



DG DEVCO Staff Seminar on Social Protection - from strategies to concrete approaches -

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SESSION 8

Fiscal Incidence in South Africa

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Two Main Questions

- How do taxes and spending in South Africa redistribute income between the rich and poor?
- What is the impact of taxes and spending on poverty and inequality in South Africa?

Based on: Inchauste et al., (2015) “The Distributional Impact of Fiscal Policy in South Africa.” CEQ Working Paper No. 29. Tulane University and the Center for Inter-American Policy and Research.

Taxes

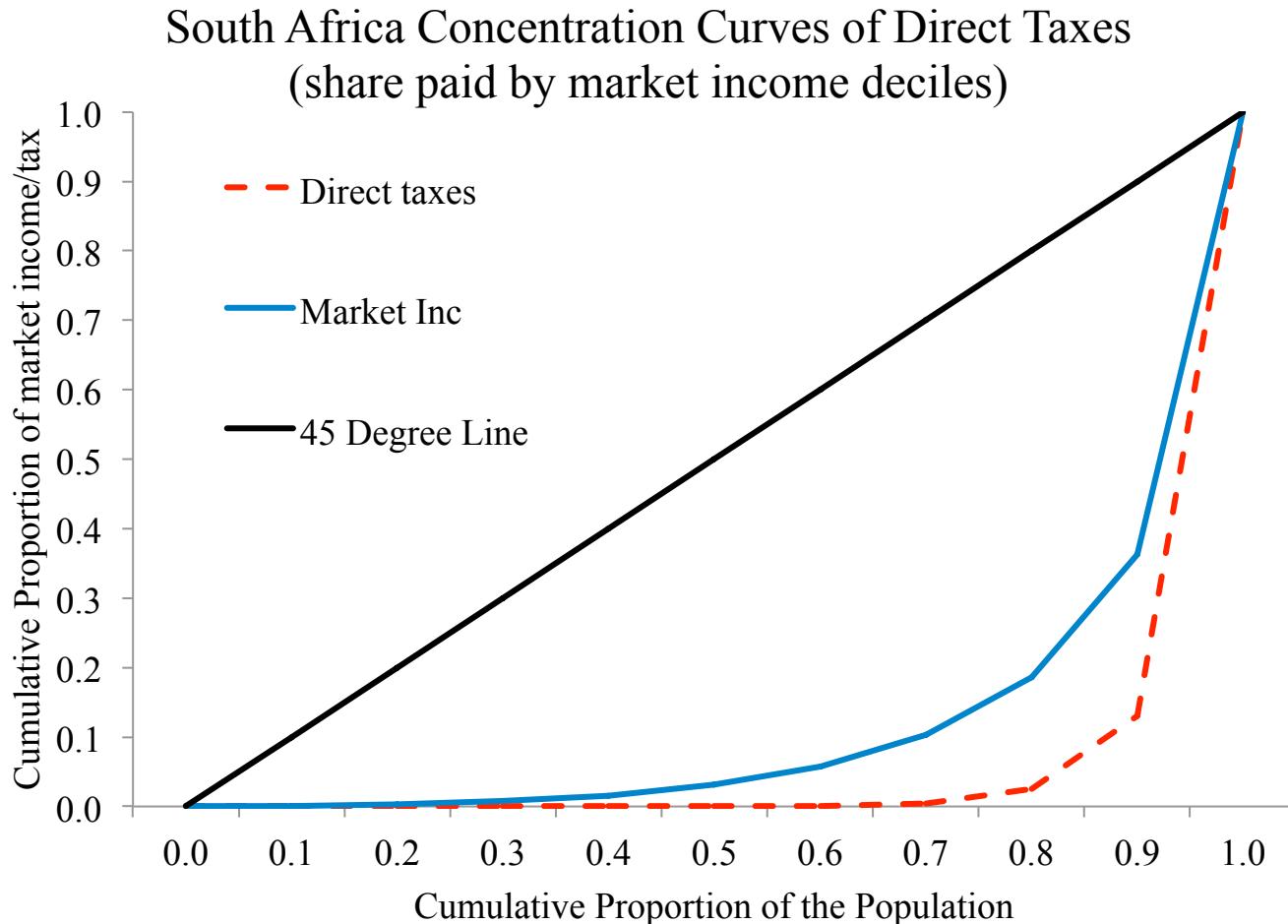
What taxes were assessed?

	2010/11	Incidence analysis
	(% of GDP)	
Total General Government Revenue	30.9	17.5
Tax Revenue	27.1	17.5
Direct taxes	14.3	8.5
Personal income tax	8.5	8.5
Corporate income tax	5.6	...
Other direct taxes	0.1	...
Indirect taxes	10.4	9
VAT	6.9	6.9
General fuel levy	1.3	1.3
Specific excise duties	0.9	0.8
International trade taxes	1	...
Other indirect taxes	0.3	...
Other taxes	2.5	...
Non-tax revenue	3.8	...

Sources: Stats SA - Financial statistics of consolidated general government, 22 November 2012 for totals. Line items under direct and indirect taxes from 2013 Budget Review, National Treasury

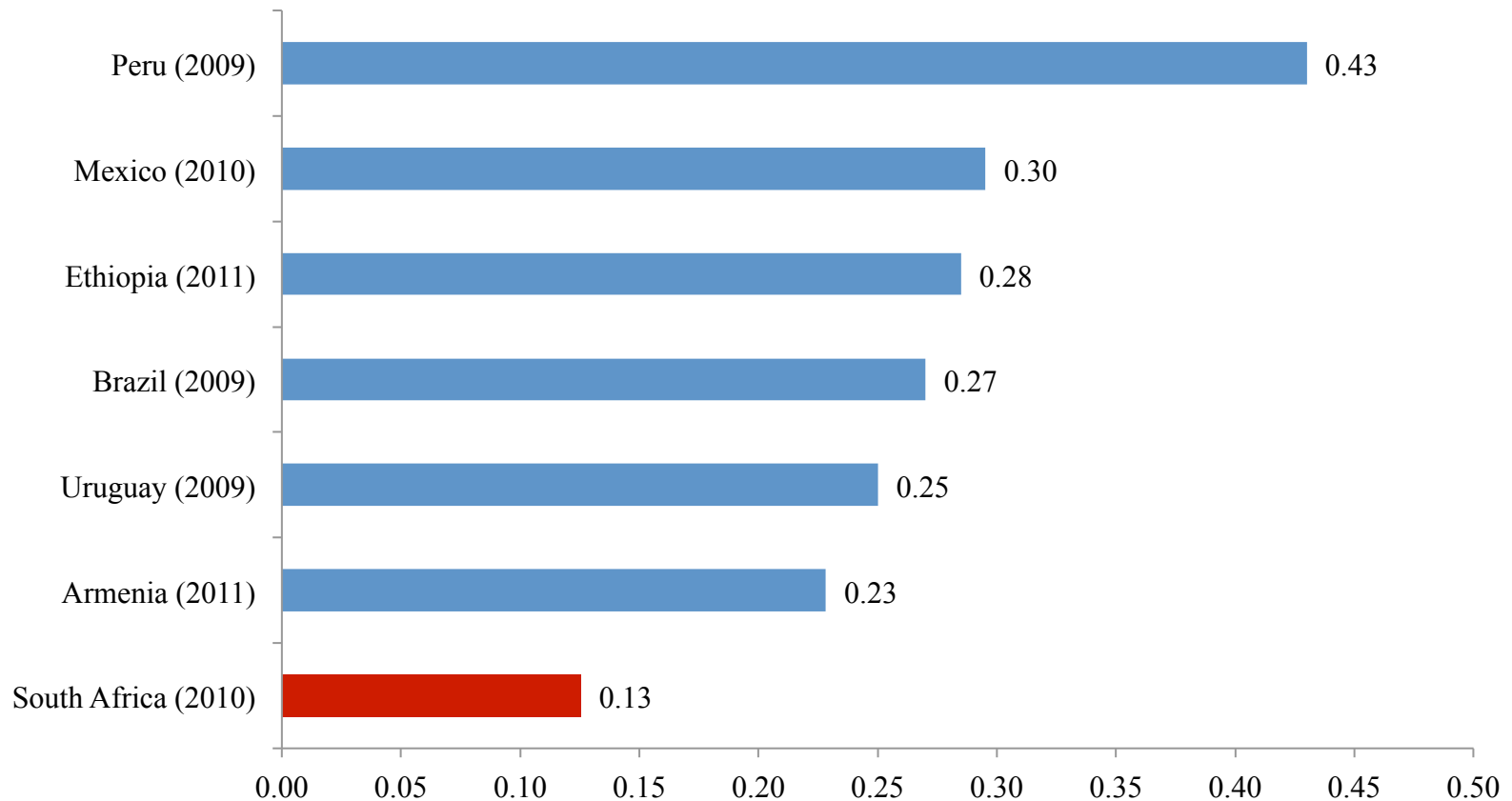
Direct taxes are absolutely progressive.

87% of direct taxes are collected from the top 10% of the distribution...



...but less so than in other countries...

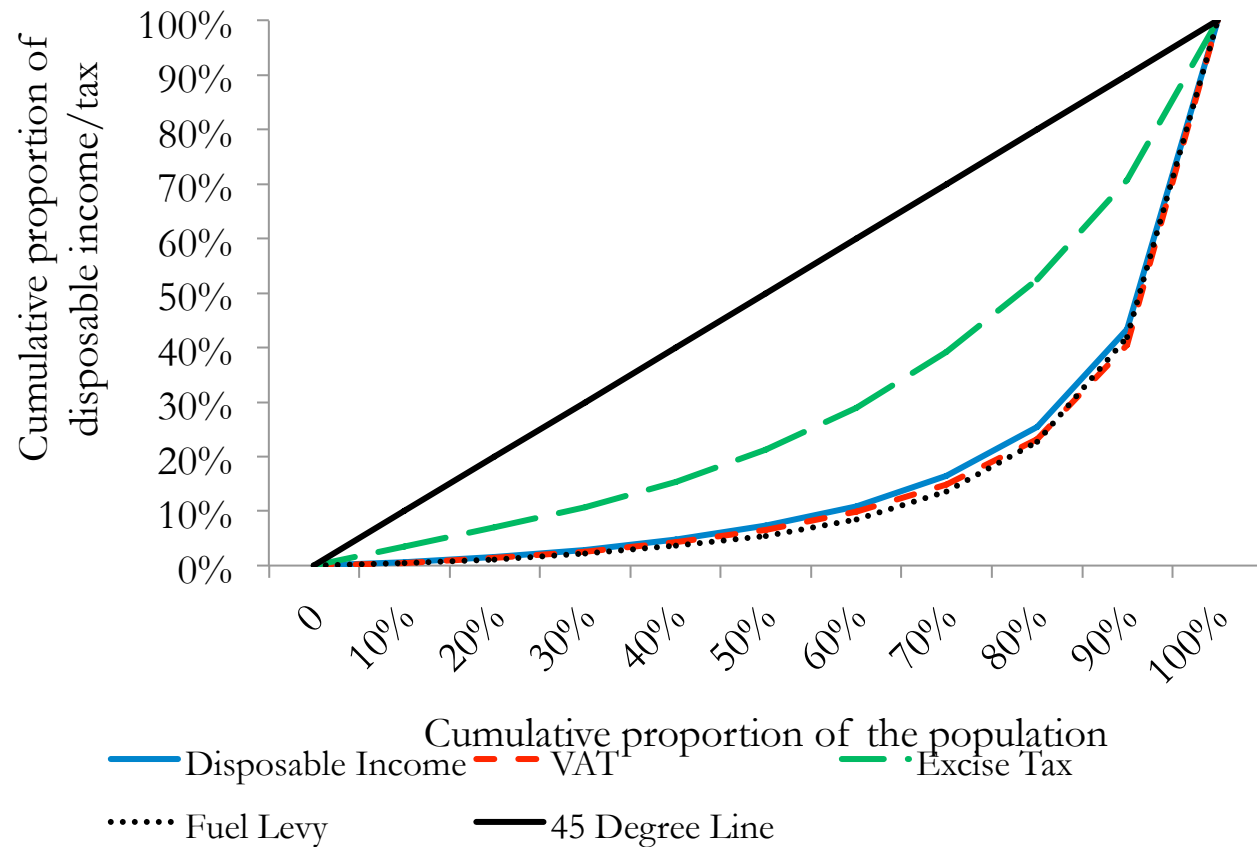
Progressivity of South Africa's Direct Tax System: The Kakwani Coefficient



Sources: Armenia (Younger et al, 2014), Bolivia (Paz et al, 2014), Brazil (Higgins and Pereira, 2014), Ethiopia (Hill et al, 2014), Indonesia (Jellema et al 2014), Mexico (Scott, 2014), Peru (Jaramillo, 2014), Uruguay (Bucheli et al, 2014), and own estimates for South Africa based on IES 2010/11.

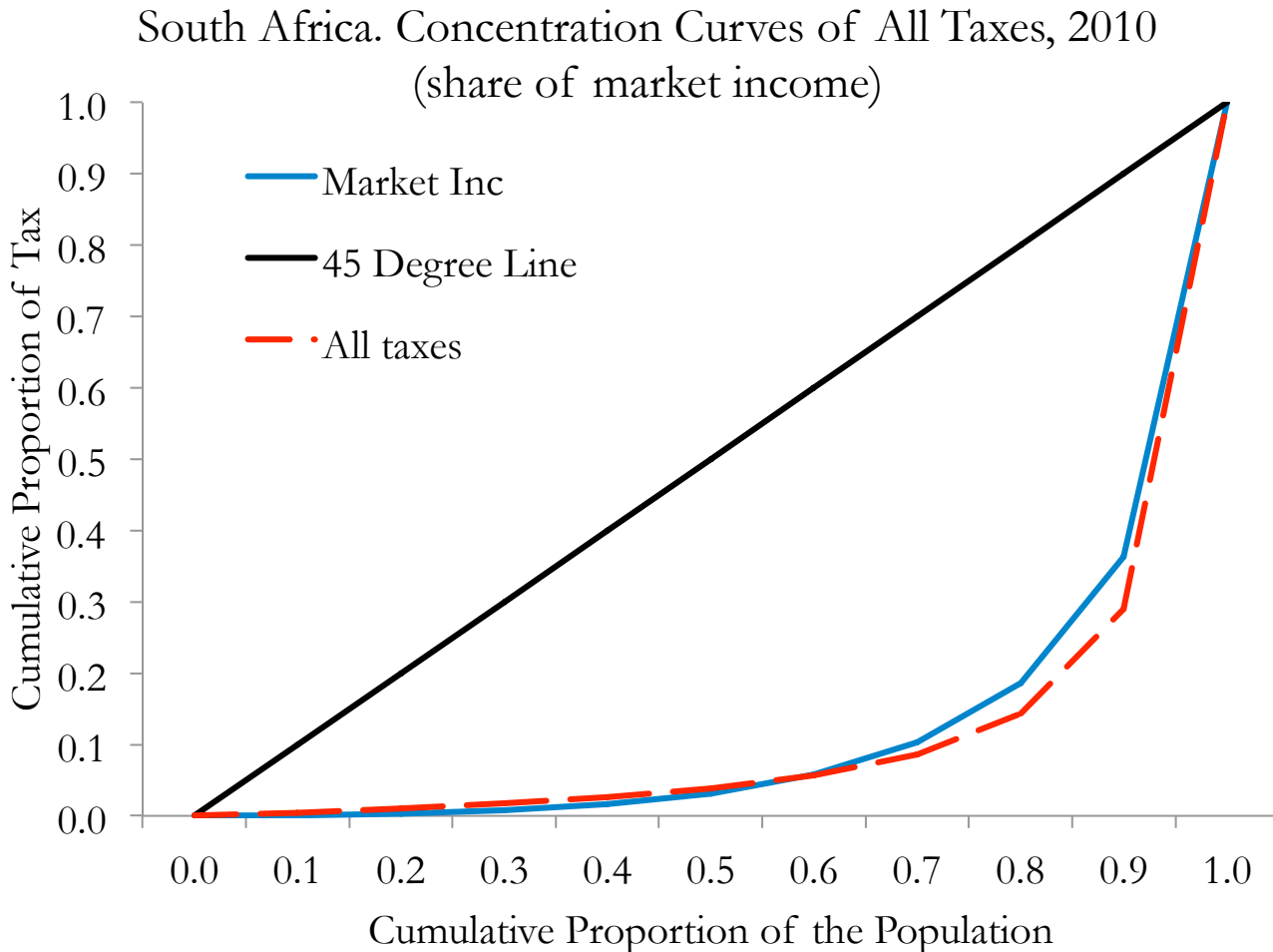
In contrast, indirect taxes are slightly regressive on account of excise taxes

South Africa Concentration Curves of Indirect Taxes
(share paid by disposable income deciles)



Source: Own estimates for South Africa based on IES 2010/11.

Overall, the tax system is globally progressive.



How progressive is social
spending in South Africa?

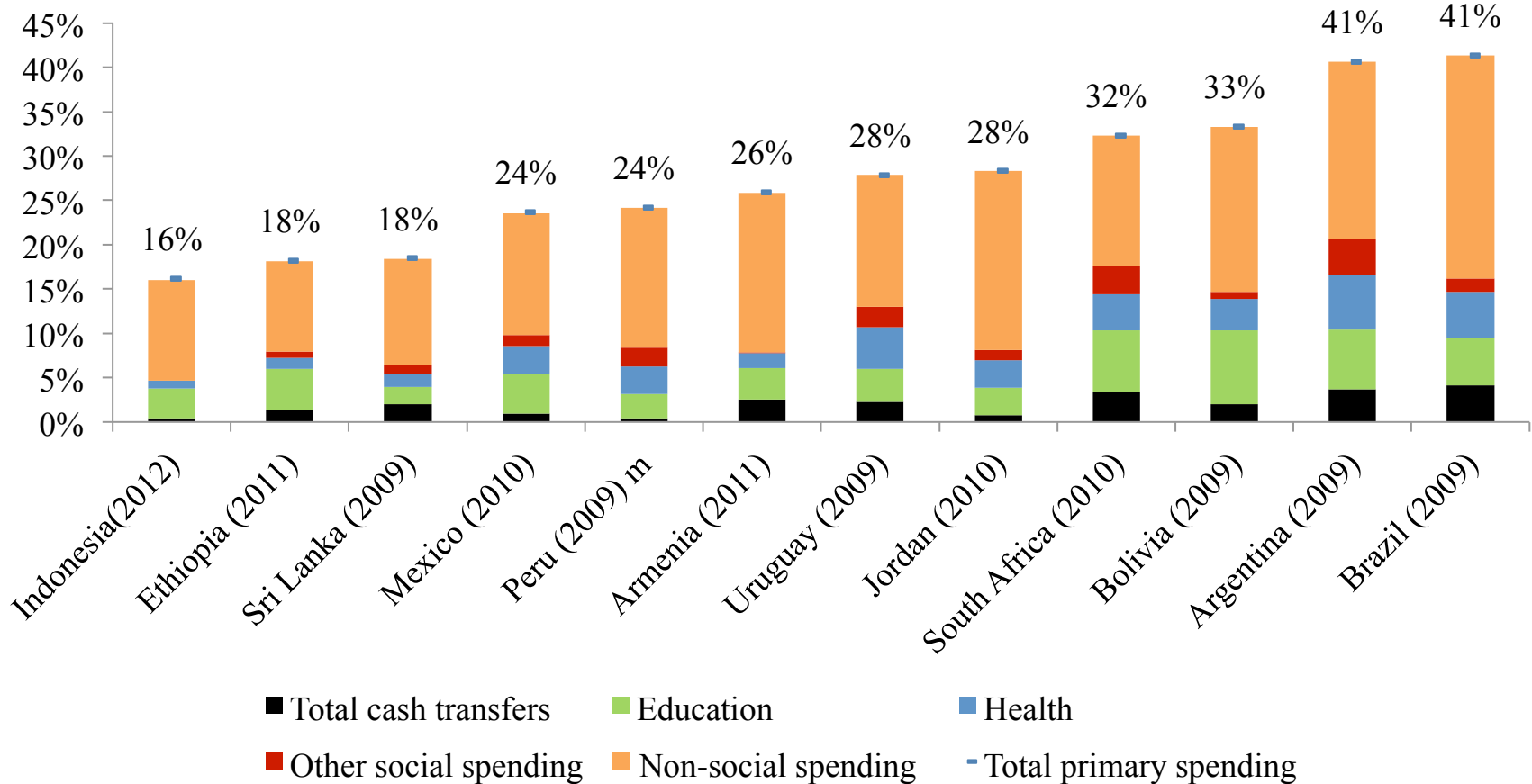
Government Spending: 2010

	2010/11	Incidence analysis
	(% of GDP)	
Total General Government Expenditure	34.8	14.9
Primary government spending	32.2	14.9
Social Spending	17.6	14.9
Total Cash Transfers	3.8	3.8
State old age pension	1.3	1.3
Child Support Grant	1.1	1.1
Disability grant	0.6	0.6
Other grants	0.6	0.6
Foster care grant	0.2	0.2
Other Transfers: Free Basic Services	0.5	0.5
In-kind transfers	12.6	11.1
Education	7	7
Health	4.1	4.1
Housing and urban	1.5	...
Other social spending	1.1	...
Non-Social Spending (incl. public sector pensions)	14.6	...

Sources: Stats SA - Financial statistics of consolidated general government, 22 November 2012 for total. Line items under direct and indirect taxes from 2013 Budget Review, National Treasury. For Free Basic Services, data represents the amount transferred under the equitable share formula for 2010/11 to municipalities to compensate them for providing basic services to poor households, and was provided by the Financial and Fiscal Commission of South Africa.

Primary spending is large relative to other MICs

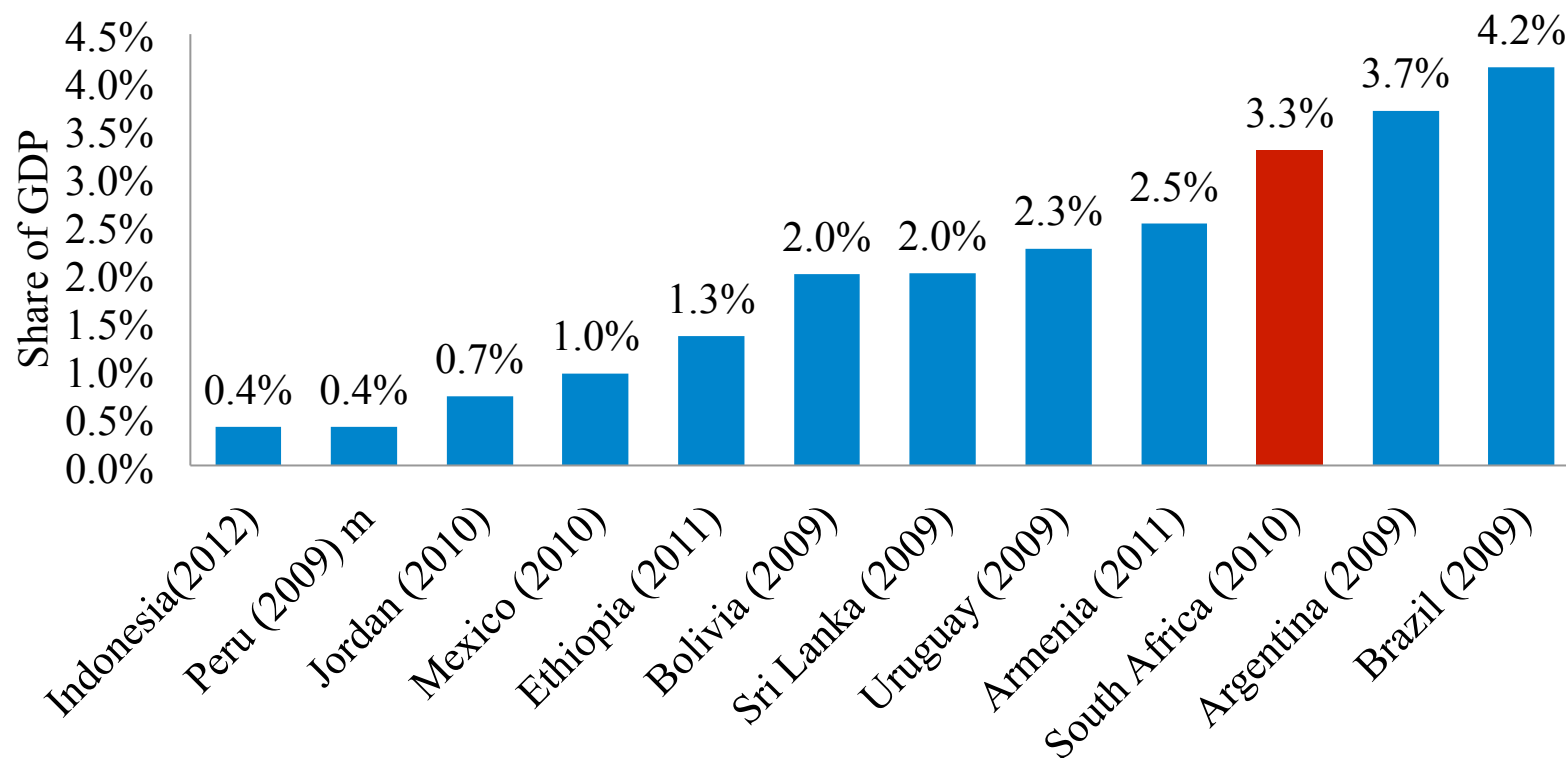
Primary Government Spending
(Share of GDP)



Direct Transfers and Pensions

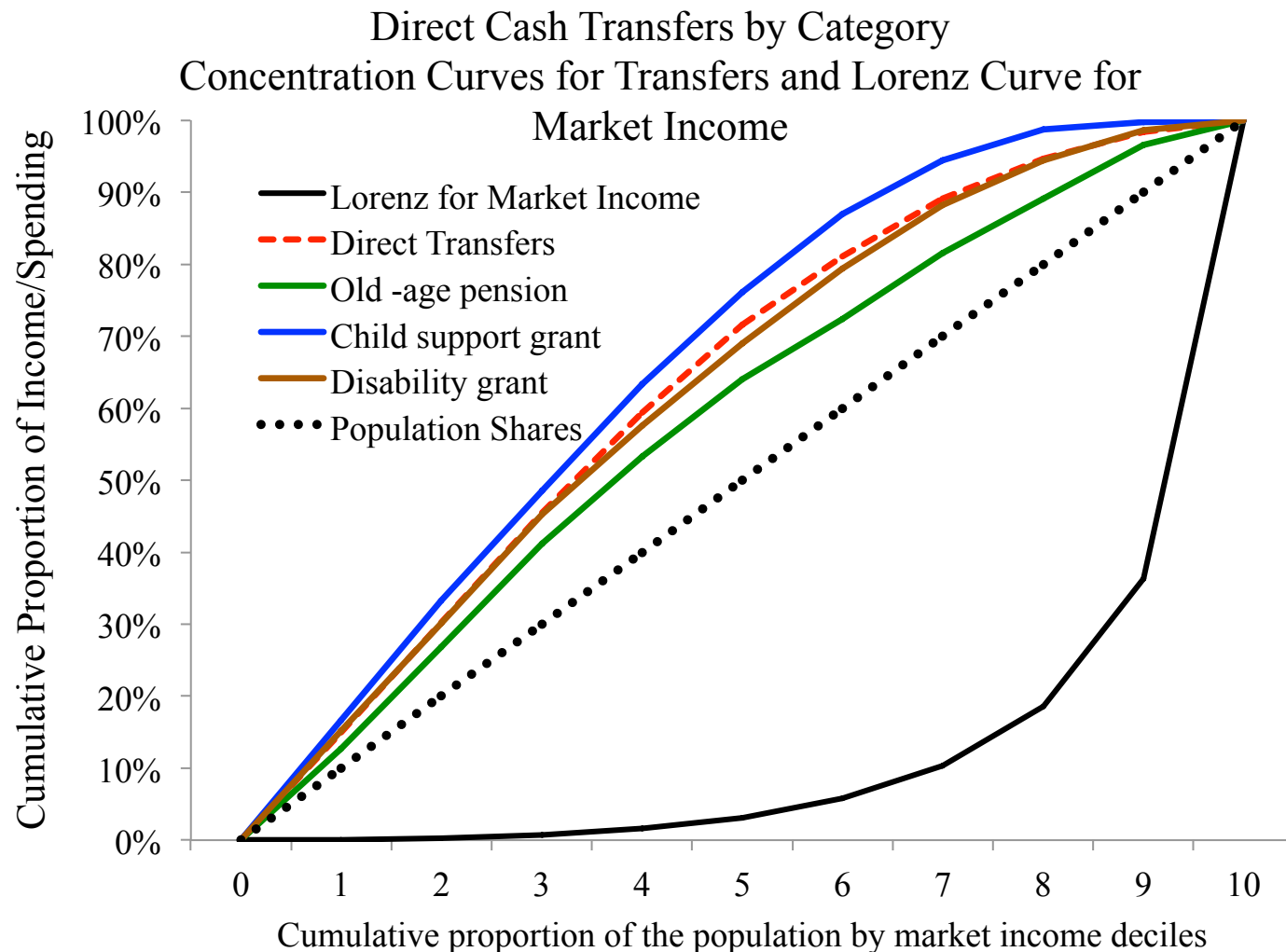
South Africa spends generously on direct transfers.

Public Social Assistance in the form of Cash Transfers
(share of GDP)

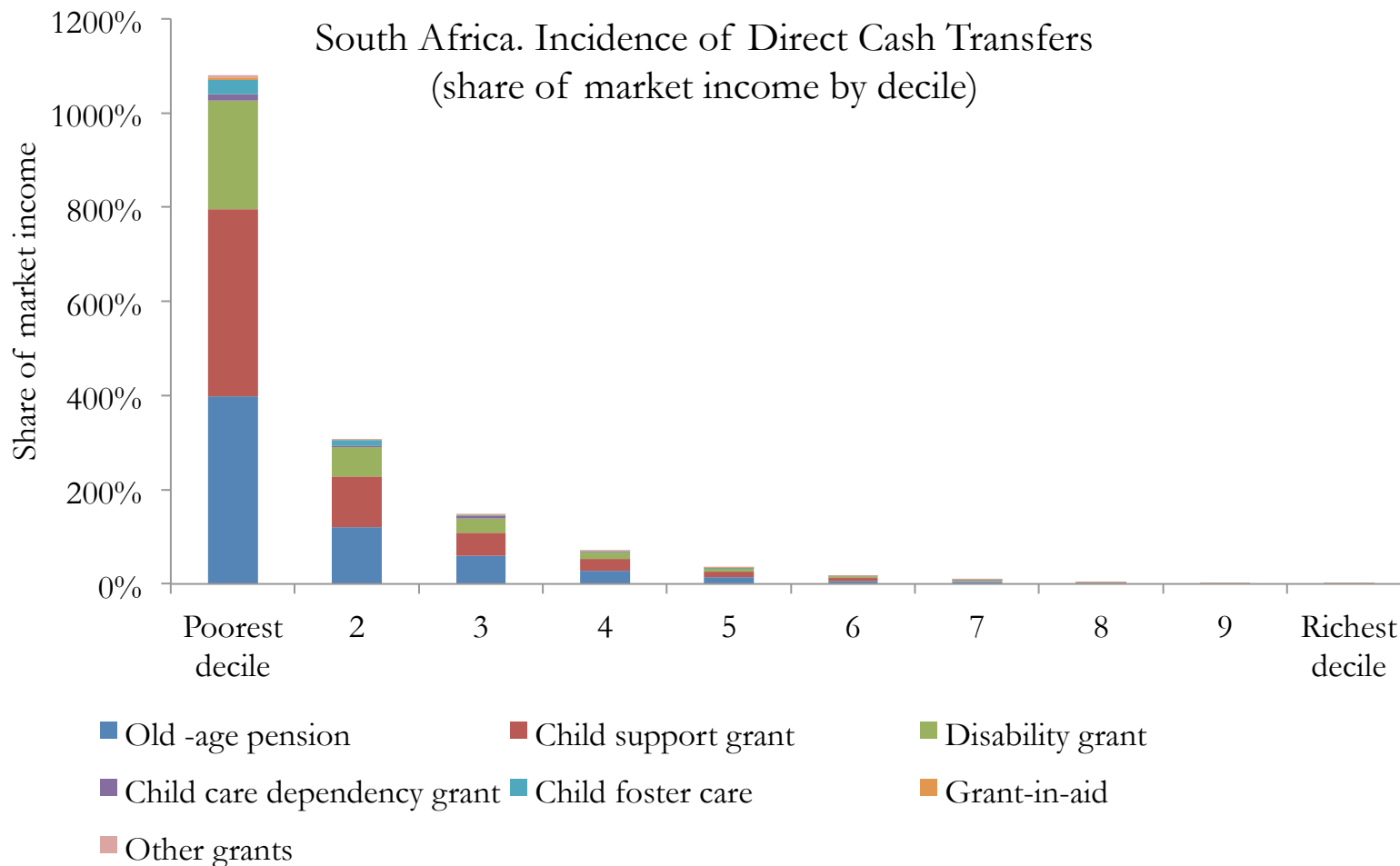


Source: For Latin America see: Lustig and Pessino, 2014; Paz et al, 2014, Higgins and Pereira, 2014; Scott, 2014; Jaramillo, 2014, Bucheli et al, 2014; Lustig et al, 2014. Preliminary results for Armenia (Younger et al, 2014) Ethiopia (Hill et al, 2014), Jordan (Serajuddin et al, 2014), Sri Lanka (Arunatilake et al, 2014), and own estimates for South Africa based on IES 2010/11.

Direct cash transfers as a whole are strongly progressive...



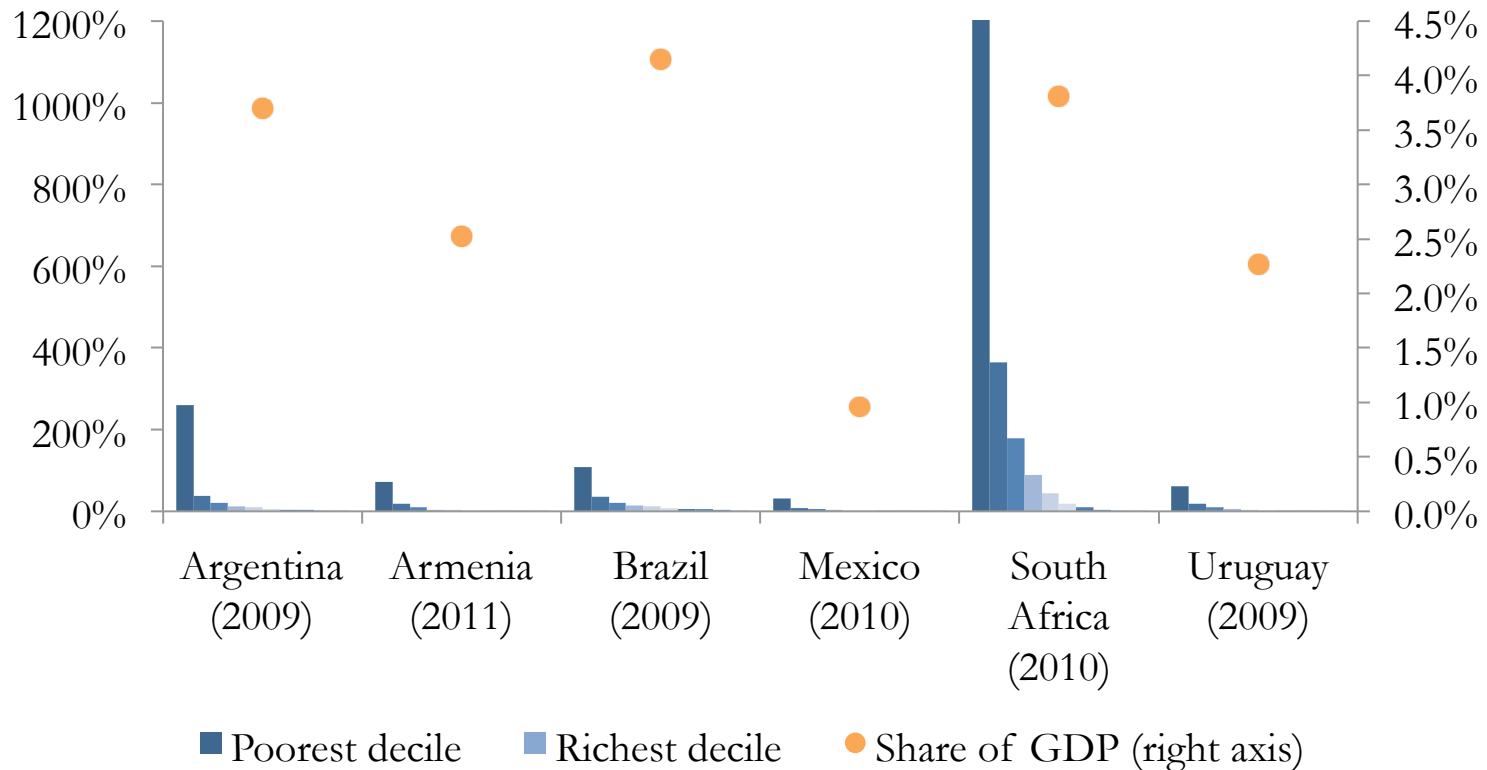
Cash transfers are huge relative to the market incomes of the poor...



Source: Own estimates based on IES 2010/2011.

...much more so than other MICs.

Incidence of Direct Cash Transfers
(share of market income deciles)



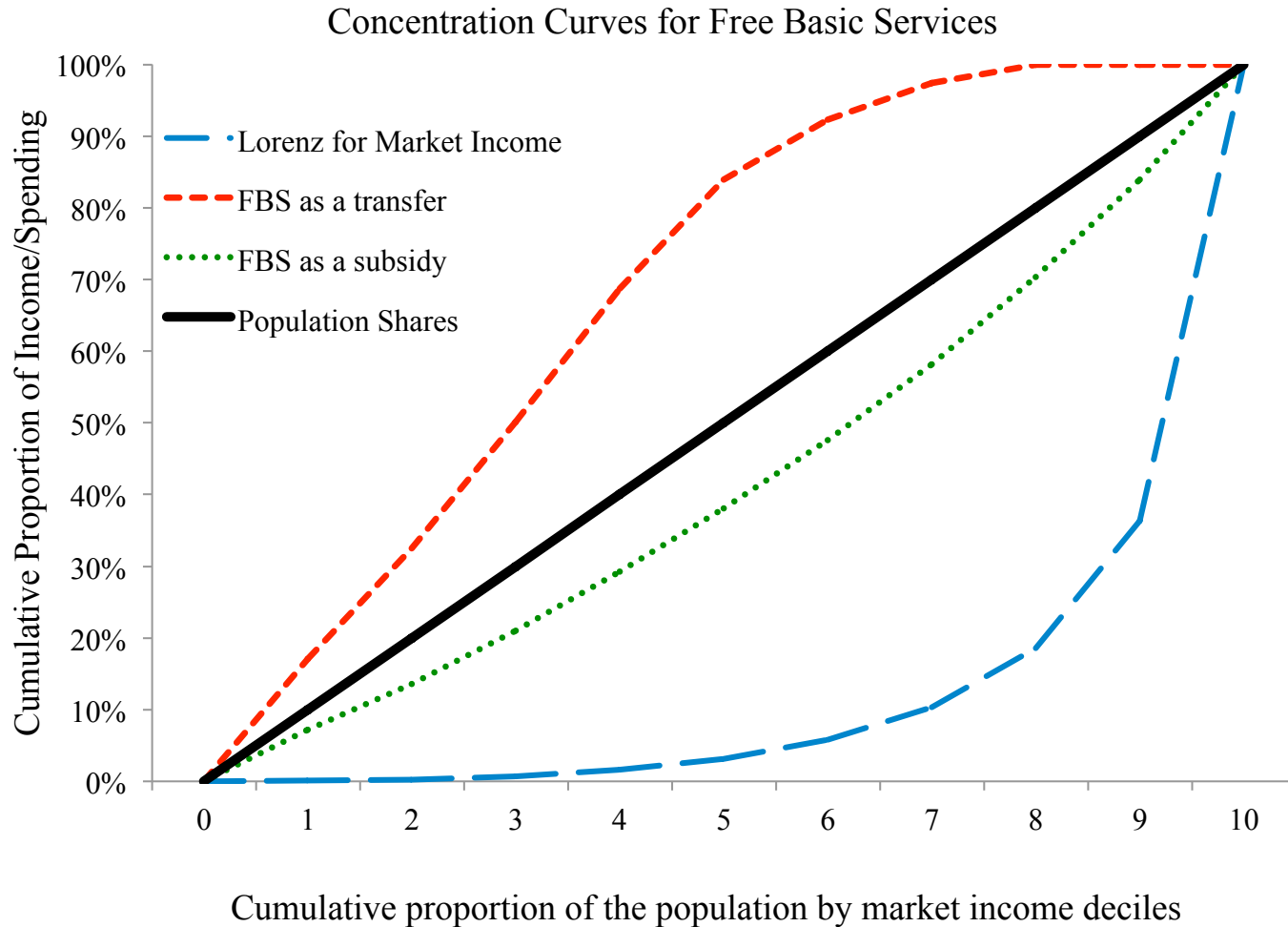
Sources: Argentina (Lustig and Pessino, 2014), Armenia (Younger et al, 2014); Brazil (Higgins and Pereira, 2014), Mexico (Scott, 2014), Uruguay (Bucheli et al, 2014), and own estimates for South Africa based on IES 2010/11.

Free Basic Services

The incidence of FBS depends on its delivery method,...

- Municipalities use different criteria for deciding on indigent households. Given that we can not directly identify the value of free basic services, we model two extremes:
- Benchmark scenario:
 - assumes all household connected to the national electricity grid equally benefitted from the inverted block tariffs and received an equal share of government subsidies for free basic services.
 - FBS are treated as an indirect subsidy.
- Sensitivity scenario:
 - assumes that the subsidy for free basic services is allocated equally among indigent households who are connected to the electricity grid.
 - household is indigent if market income < R18,000 per year
 - FBS are treated as direct transfers since municipalities that target FBS typically deliver these through rebates.

If FBS were targeted nationwide, there would be clear advantages for the poor, as they would be more progressive

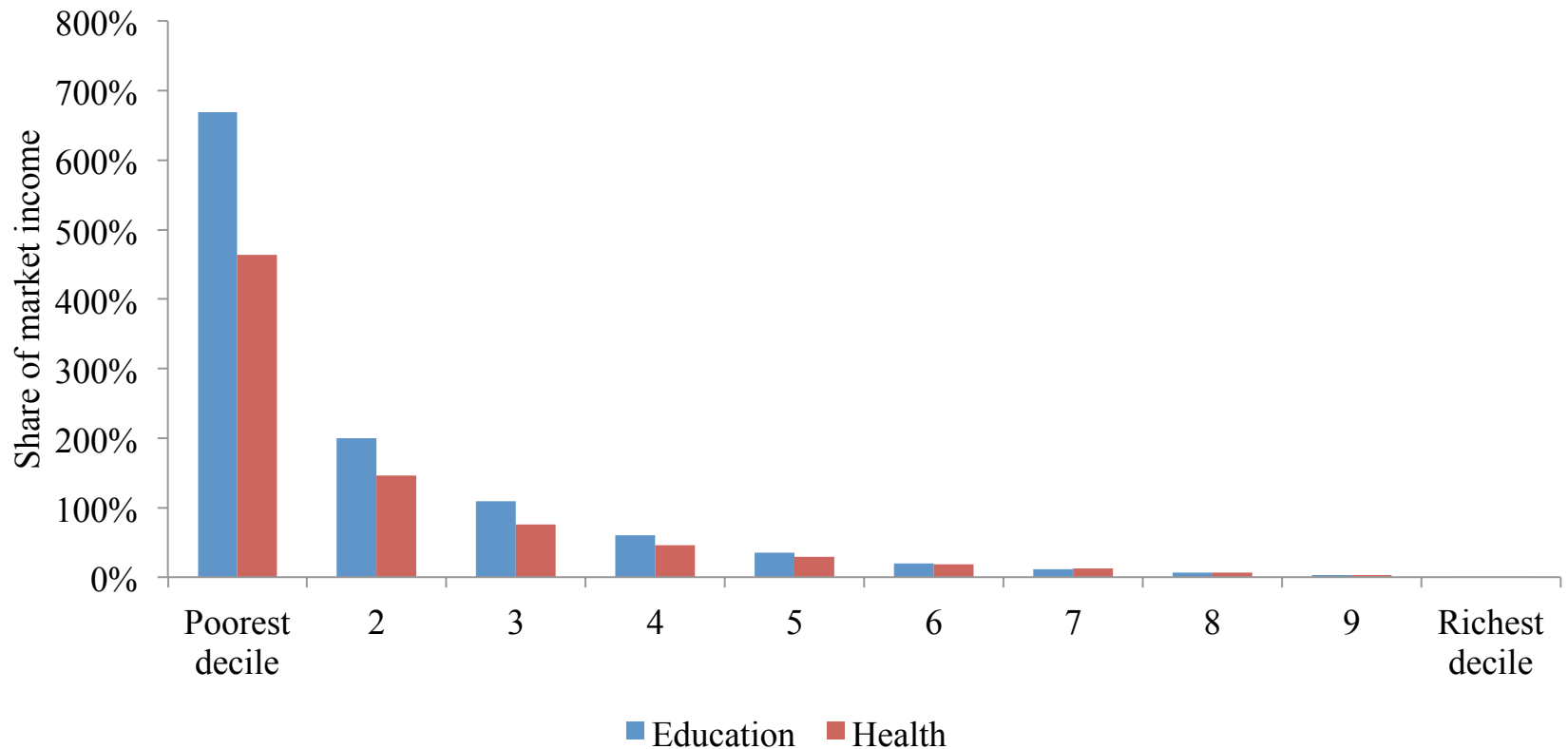


Source: Own estimates based on IES (2010/11).

In-kind transfers on health and education

Public education and health spending are large compared to the market incomes of the poor,...

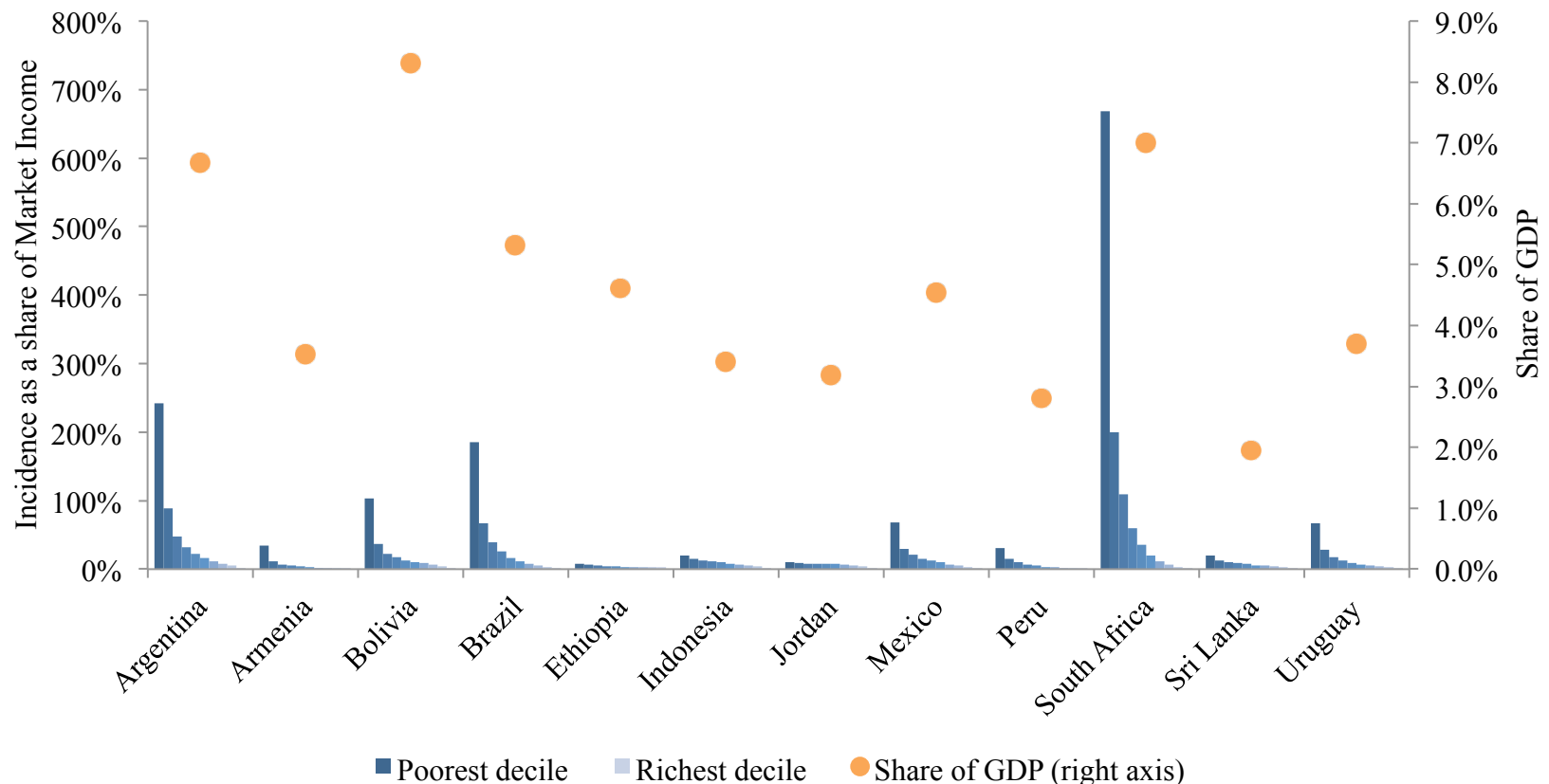
South Africa. Incidence of
Education and Health Spending
(share of market income deciles)



Source: Own estimates using IES, 2010/11 and NIDS 2008w1.

...more so than in other MICs. This is true for education....

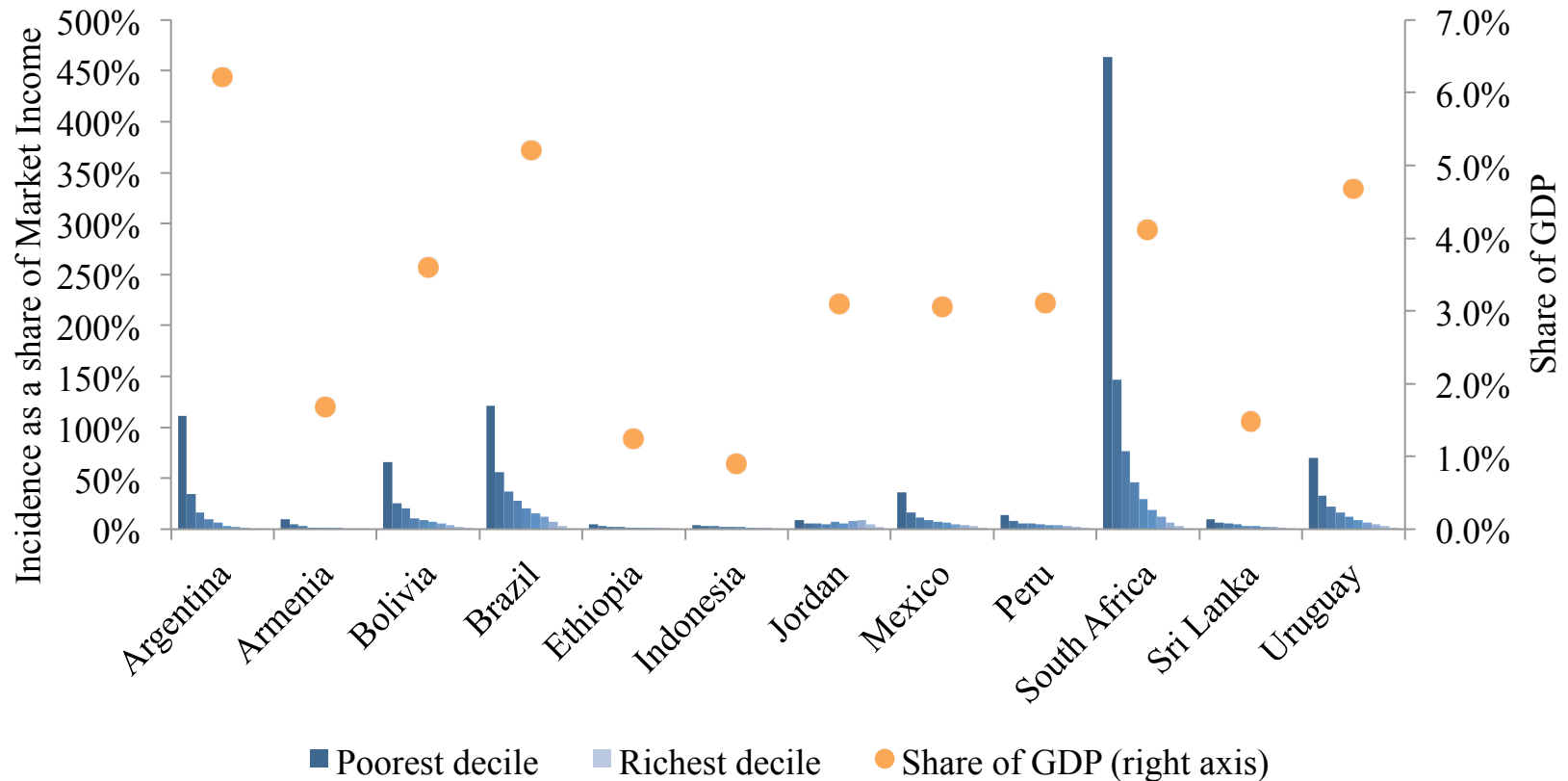
Incidence of Education Spending relative to its size
(share of benefits by market income deciles; spending as a share of GDP)



Source: For Latin America see: Lustig and Pessino, 2014; Paz et al, 2014, Higgins and Pereira, 2014; Scott, 2014; Jaramillo, 2014, Bucheli et al, 2014; Lustig et al, 2014. Preliminary results for Armenia (Younger et al, 2014) Ethiopia (Hill et al, 2014), Jordan (Serajuddin et al, 2014), Sri Lanka (Arunatilake et al, 2014), and own estimates for South Africa based on IES 2010/11.

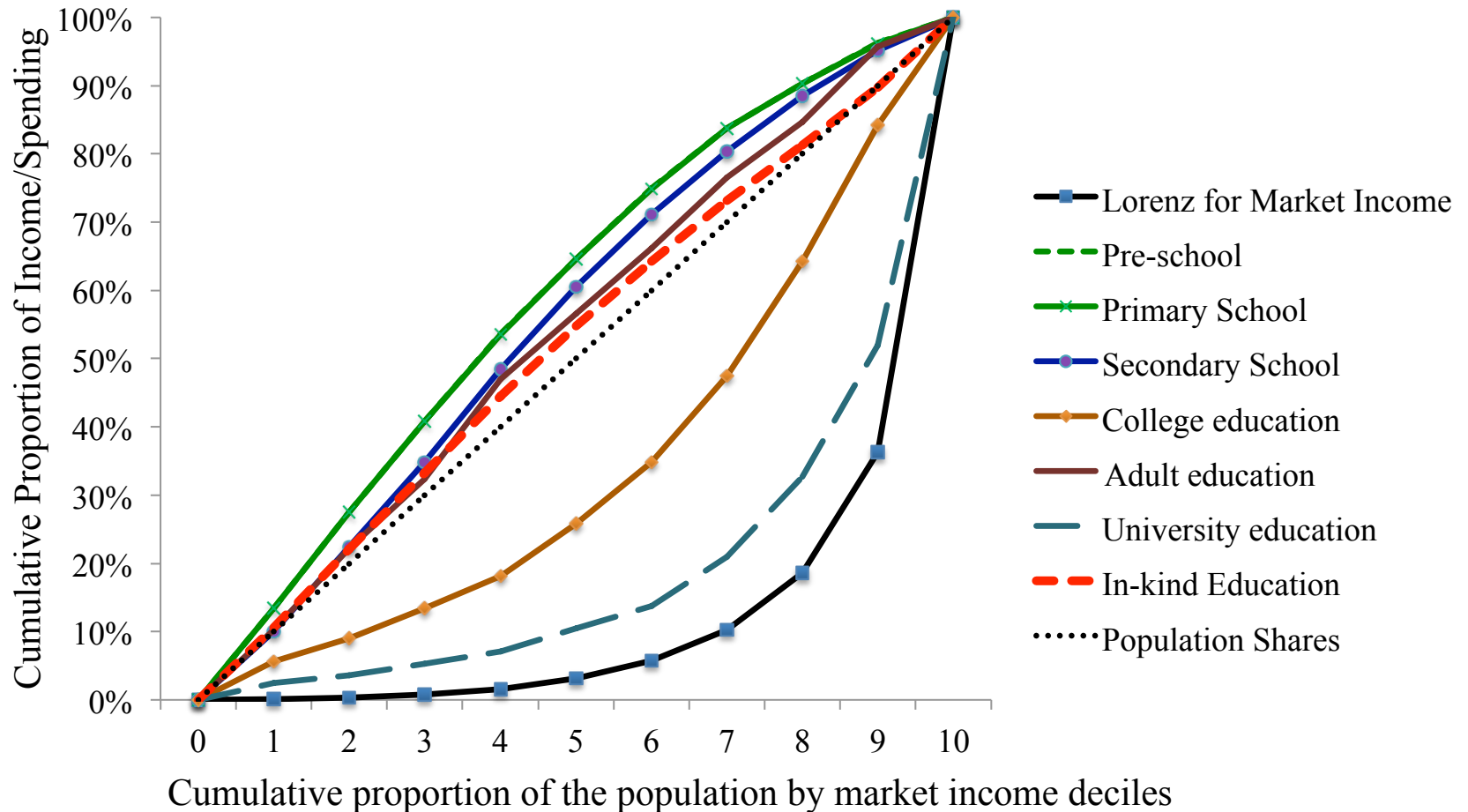
...and health.

Incidence of Health Spending relative to its size
(share of benefits by market income deciles; spending as a share of GDP)



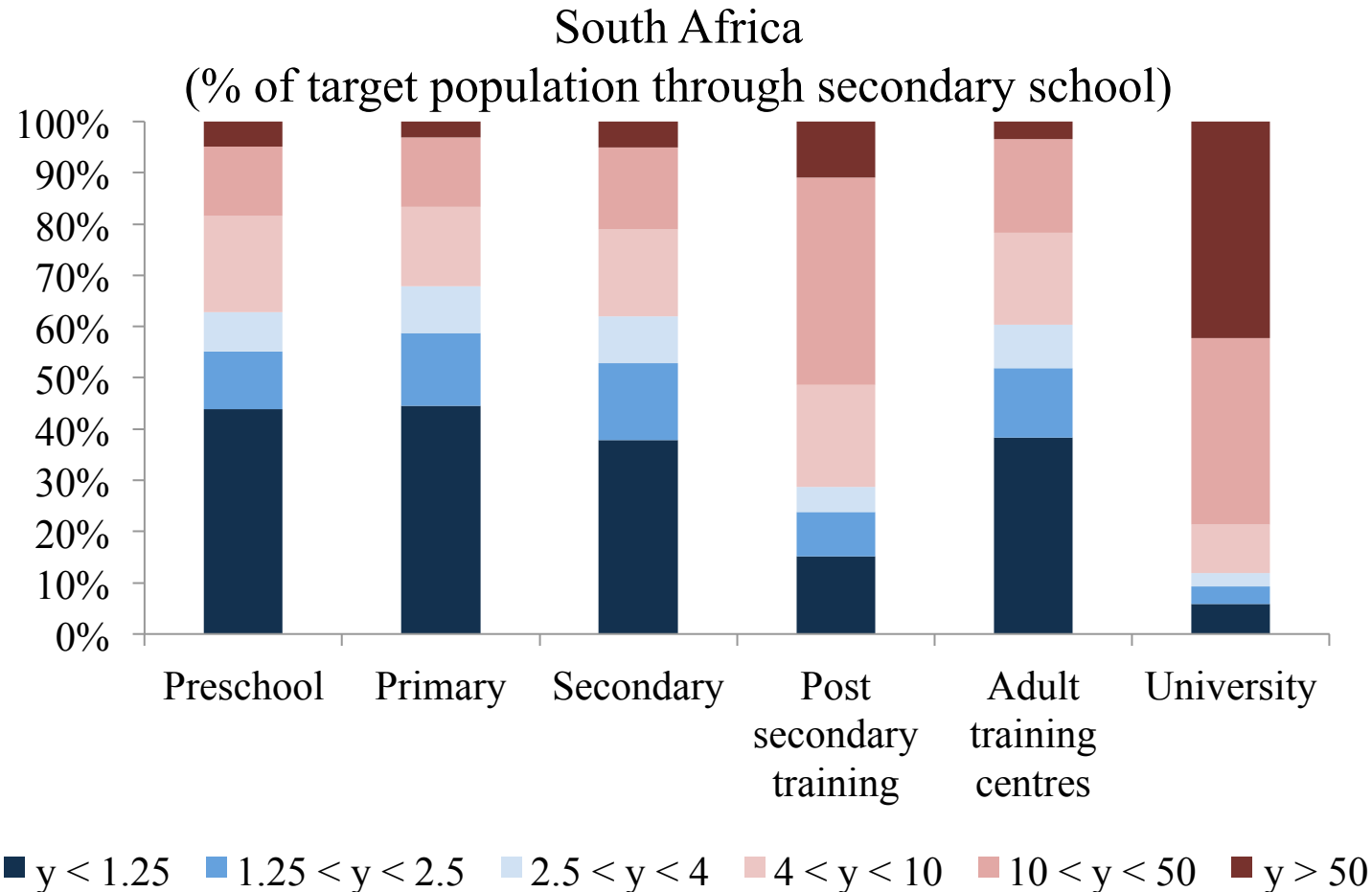
Source: For Latin America see: Lustig and Pessino, 2014; Paz et al, 2014, Higgins and Pereira, 2014; Scott, 2014; Jaramillo, 2014, Bucheli et al, 2014; Lustig et al, 2014. Preliminary results for Armenia (Younger et al, 2014) Ethiopia (Hill et al, 2014), Jordan (Serajuddin et al, 2014), Sri Lanka (Arunatilake et al, 2014), and own estimates for South Africa based on IES 2010/11.

Primary and secondary education spending disproportionately benefits those at the bottom of the distribution...



Source: Own estimates using IES, 2010/11.

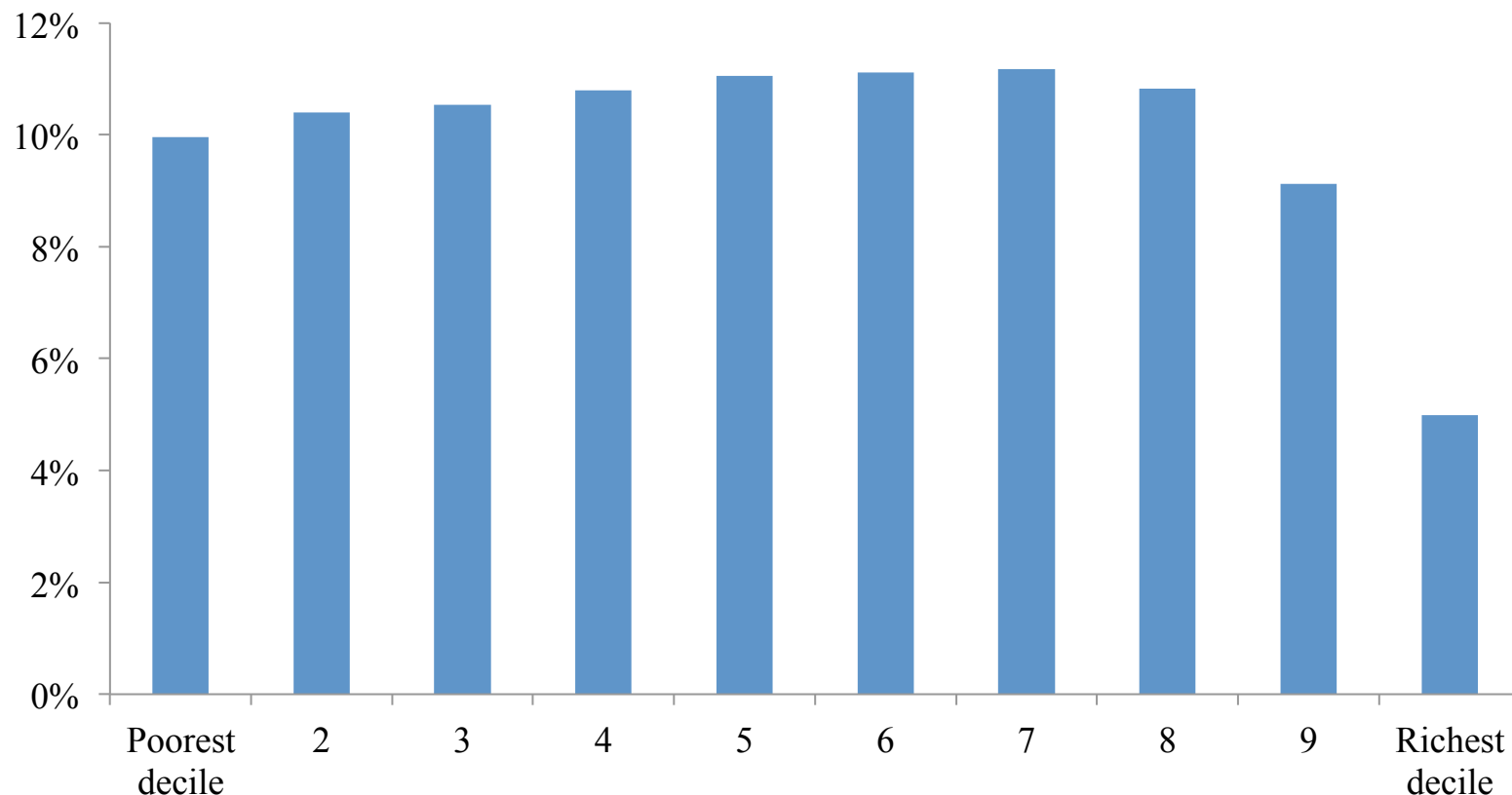
...but no so for post-secondary education



Source: Own estimates using IES, 2010/11.

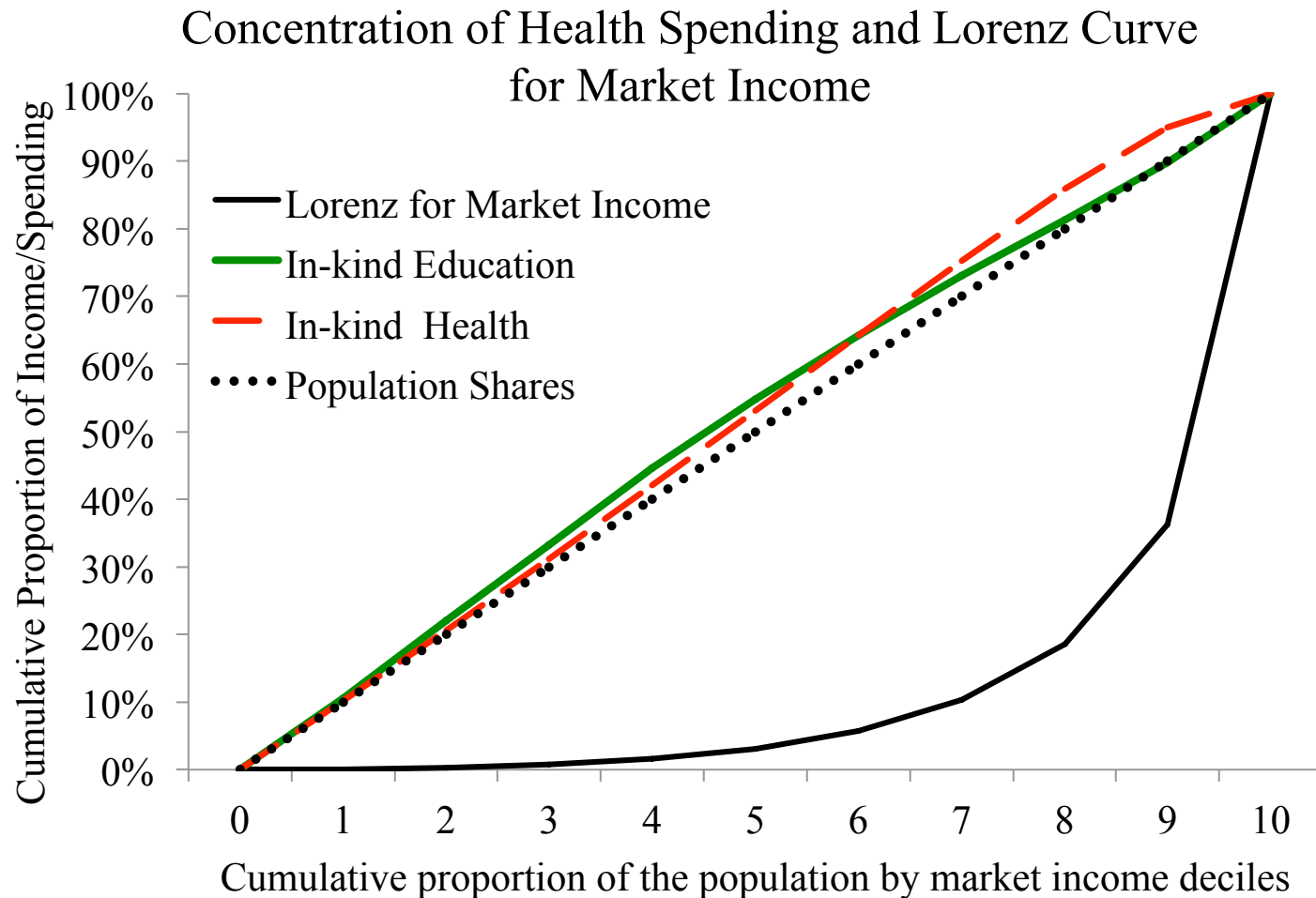
In contrast, health spending is more progressively distributed than education...

South Africa. Concentration Shares of Health Spending
(share of benefits concentrated in each Market Income Decile)



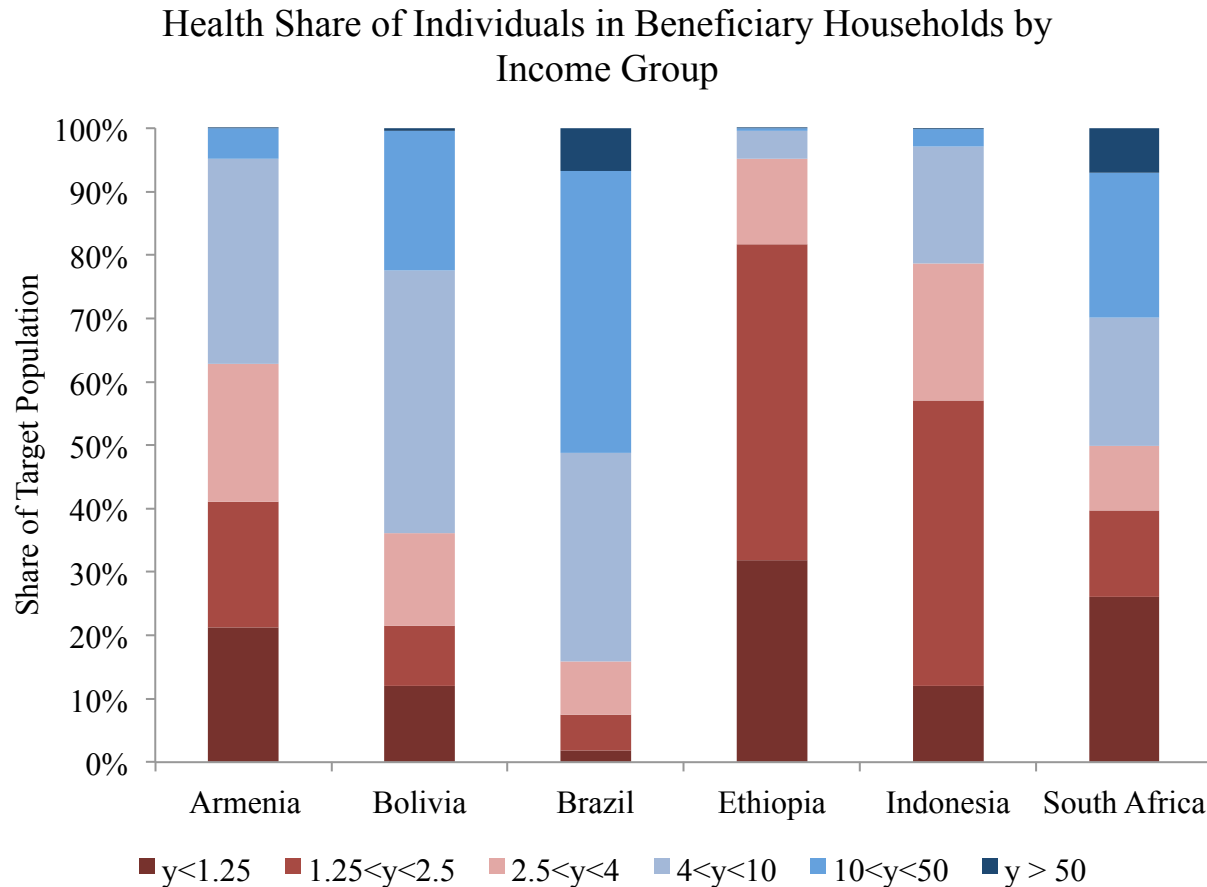
Source: Own estimates using IES (2010/11) and NIDS (2008w1).

Health spending is also progressive in absolute terms..



Source: Own estimates using IES, 2010/11 and NIDS 2008w1.

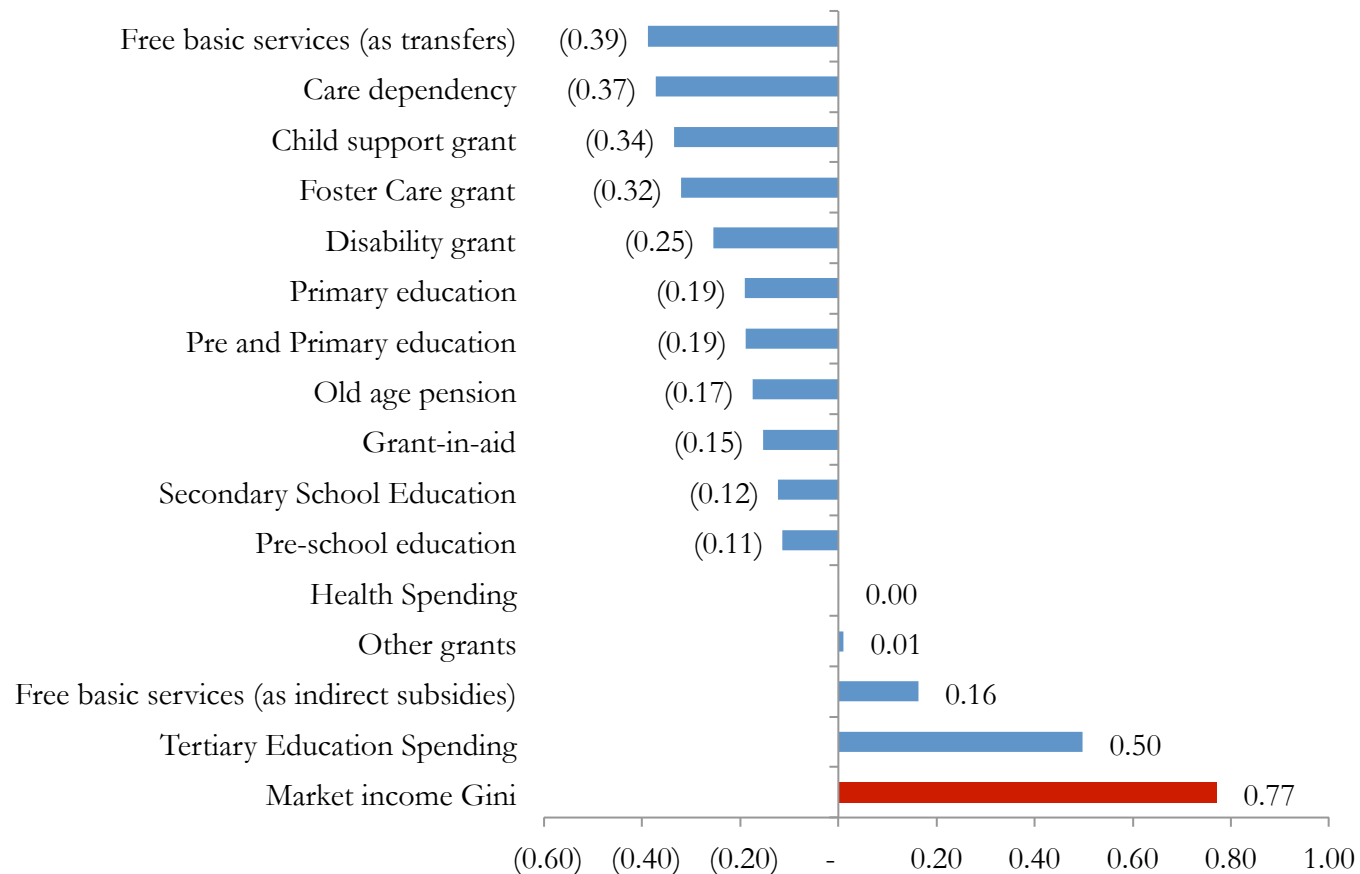
With health utilization more evenly distributed across socioeconomic groups than in other MICs



Source: Armenia (Younger et al, 2014), Bolivia (Paz et al, 2014), Brazil (Higgins and Pereira, 2014), Ethiopia (Woldehanna et al, 2014); and Indonesia (Jellema et al, 2014). For South Africa, own estimates based on IES 2010/2011.

Social spending as a whole is strongly progressive

South Africa. Concentration coefficients for Spending

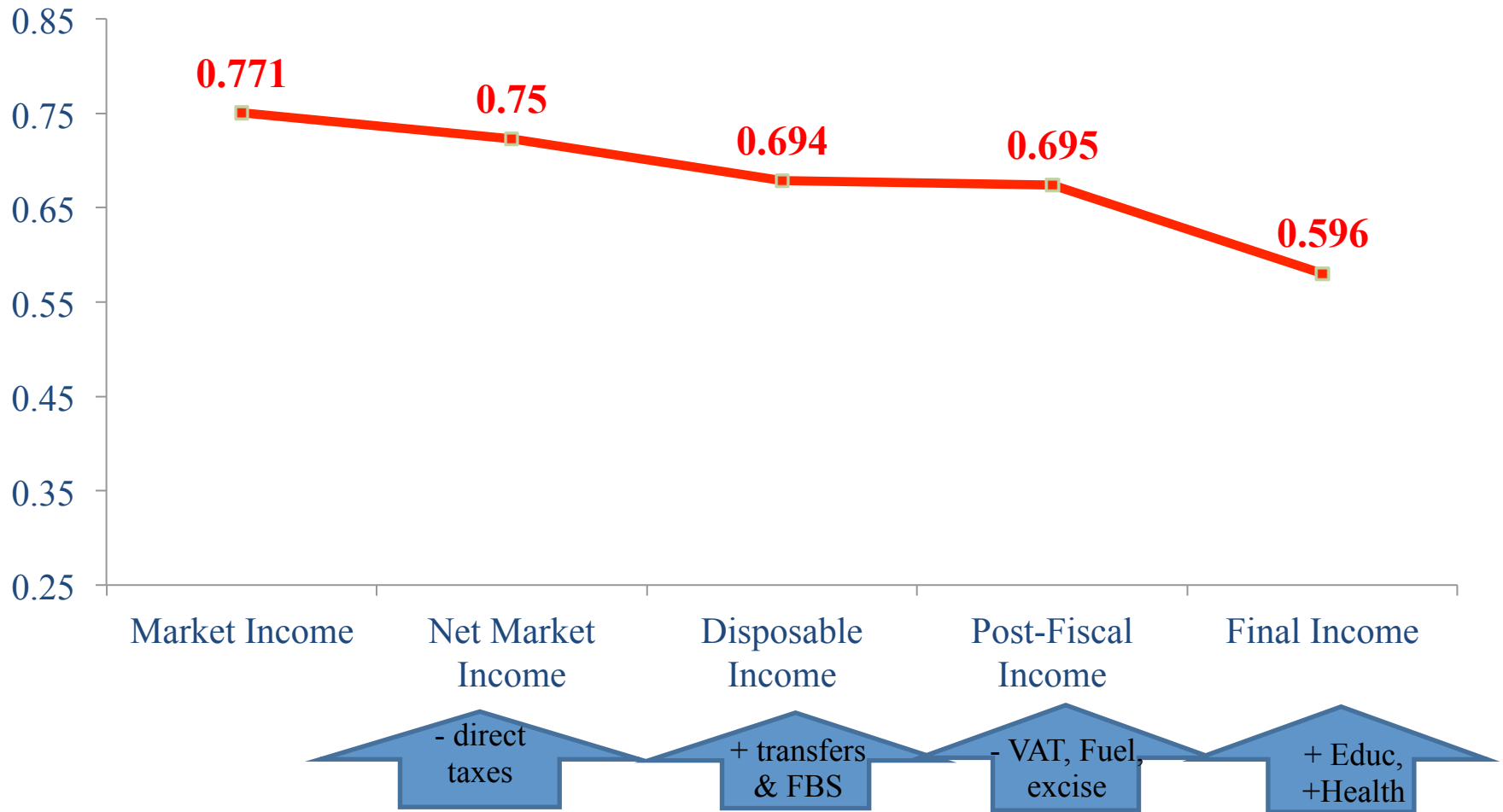


Source: Own estimates using IES, 2010/11.

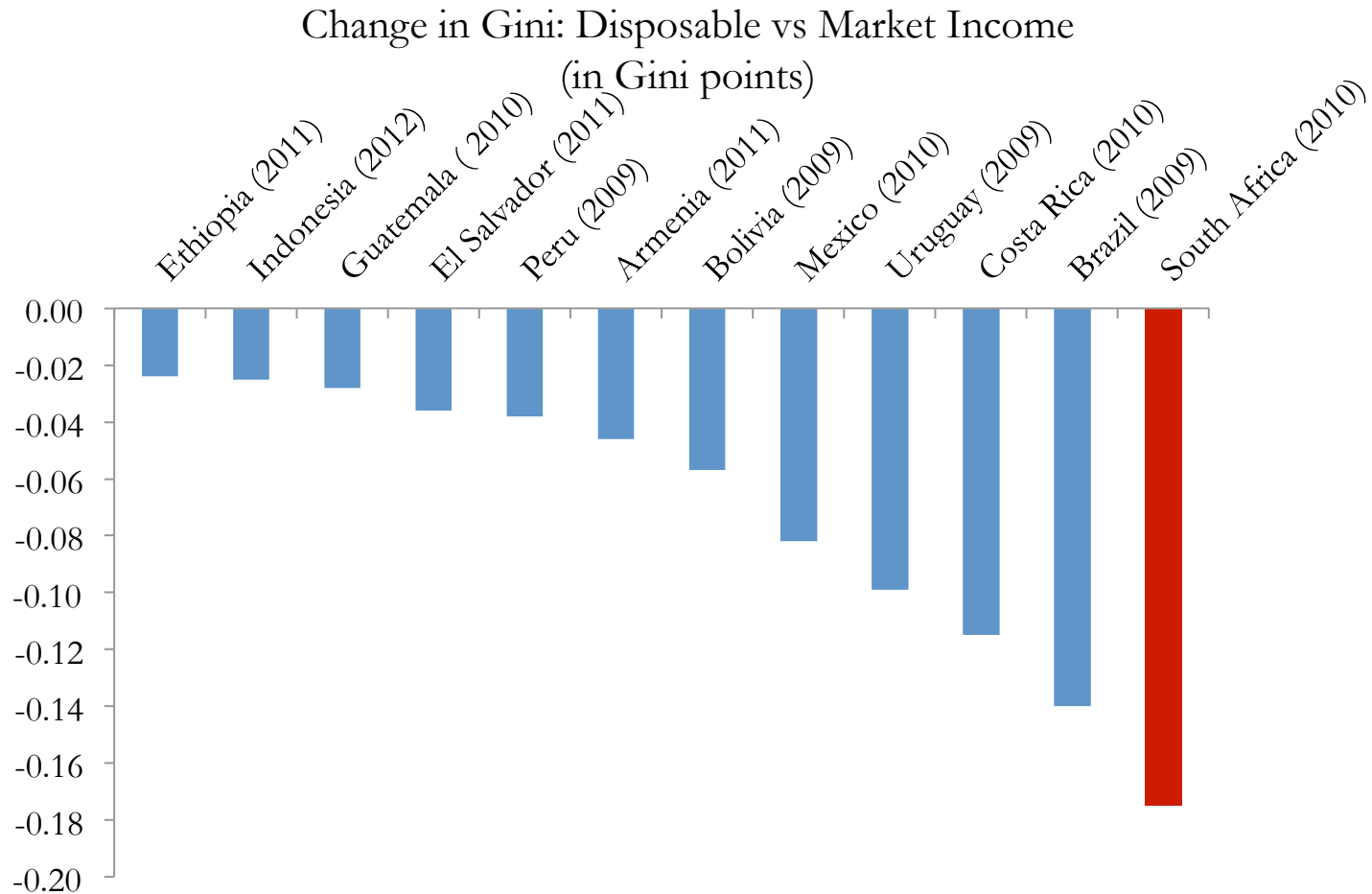
What is the net impact of taxes and government transfers on inequality and poverty?

Inequality falls substantially with Government interventions,...

The Gini Coefficient before and after Taxes, Transfers and Free Services, Education and Health Falls by over one-fifth



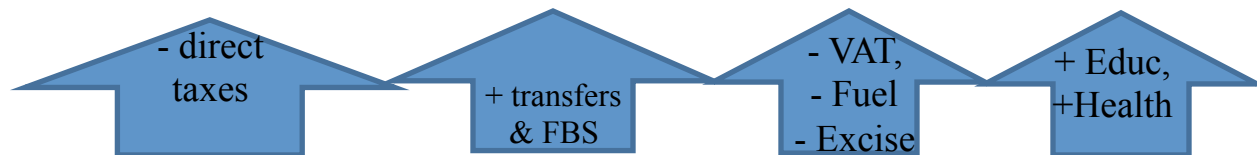
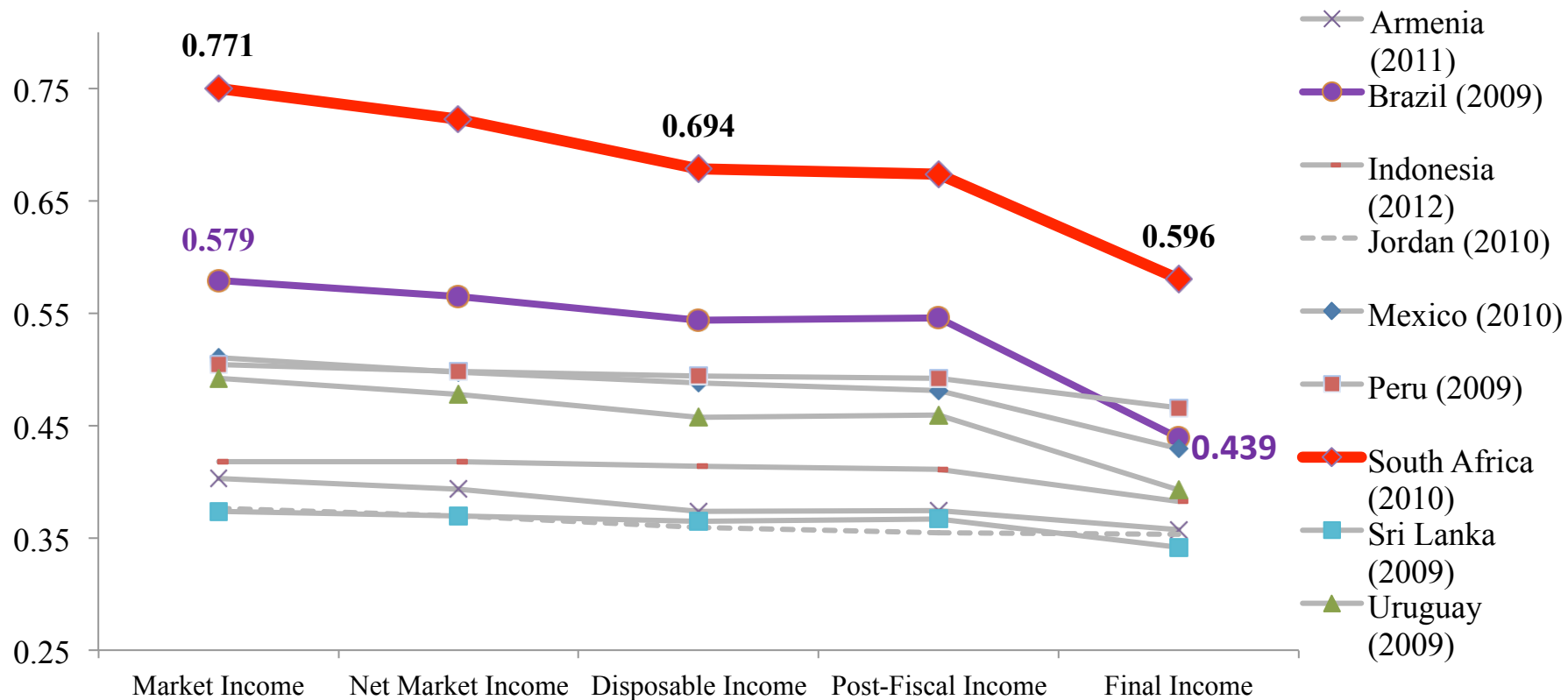
...more so than in other middle-income countries...



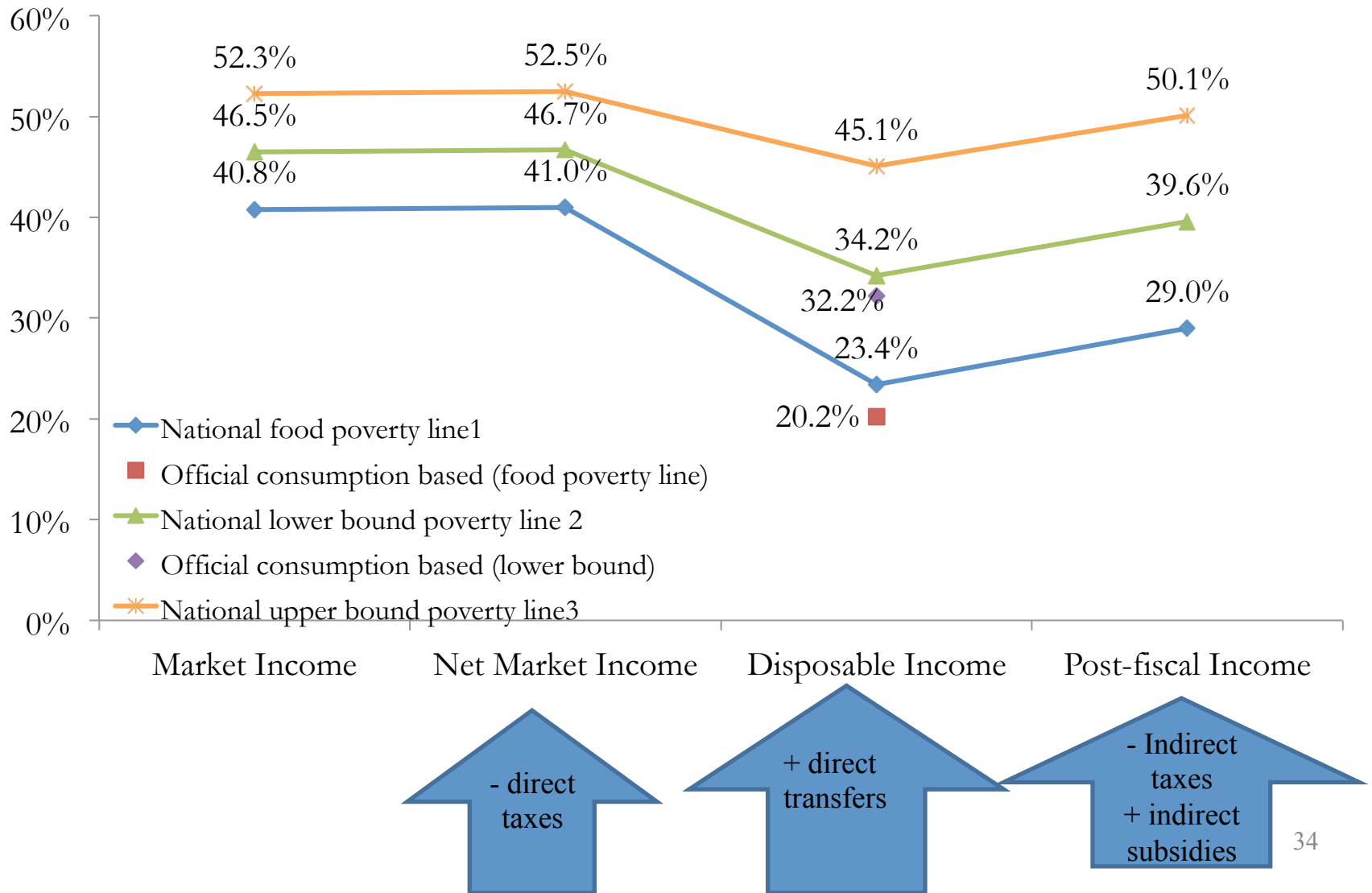
Source: Armenia (Younger et al, 2014); Bolivia (Paz et al, 2014); Brazil (Higgins and Pereira, 2014); Ethiopia (Woldehanna et al, 2014); Indonesia (Jellema et al 2014); Mexico (Scott, 2014); Peru (Jaramillo, 2014); Uruguay (Bucheli et al, 2014); Lustig(2014) based on Costa Rica (Sauma et al, 2014), El Salvador (Beneke de Sanfeliu et al, 2014), and Guatemala (Cabrera et al, 2014); and own estimates for South Africa based on IES 2010/11.

...but inequality is still higher *after* fiscal policy than inequality *prior* to fiscal policy in other countries

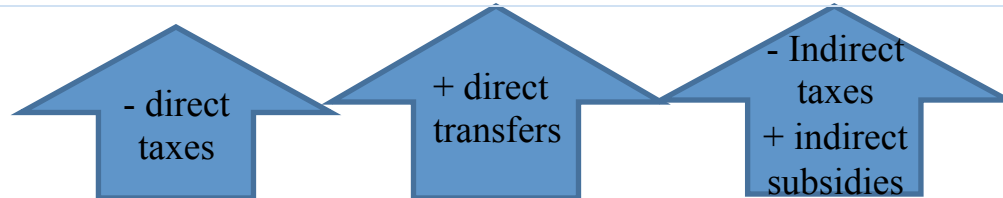
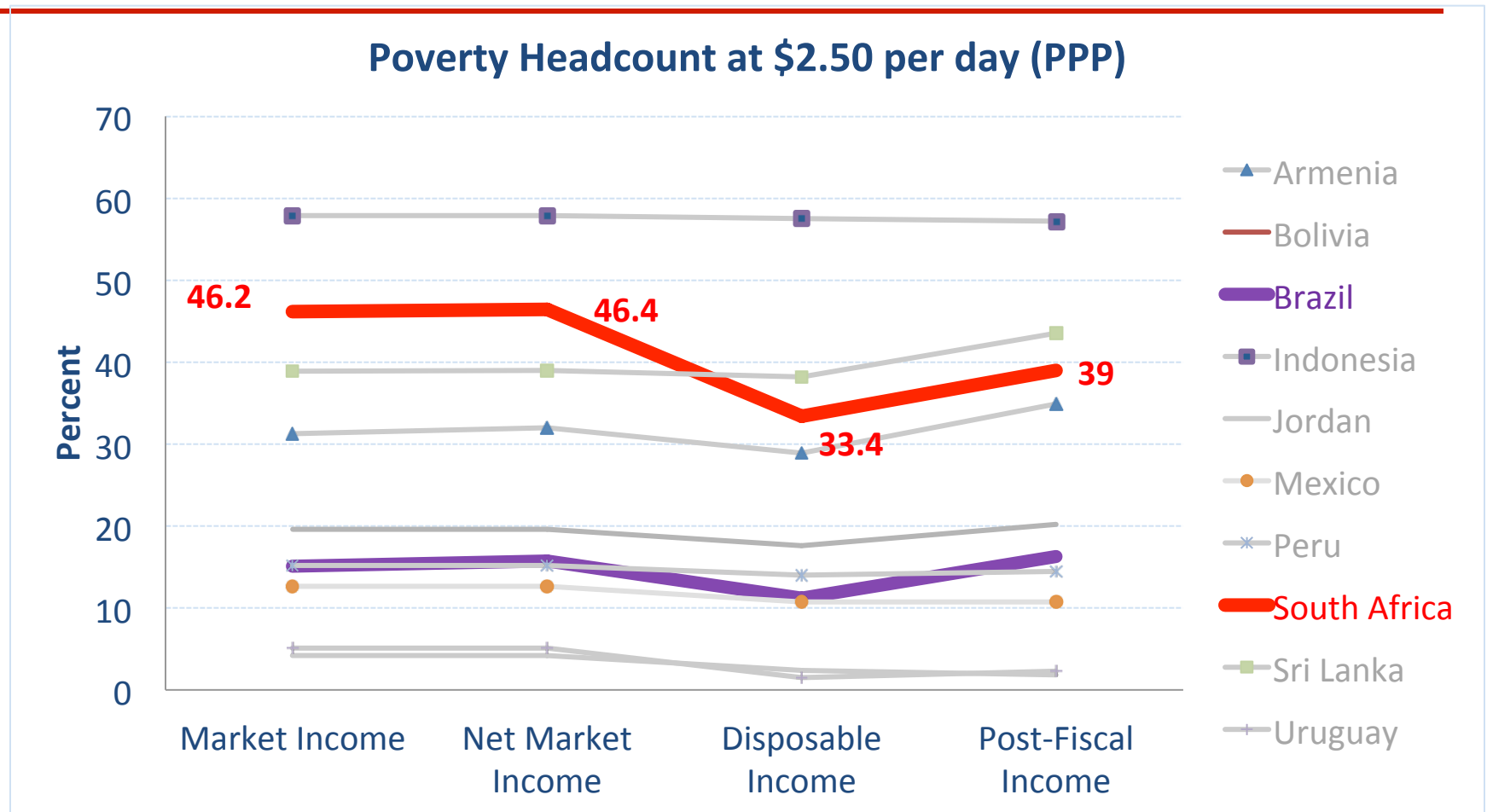
Gini Coefficient for Each Income Concept



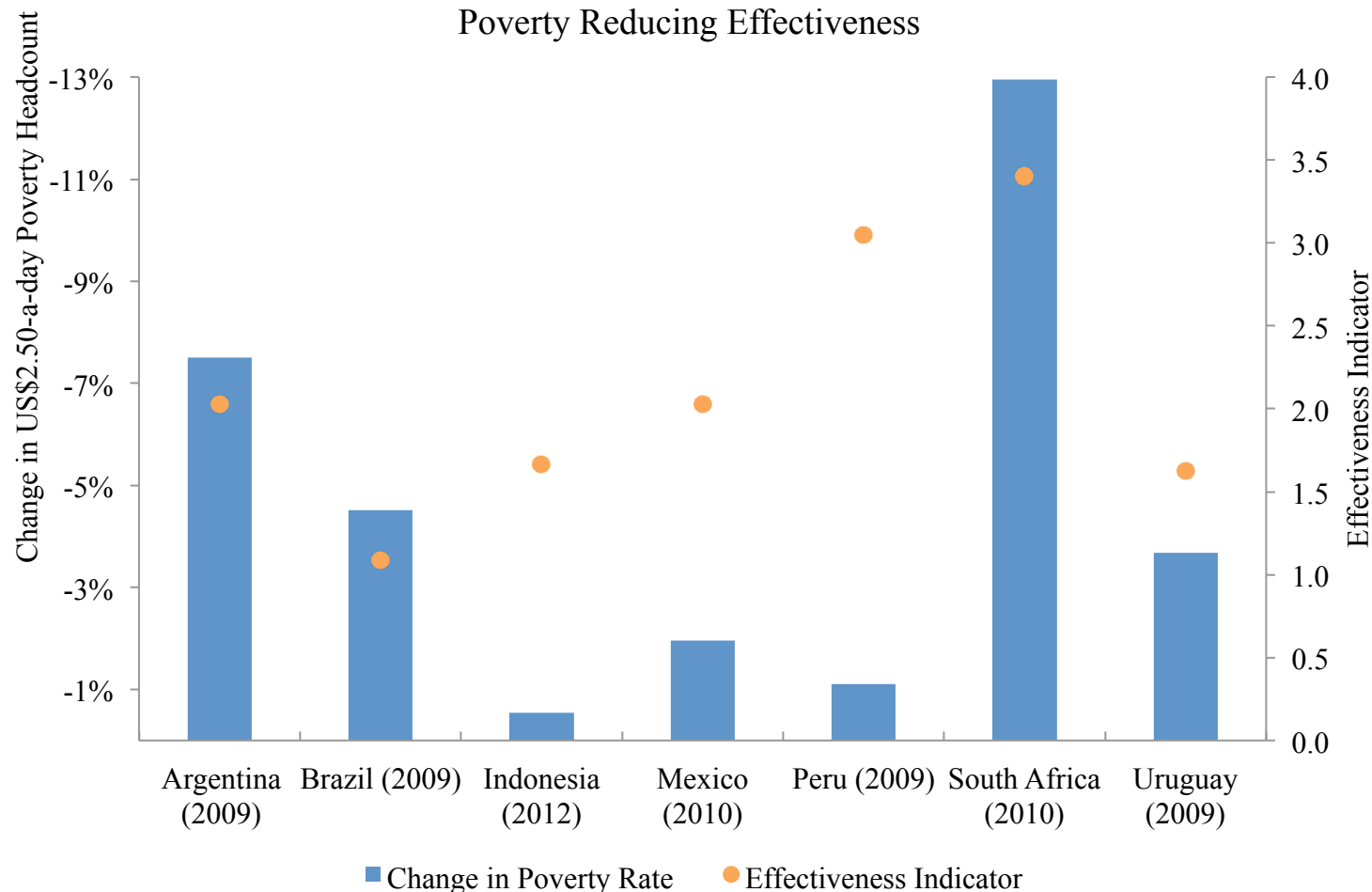
Poverty also declines substantially...



With the effect on poverty larger than other middle income countries.

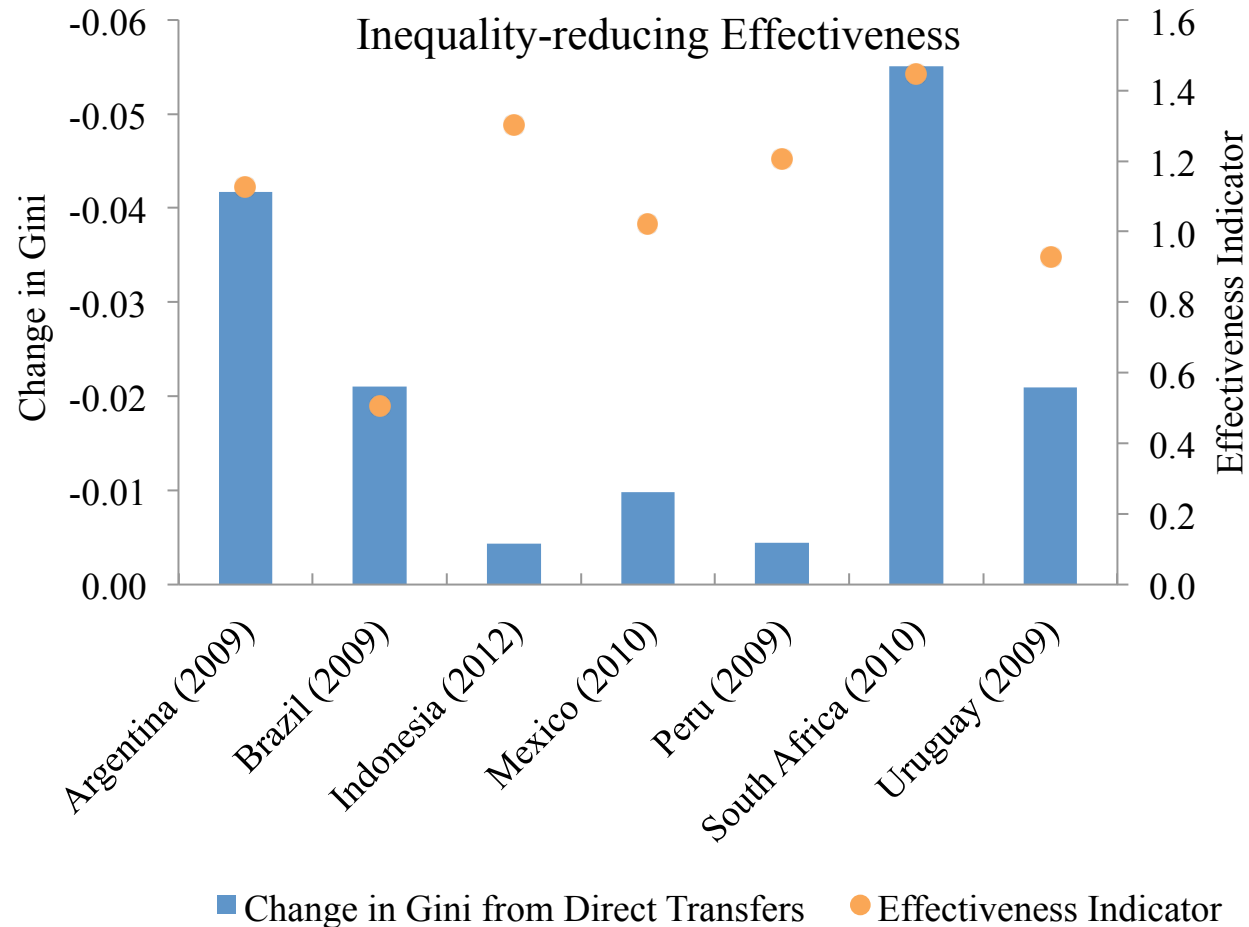


Direct cash transfers are highly effective at redistributing fiscal resources towards the poor...



Source: Argentina (Lustig and Pessino, 2014); Brazil (Higgins and Pereira, 2014); Indonesia (Jellema et al), Mexico (Scott, 2014); Peru (Jaramillo, 2014), Uruguay (Bucheli et al, 2014); and Inchauste, Lustig, Maboshe, Purfield and Woolard (2014) for South Africa based on IES 2010/11.

...and in reducing inequality.



Source: Argentina (Lustig and Pessino, 2014); Brazil (Higgins and Pereira, 2014); Indonesia (Jellema et al), Mexico (Scott, 2014); Peru (Jaramillo, 2014), Uruguay (Bucheli et al, 2014); and Inchauste, Lustig, Maboshe, Purfield and Woolard (2014) for South Africa based on IES 2010/11.

Conclusions

- South Africa uses its fiscal instruments to effectively reduce market income poverty and inequality through a slightly progressive tax system and highly progressive social spending
- On the tax side, fiscal policy relies on a mix of progressive direct taxes such as personal income taxes, slightly regressive indirect/consumption taxes that when combined generate a slightly progressive tax system.
- On the spending side of fiscal policy, social spending is not only progressive, but it also contributes to large reductions in poverty and inequality.
- In fact, South Africa performs very well when compared with other middle income countries: it achieves the most “redistribution” compared to the other middle income countries in the CEQ analysis.

Conclusions (2)

- However, there are concerns about the quality of such spending which begs the question could more be done to improve the quality of such services so to allow education and health spending to maximize their potential in reducing poverty and inequality.
- Although fiscal policy is going a long way towards achieving redistribution, the level of inequality and poverty in South Africa after taxes and spending remains unacceptably high.
- Addressing the twin challenges of poverty and inequality going forward in a way that is consistent with fiscal sustainability requires higher and more inclusive economic growth. This would be particularly important in addressing the need for jobs and higher incomes, especially at the lower end of the income distribution, helping narrow the gap in incomes between the rich and the poor and reinforce the effectiveness of fiscal policy.

Questions for additional analysis...

- Potential further targeting of free basic services
- Distributional impacts of proposed health insurance, given sources of funding considered
- Fiscal space for further redistributive policies
- Potential labor disincentive effects of transfers
- Equity – efficiency tradeoffs
- Inter-generational mobility and implications for transfers in future - Quality of education