Informal transfers and informal taxes in Developing Countries: how do they affect household welfare distributions and fiscal incidence?

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Today’s presentation

• Work in Progress:
  • Current version is ‘proof of concept’
  • Lays out Approach to Arithmetic Accounting of Informal Taxes & Transfers
  • Considers Role in Redistribution Alongside Formal Taxes & Transfers
  • But empirical results are ‘first run’ and preliminary.
Motivation:

- New work in Rwanda and Uganda in 2019 as part of DfID funded ‘TAXDev’ project (joint with IFS):
  1. Provide advisory to Tax Policy Unit
  2. Assist in improving evidence base on distributional impacts of taxes and transfers
  3. Eventual work on micro-simulation model.

- But before proceeding on 2 and 3, what is the context of formal verses informal taxes and transfers?

- Other analysis and support seems to ignore the issue (CEQ, UN-WIDER ‘Southmod’, TaxDev in Ghana & Ethiopia)

- TaxDev Research Fund support to assess scale and importance
Literature:

• Informal Taxes now recognized as part of ‘tax policy’ following Olken & Singhal (2011)

• Informal Transfers (receipt and payment of remittances and other inter-household transfers) known to be of large scale 30%-40% of population in many LICs (Fafchamps & Cox 2008)

• Informal ‘Social Protection’ and Risk Pooling also at scale (Fafchamps & Cox, Dercon 2007)

• Formal fiscal incidence and redistribution (Lustig 2018) and CEQ (but also the ‘cash only’ approaches of micro-simulation UN-WIDER ‘Southmod’ and others).
Definitions

- **Informal Taxes** Olken & Singhal (2011) ‘*a system of local public goods finance coordinated by public officials but enforced socially rather than through the formal legal system*’
  - We further specify they are not identified as ‘local taxes’ collected by municipal authorities
  - We widen concept to include ‘religious taxes’ (e.g. Zaqat) – but not in this version of the paper.

- **Informal Transfer Income**
  - Receipt of remittances and other inter-household transfers in cash & kind (regular and gifts)
  - Payments from informal risk sharing institutions: Savings Co-operatives, ‘Tontine’

- **Informal Transfer Expenditure**
  - Payments of remittances & inter-household transfers from donor households
  - Payments into informal risk sharing institutions
  - Are expenditures ‘*non-consumption expenditure*’ (Deaton & Zaidi 2002) and have a redistributive effect?
Arithmetic Accounting Approach: Direct Taxes & Transfers

CEQ

PREFISCAL INCOME (i.e., income used to rank households before state action through taxes and transfers) = Market Income =

Faster Income (wages and salaries and income from capital) PLUS private transfers (remittances, private pensions, etc.) PLUS
imputed rent and own production
BEFORE taxes, social security contributions, government transfers

Disposable Income

Direct cash and near cash transfers (conditional and unconditional cash transfers, noncontributory pensions, school feeding programs, free food transfers, etc.) and contributory pensions

Indirect subsidies: energy, food, and other general or targeted price subsidies

Consumable Income

Monetized value of in-kind transfers in education and health services at average government cost

Final income

TAXES

Indirect taxes: VAT, excise taxes, and other indirect taxes

Co-payments, user fees

Disposable Income

Source: Figure 1.1, Lustig & Higgins 2018

This Paper

Pre-Transfer Income

Income used to rank households prior to informal and formal transfers and taxes. Wages, income from self-employment and non-investments plus accrued income, measuring credit and depreciation of household factor account

Expenditures and Taxes (subtractive)

Informal Transfers (remittances and international)

Direct Formal Transfers (state cash and near cash transfers)

Pre-Fiscal Income

Gross Income

Formal Direct Taxes

Formal Direct Taxes Income and other taxes and Social Security/Contributions

Payments of Informal Transfers

Informal Taxes

Source: Figure 1.1, Lustig & Higgins 2018
Data

- **Rwanda**
  - Rwanda Integrated Household Living Conditions Survey 2016-2017 (RIHCS)
  - 14,580 household sample
  - Identified transfers
    - Formal: RSSB Pensions & other benefits, VUP transfers & Public Works (cow for the poor)
    - Informal: international and national remittances/inter-household transfers, Tontine, (SACCOs)
  - Identified taxes & expenditures
    - Formal: Property Tax, ‘Other Taxes’, Mandatory Health Insurance
    - Informal: ‘Mutual Aid for Community Devt’, expend on transfers from donor households, tontine payments

Notes: no **Income Tax or SSICs** – to be modelled
  - small samples of beneficiaries and payees
  - taxes in kind from labour – not identified
Data

• **Uganda**
  • Uganda National Panel Survey 2013/14 (UNPS)
  • 3,119 household sample **** we want to repeat with larger UNHS 2016-2017
  • Identified transfers
    • Formal: RSSB Pensions & other benefits,
    • Informal: international and national remittances/inter-household transfers,
  • Identified taxes & expenditures
    • Formal: Income Tax, Property Tax, SSIs
    • Informal: expend on transfers from donor households, ‘local taxes’

**Notes:**

v small samples for beneficiaries/payees
in kind informal tax through labour – seen in community level data but not in hhld level data
No data on SACCOs
Future exploration/imputation of Zaqat payments for Muslim population (14%)
Incidence of Transfers

Provisional results
Gross Household Per-capita Income:
(for comparison with CEQ)
Incidence of Taxes

Rwanda

Uganda
(Note y scale)

Provisional results
No Rwandan Income Tax or SSIs
Gross Household Per-capita Income:
Incidence of Expenditure on Transfers

Provisional results
Gross Household Per-capita Income:

Rwanda

Uganda
Inequality by Income Definition

Rwanda

Uganda

Provisional Results
Early Conclusions

• Provisional but proof of concept:
  • Including Informal Taxes and Transfers makes a considerable difference to interpretation of ‘Income Redistribution’ in Rwanda and Uganda.
    • (Analysis solely on ‘direct’ taxation: likely to see more from impact of VAT, services and subsidies)
• Largest additional effect is from the payment of and receipt of informal inter-household transfers
  • Incidence of informal transfers 25-50% (matching earlier evidence from other LICs)
  • Many formal and informal taxes have low incidence and low values
    • Rwanda exception: Mandatory Health Insurance payments.
• Data constraints are many
  • Incomplete set recorded/ observed in Household Surveys
  • Computation of Income produces large outliers and uncertainty
• Overall effects on Income Inequality are low but informal transfers seem to have the largest overall contribution
Much Still To Do

• Data work
  • More on robustness and sensitivity: income distribution, outliers and samples; revise point estimates
  • Imputation of ‘missing’ forma taxes in Rwanda
  • Explore religious taxation (esp Zaqat)
• Explore Relationships and Correlates
  • Exploit panels?
• How Representative are Rwanda and Uganda?
  • What is potential to similar consideration across Sub-Saharan Africa?
    • What do household surveys capture?
• Clarify theory and definitions
• Explore influence on applied analysis?
  • Moving from ‘income’ to ‘consumption aggregates’ for poverty and inequality to match policy makers’ metrics
  • Input into policy advice in Rwanda and Uganda through TaxDev.