How can tax-benefit systems support households through crisis?

Presenter: Jukka Pirttilä
Panellists: Gioia De Melo (OECD), Murray Leibbrandt (University of Cape Town)
Chair: Ravi Kanbur
Tax-benefit goals

• One key objective: offer social protection to alleviate (chronic) poverty

• But also: offer social insurance
  – Cushioning against negative shocks, e.g. unemployment

• Can also be examined via the lens of automatic stabilization
  – Increase in benefits and reduction in taxes paid when incomes decline
Automatic stabilization in developing countries

- Examined by Adu-Ababio (2022) for three different countries: Ecuador, Ghana, South Africa using SOUTHMOD microsimulation models

- Calculates how well tax-benefit policies insulate households from shocks

- Can, in principle, range from 0 to 100%

  If 0%: disposable income declines in 1:1 manner with market income
  If 100%: disposable income stays constant despite drop in market income
## Autom stabiliz in developing countries: Results

<table>
<thead>
<tr>
<th>Share of income decline cushioned by taxes and benefits</th>
<th>Ghana</th>
<th>Ecuador</th>
<th>South Africa</th>
</tr>
</thead>
<tbody>
<tr>
<td>1%</td>
<td></td>
<td>10%</td>
<td>22%</td>
</tr>
</tbody>
</table>

Calculated using a 5% decline in gross incomes. Source: Adu-Ababio (2022)
## Autom stabiliz in developing countries: Results

<table>
<thead>
<tr>
<th>Share of income decline cushioned by taxes and benefits</th>
<th>Ghana</th>
<th>Ecuador</th>
<th>South Africa</th>
<th>EU</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>1%</td>
<td>10%</td>
<td>22%</td>
<td>38%</td>
<td>39%</td>
<td></td>
</tr>
</tbody>
</table>

Calculated using a 5% decline in gross incomes. Sources: Adu-Ababio (2022) and Dolls et al. (2012)
A specific shock: the coronavirus pandemic

- The extent of protection against the pandemic in 2020 has been studied by Lastunen et al. (2021)

- Simulations conducted for five countries in Africa (Ghana, Mozambique, Tanzania, Uganda, Zambia)

- Automatic stabilization very modest

- New COVID specific policies introduced during the year also barely reduced poverty (with the exception of Zambia)
Why so little automatic stabilization?

• Three key reasons
  1. Government size (and hence the level of taxes and benefits) smaller in developing countries
  2. Large share of workers in the informal sector; do not pay income taxes
  3. Many benefits not means tested
     • Rather: based on proxy means test (PMT): eligibility depends on proxies (e.g. asset ownership); requires data collection
Are there reform options?
Conceptual framework

• Provided by the optimal income tax work (Mirrlees 1971)

• Chosen redistribution
  – pre-tax income differences increasing
  – Society puts a greater value on equal distribution
  – Negative impacts of tax on economic efficiency decline

• Likely implication (Miao et al. 2022): redistributive capacity should be increased, especially in the wake of the crisis
Targeted or more universal benefits?

• If gross incomes difficult to observe, one can use
  – Targeted (proxy means tested) transfers
  – More universal benefits (to certain demographic groups or everyone)

• Trade-off:
  – Targeting to minimize poverty in ”normal” circumstances
  – Shocks: the profile of the needy may change => A case for more universalism?
Ongoing work

- This is examined in Ethiopian context by Shahir et al. (2022)
- Two shocks investigated: COVID-19 and an agricultural shock
- Result: The increase in poverty smaller under a more universal system than in a targeted system
Conclusion

• Better social insurance system requires resources = revenues and the capacity to implement transfers

• The desirable scale of cushioning likely greater than the existing one

• More universal systems useful especially if shocks considerable and frequent
This webinar will be recorded and the recording will be added on UNU-WIDER YouTube channel and on our website.

UPCOMING WIDER WEBINARS
Tuesday 7 February
Kunal Sen & Rose Ngugi
The potential of domestic savings in the Global South

Think WIDER Webinar | UNU-WIDER | 13 December 2022

How can tax-benefit systems support households through crisis?

Thank you for joining!
### Changes in income and the role of tax/benefit policies (Source: Lastunen et al. 2021)

<table>
<thead>
<tr>
<th></th>
<th>Pre-crisis</th>
<th>Crisis</th>
<th>Total change</th>
<th>Decomposition of total change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Effect of COVID policies</td>
</tr>
<tr>
<td>Ghana</td>
<td>2 744</td>
<td>2 692</td>
<td>-50.6***</td>
<td>+1.3***</td>
</tr>
<tr>
<td></td>
<td>(-1.9%)</td>
<td></td>
<td></td>
<td>(+0.05%)</td>
</tr>
<tr>
<td>Mozambique</td>
<td>526</td>
<td>489</td>
<td>-36.9***</td>
<td>+0.8***</td>
</tr>
<tr>
<td></td>
<td>(-7.0%)</td>
<td></td>
<td></td>
<td>(+0.2%)</td>
</tr>
<tr>
<td>Zambia</td>
<td>966</td>
<td>871</td>
<td>-84.3***</td>
<td>+4.6***</td>
</tr>
<tr>
<td></td>
<td>(-9.8%)</td>
<td></td>
<td></td>
<td>(+0.5%)</td>
</tr>
<tr>
<td>Tanzania</td>
<td>920</td>
<td>912</td>
<td>-8.8***</td>
<td>+0.5</td>
</tr>
<tr>
<td></td>
<td>(-0.9%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uganda</td>
<td>704</td>
<td>665</td>
<td>-41.2***</td>
<td>+7.5</td>
</tr>
<tr>
<td></td>
<td>(-5.5%)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


