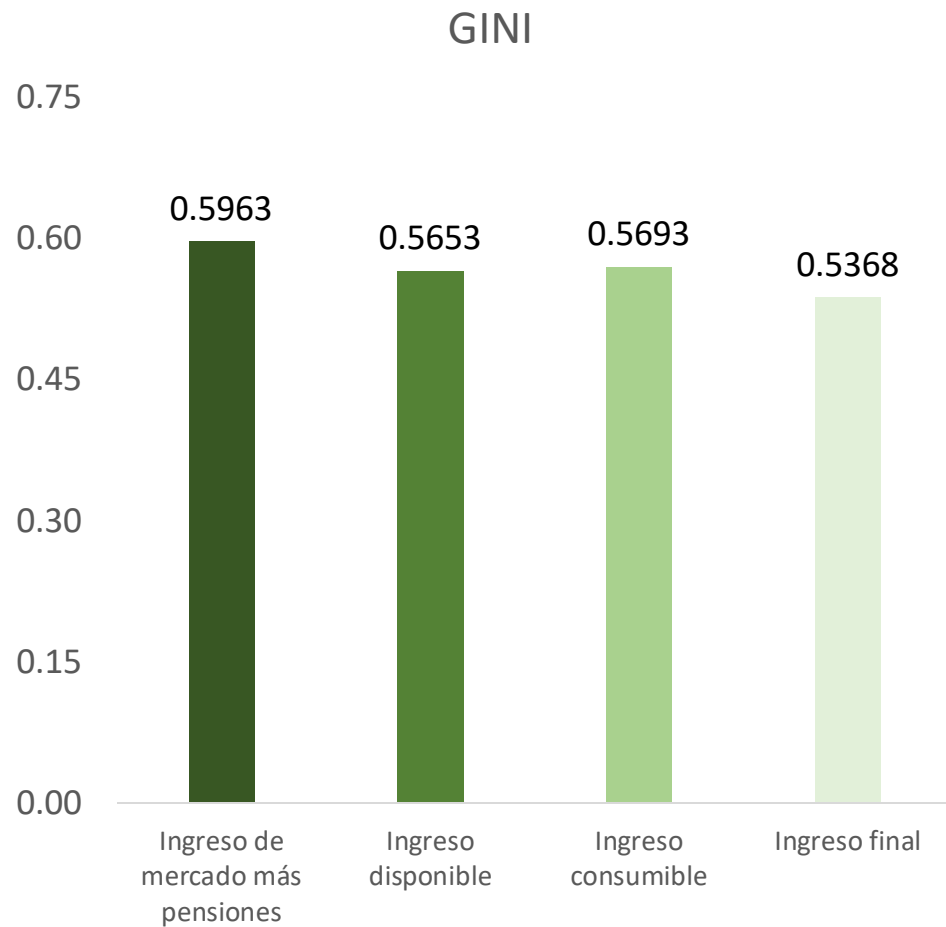
Finally, we add in-kind transfers (health and public education) and subtract copayments.

In each state we estimate poverty and inequality to obtain the incidence of distributive mechanisms.



# Baseline Results

Regarding total poverty, we find that the redistributive effects of taxes and social spending are not significant, except for spending on health and education, which reduce poverty by 4.5 percentage points. Regarding extreme poverty, the results are more sensitive, thanks to cash transfers. The total effect is a reduction of 7 points. In both cases, VAT is regressive.



# Baseline Results

Regarding income distribution, the results have similar tendencies, and the most important effects are those of education and health. In the end, the Gini coefficient is reduced by 6 points.

# Policy Simulations

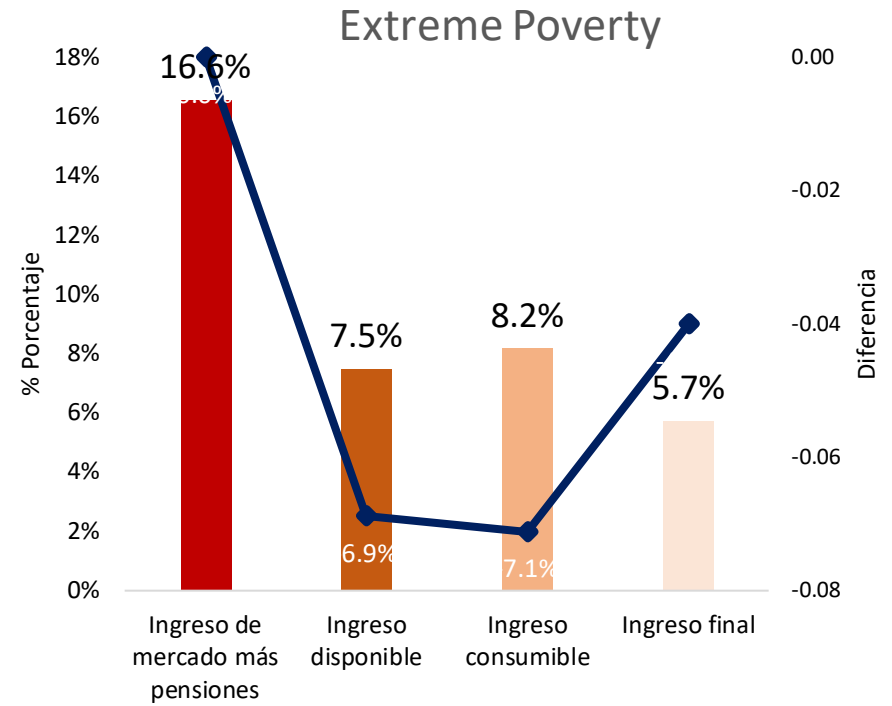
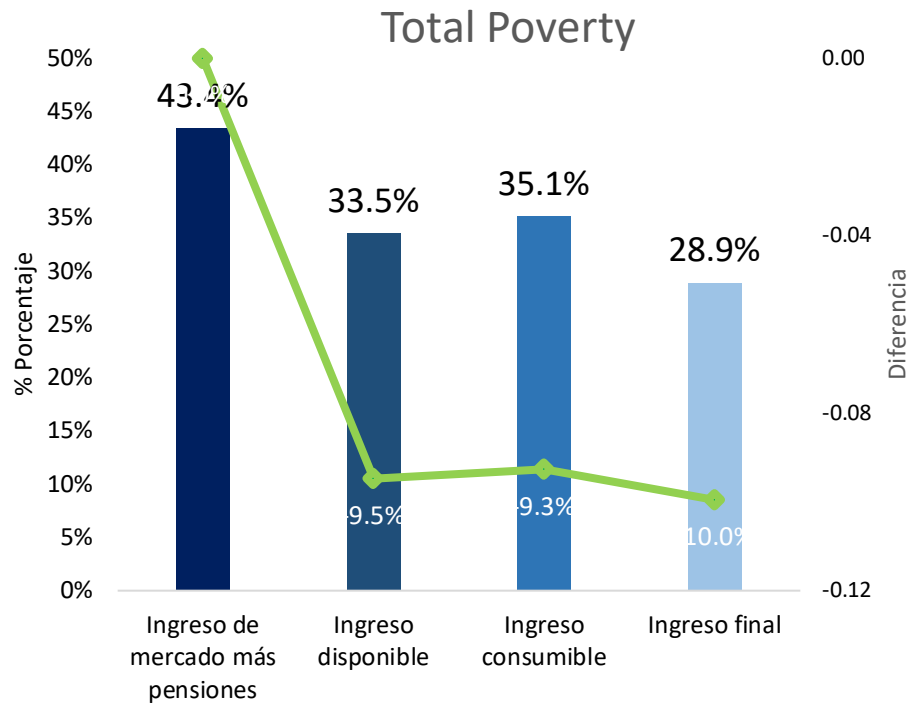
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## 1. Taxes

- a. We increased the tax base in such a way that the income limit to declare taxes was half of the current value
- b. We modified the progressive tax structure to obtain higher effective rates
- c. We cut exemptions in half: from 34% to 17% of net income
- d. We double the nominal tax rates on dividends and occasional earnings (at 10% and 20%)

## 2. Social spending

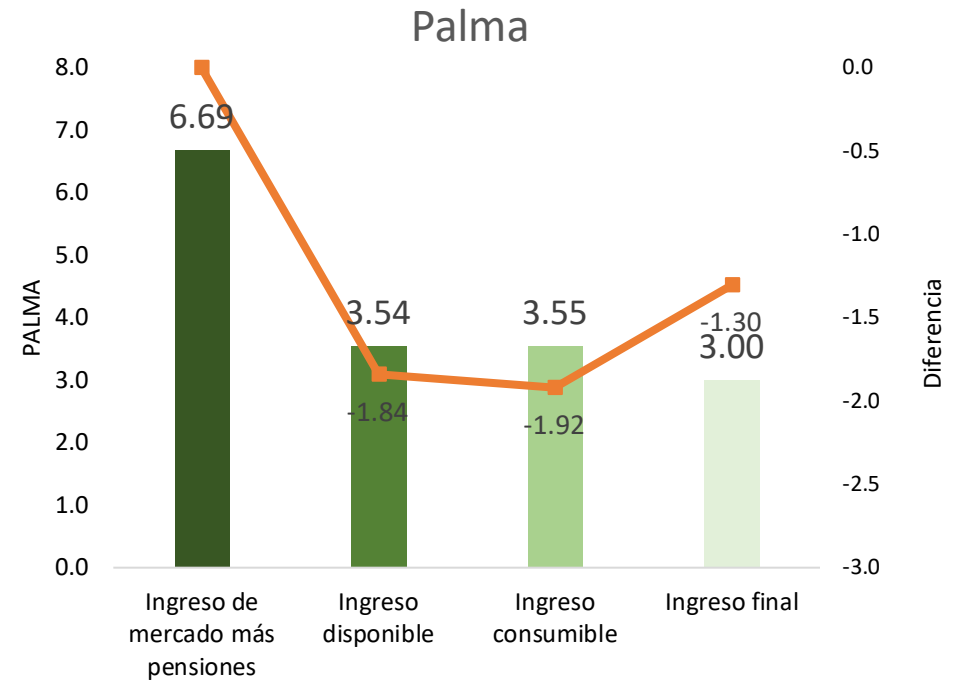
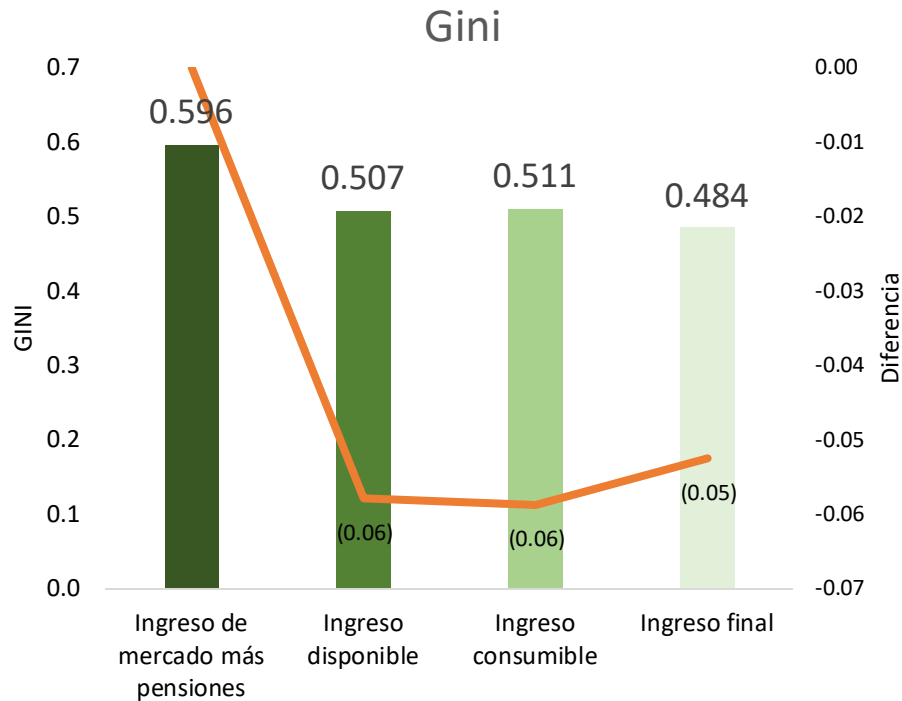
- a. Cash grants during the pandemic (ISP): coverage was increased from 3.1 to 4.1 million and we introduced a progressive subsidy that was previously flat
- b. A universal coverage of the program for older adults living in poverty was introduced with a transfer of 1 poverty line
- c. An extension of the VAT refund from 1 to 2 million households



# Joint simulation

Thanks to changes in social programs, poverty was reduced by 9.5 percentage points in disposable income and the combined effect of taxes and spending reduced poverty by 14.5 points in final income (from 43% to 29%).

Regarding extreme poverty, it was reduced 9.5 points in disposable income and 11 points in final income (from 16.6% to 5.7%, a reduction of one third)



# Joint simulation

The simulated changes in social programs and taxes have a huge effect on disposable income inequality by reducing the Gini by 9 points (compared to the current 3 points reduction).

The final effect reaches 11 Gini points, which would leave Colombia with a redistributive effect like that of some developed countries.



# Conclusions

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- A package that improves the basic income (solidarity) and the universal pension may be the best tool to sustain a population that lives in very precarious conditions of hunger and access to basic services.
- The current redistribution of disposable income reaches 3 points in the Gini, but with improvements in taxes and social spending, improvements of 8 additional points (11 points in total) could be achieved.
  - From market income to final income, the changes are transcendental even with such a marked initial concentration.