A Namibian universal income grant
Income Redistribution and Poverty Relief

Expectations as to the actual and perceived redistributive effects of the tax system have been mentioned above. It is recognised, however, that redistribution is often better achieved by other means, particularly through the expenditure side of the budget, albeit with its own limitations and difficulties. Furthermore, we have taken note of the extensive literature according to which taxes imposed on the rich often do not translate into benefits for the poor, and hence do not address the fundamental objective of creating greater equity.

The Consortium therefore proposes that the government give consideration to furthering a research proposal set out in Appendix 4 which recommends the payment of a small monthly grant to *every* Namibian 6 years old and older, funded by an increase in VAT.

The net effect of such an approach would be the same as paying a progressively higher anti-poverty grant to all Namibians whose monthly per person expenditure is lower than about N$1100, and to progressively tax those with a higher per person monthly expenditure. The automatic targeting achieved by this scheme overcomes all the inefficiencies of traditional poverty relief grants. About N$500 million would be re-distributed annually, targeted at the poorest. The reduction in the disparity of income between individuals brought about by the introduction of this proposal would result in Namibia's Gini coefficient improving from 0,68 to 0,61.

This proposal requires further field research on how best to deploy the technology in order to reach the widely distributed rural population. We believe that foreign donors could be secured to fund the capital expenditure needed for the delivery system. If successful, this will provide Namibia with a modern and secure means of delivering not only the grant to households, but also old age pensions. South Africa is currently giving serious consideration to a similar proposal. The detail regarding this proposal is set out in Appendix 4.

Appendix 4

Income Redistribution and Poverty Relief - A Universal Income Grant Combined with Indirect Tax Increases

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Proposal for a Development Grant to the Poor Financed out of a Progressive Expenditure Tax on the Affluent

Introduction

This appendix contains the Consortium's tax proposal to address the serious problem of poverty and income inequality in Namibia.

Following an extensive review of the relevant literature and an analysis of possible alternative strategies, we found that by far the best method of addressing poverty and inequality would be a universal income grant of at least N$70 per month to all Namibians of six years and older. This grant is to be financed out of an increase in indirect taxes earmarked for a universal income grant.

Provided that an effective delivery system can be implemented, such a grant funded by an increase in indirect taxes will:

- Significantly reduce absolute poverty levels
- Significantly reduce the degree of inequality, bringing the Gini coefficient down from 0.68 to 0.60
- Target those most in need without requiring a complex administrative system
- Be sustainable and affordable without retarding economic growth
- Avoid the negative consequences of alternative strategies to transfer income from the rich to the poor.

We found that a universal income grant financed out of indirect taxes will effectively offer a progressive anti-poverty grant to the poor, and impose a progressive expenditure tax on the affluent.

The Problem

In terms of income distribution, Namibia is one of the most unequal societies in the world. Nambia's Gini Coefficient (a measure of inequality), is about 0.68. Income inequality is thus worse in Nambia than it is in Brazil and South Africa - two countries infamous for their high Gini coefficients of just above and just below 0.60. Namibia's Gini coefficient is thus the highest measured Gini coefficient in the world

The Gini Coefficient measures a society's ratio of income inequality on a scale between 0 - 1. If all the country's income were earned by only one person, the Gini-coefficient of the country would be 1. If all income were equally distributed, the Gini co-efficient would be 0. The higher the coefficient between 0 and 1, the more unequally the society's income is distributed. With a Gini coefficient of 0.68 and a per person annual expenditure of N$9,735 it can be shown that the expected difference between the annual expenditure of any two randomly drawn individuals would be as much N$13,240.

In addition to the extreme disparities in income distribution, Namibia has a very serious problem of poverty. It is obviously important for a government to try to address this problem in a way that is sustainable, encourages investment and economic growth, and avoids the poor becoming dependent on the state (rather than seeking ways to become self-supporting).

Various countries have tried to reduce income inequalities through the tax system, but these attempts have often failed. Sometimes this is because the system enables the more affluent to pass the real burden of the increased taxes on to the poor. Sometimes the system encourages people to move their income generating assets into investments (or foreign countries) to avoid the increased taxes. Often the increased revenue does not result in increased benefits to those most in need because the additional revenue is spent on creating a new bureaucracy to administer the distribution of grants. This usually means that very little reaches the poor, for whom the money was intended.

We have devised our tax proposal to fund the universal income grant in a way that will avoid these negative consequences.

The Proposal

We recommend a grant of N$70 per month to every Namibian of 6 years and older, to be funded by increases in Value Added Tax (VAT) and preferably also increases in excise tax[1] and possibly also the institution of a bed tax or tourist levy. Every Nambian would receive such a grant until s/he becomes eligible for a state pension at 60 years.[2] In the case of children aged 17 or younger, the care-giver would receive the grant on behalf of the child.

Financing this grant will require an increase in VAT of about 6 ½% . It should be possible to also fund the grant through a proportional increase in excise taxes (eg on alcohol, tobacco, luxury motor vehicles etc.), and if some of it is funded out of a tourism levy, the VAT increase could be kept down to about 4 ½ %.

If every Namibian gets a state grant of N$70 per month and every Namibian pays an additional 6,7% in indirect taxes, it follows that every Namibian benefits from the grant, and every Namibian contributes to it. However, they do not do so in the same proportion. Those who spend more, contribute more through indirect taxes to the funding of the grant and benefit less from receiving the grant. Those who spend less, contribute less to the funding of the grant, but benefit more from receiving the grant. Our funding model shows that the wealthier will subsidise the poor to a very significant extent. Our model also shows that about 85% of Namibians will receive a grant that is worth more than the additional amount they pay in indirect taxes to fund it. Those who benefit the most will be the poorest 40% of the population. Furthermore the grant will target and benefit the poor, effectively transferring a larger

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[1] Increases in excise taxes could, however, only be made with the agreement of the other SACU members.

[2] We recommend that the existing pension of N$250 be retained, and not, as has been argued in some quarters, replaced by a “means tested” pension. A means test is extremely difficult and costly to administer efficiently. If the recommendations of this report are accepted, the pensioners with a high per person expenditure will in any case be worse off, because of the increase in the indirect taxes. The pensioners with a low per person expenditure will probably be better off if our recommendations are implemented, because the other members of the household who at present also live off the pension, will then be receiving a grant.

nett benefit the poorer one is, without requiring the cumbersome bureaucratic application of a means tests.

If a person spends exactly N$1,040 per month (in an average expenditure pattern), the 6,7% increase in indirect tax is exactly equal to the N$70 received in a grant from the state. This person will neither gain nor lose from the grant or the tax. This is the break-even point. In a household of four with an average expenditure pattern, the break-even point, where the household gains as much from the grant as it contributes in tax, will be N$4,160.

Individuals who spend less than N$1,040 per month (in an average expenditure pattern) will gain more from the grant than they contribute in additional VAT. Those who spend more than N$1,040 per month will gain less from the grant than they pay in additional taxes to fund the grant. This form of tax is called a negative expenditure tax because below the break-even point, the person receives more back than s/he pays. A negative expenditure tax is, in fact, a grant to the poor. The lower the person's expenditure, the higher the grant will be. The higher a person's expenditure, the larger the additional tax burden both in absolute terms and as proportion of expenditure.

If the grant is also funded by increased excise taxes (on alcohol and tobacco and cars) those who spend a lot on these products will subsidise the grant to a greater extent. (This is difficult in Namibia's case, because excise taxes are determined by the SACU arrangement).

For example, a person who neither drinks, smokes nor drives expensive cars, will have a far lower "break-even" point of approximately N$580. When he spends more than this amount, he will contribute more to funding the grant through additional taxes than the monthly benefit of N$70 he receives through the grant.

Conversely, a person who neither drinks alcohol nor smokes, will have a far higher "break-even" point of about N$1,460. Such persons will benefit more from the grant than they contribute towards funding it, if they spend less than N$1,460 per month.

The Assumptions

The funding model rests on the following assumptions:

- The poor, who receive a benefit from the grant, will spend the additional money they receive. This is very likely to happen as poor people generally use increases in their disposable income to fund their daily cost of living.

- Those who receive less from the grant than they contribute in VAT to the grant will maintain their existing expenditure levels. (Very similar results to those reported here will, however, be obtained even if the expenditure is cut back by half or by the full amount of the indirect tax increase)[3] The assumption that expenditure levels of the affluent will not be too dramatically reduced is only likely to hold if the increases in indirect taxes are not too high. The higher the grant, the higher the tax required to fund it, and the more this assumption will be open to question. For this reason we have proposed that the grant be limited to N$70 per month. If increased excise taxes are also used to fund the grant, it is easier to assume that people will not reduce their levels of expenditure significantly, because people using alcohol and tobacco products generally do not reduce their consumption because of increased costs.

- The reduction in savings will not influence the rate of investment in Namibia. This is also a reasonable assumption to make, given the nature of existing savings and investments.

The system we propose can only be implemented successfully if three administrative conditions are met:

[3] If the expenditure level increases with the full amount of the indirect tax increase, in other words, if expenditure is not cut back at all because of the tax increases, the increase in indirect taxes required to finance the grant is 6.7%. If, on the other hand, the affluent cut back on their expenditure levels by the amount that tax increases, so that the overall expenditure remains the same, then the increase in indirect taxes required will be about 7.1%. Assuming that the expenditure of the affluent increases by half the increase in indirect taxes, an increase of 6.9% in indirect taxes is required.

- The efficiency of the existing indirect tax system must be maintained or improved
- Every Namibian citizen must be capable of unique identification, preferably biometrically (by finger print or eye pupil)
- An efficient and cost effective delivery system must be established.

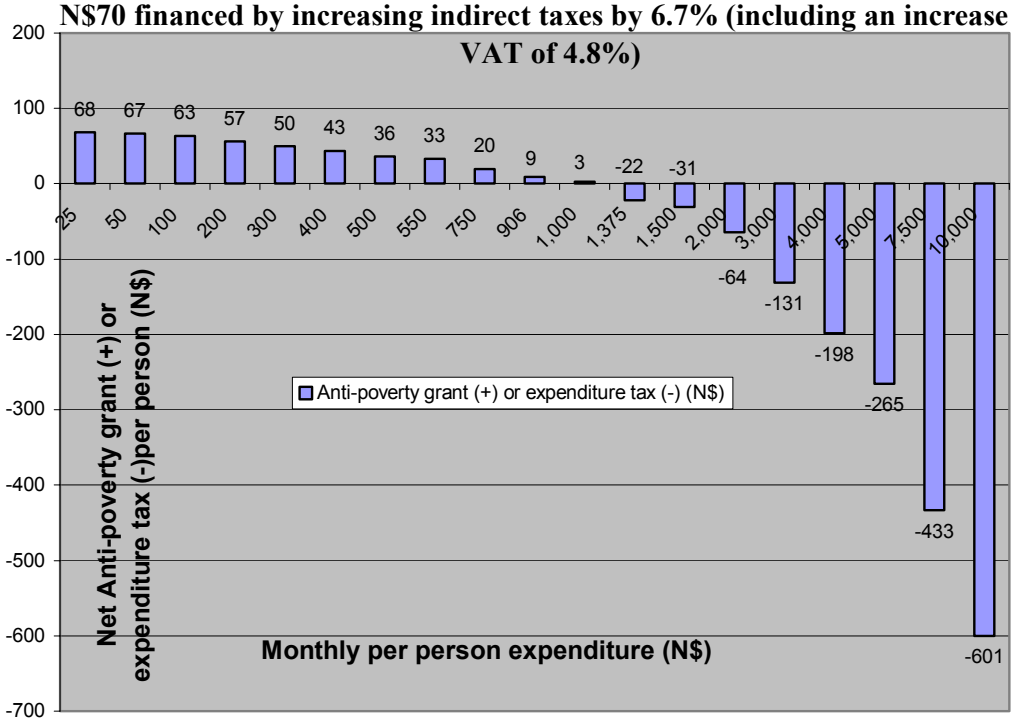
Despite the challenges posed by the above conditions, we believe it is possible for Namibia to develop the institutional capacity to fulfill them. The biggest challenge that must be met is the establishment of an efficient and cost effective delivery system. Unless this condition is met, the universal income grant cannot be implemented. The development of an appropriate delivery system will take at least four years and require substantial donor assistance.

The Nett Impact of a Grant Combined with an Increase in Indirect Taxes

Figure 3 illustrates this very clearly:

Figure 3

Nett anti-poverty grant received or progressive expenditure tax paid with grant of N$70 financed by increasing indirect taxes by 6.7% (including an increase in VAT of 4.8%)



The Actual Fiscal Burden Imposed by a Universal Grant

Paying a monthly N$70 grant to every Namibian between ages 6 to 60 yrs will cost N$1,156-million per year. This *gross* additional tax burden appears extremely high and could lead people to conclude that the proposed universal grant is unaffordable for the Namibian economy. However, this is a misleading conclusion. According to the fiscal model, everyone will pay taxes to fund the grant - but everyone will benefit from it in return. About 85% of Namibians will get back more than they pay. The total value of the amount they receive over and above the amount they contribute is N$522mil.[4] This amount comes from the 15% of people with the highest monthly expenditure who will contribute a total of N$522 mil more than they get back in return. This nett tax burden of N$522 mil per year is the real measure of the tax

[4]If one assumes that the rich cut their expenditure back by half of the indirect tax increase (which means that indirect taxes have to be increased by 6.9%), this amount will by N$516 million, and if the rich cut back their expenditure by the full amount, they will contribute only N$509. The higher the required tax rate, the lower the net benefit and the net burden. The more the affluent cut back their expenditure because of the tax increases, the less the actual additional tax burden is, even though the indirect tax increase is higher.

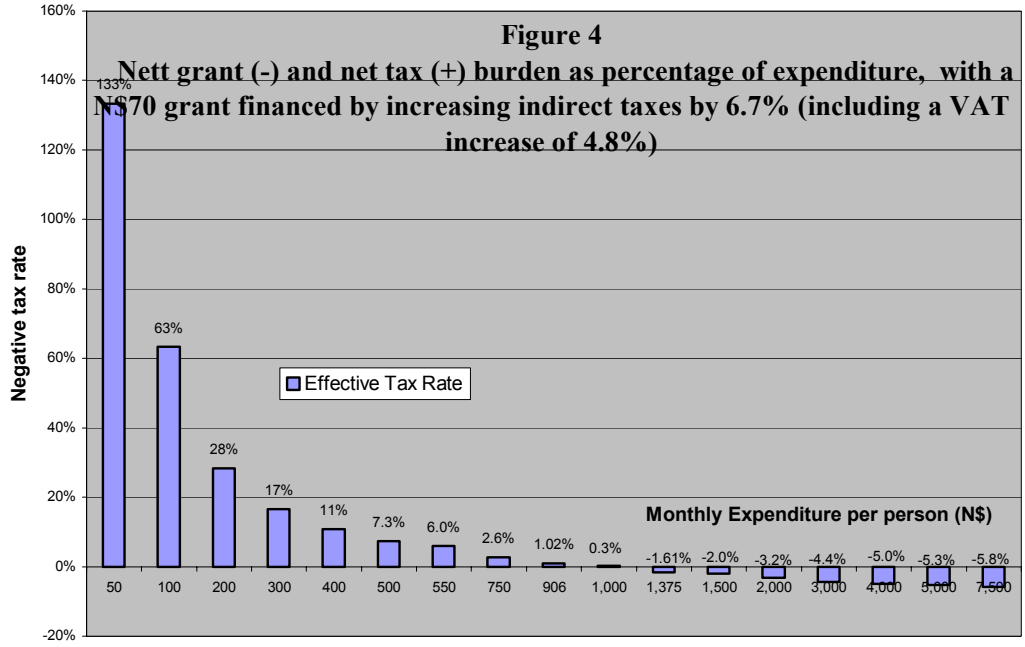
burden, and falls on the 15% of the wealthiest Namibians. This nett burden in this redistributive model, falls only on those who spend more than the "break-even" point of R1040 per person each month. This nett tax burden represents the real cost of the universal grant, and brings it well within the realm of affordability for Namibia.

It is easier to understand the argument regarding the difference between a nett and gross burden by assuming a hypothetical situation in which all income and expenditure in Namibia were completely equally distributed (i.e. a Gini Coefficient of 0). Under such circumstances everyone would pay N$70 through VAT increases to fund the grant, and everyone would get back N$70 in return (assuming no cost of collection and delivery). The state would raise N$1,156-million and pay back N$1,156-million to the same people. Thus the nett tax burden on each individual would be nil. This is the tax burden that counts. In this case it obviously makes no sense to argue that this is unaffordable to the society, based on the gross tax value of N$1,156-m.

It would, however, make no sense to introduce a universal income grant if everyone had the same income and expenditure. It only makes sense to offer such a grant because there is such disparity in incomes. The greater the inequality in a society, the greater the nett gain of the income grant will be to the poor, and the greater the nett burden in taxes for individuals with a high level of expenditure. In Namibia, which has one of the most unequal distributions of income in the world, the nett tax burden is close to half the gross amount paid out.

Although an increase in indirect taxes is usually regressive because the poor spend a larger proportion of their income than the rich, the nett impact of a grant combined with an increase in indirect taxes is clearly progressive. 85% of the population will be better off if indirect taxes are raised and an income grant is paid out to everyone above five years of age. Those who benefit most will be the poorest four or five deciles of the population, with a low monthly per person expenditure. Those with a N$200 per month expenditure will be able to increase their expenditure by at least a third. Those with an expenditure of N$100 per month will be able to increase their expenditure by two thirds. This makes a significant difference to the poorest of the poor.

The progressive benefit and burden imposed by a combination of a universal grant and an indirect tax increase is shown in Figure 4. This diagram shows that although the indirect tax has to be increased by 6.7% to finance a grant of N$70 per person, all those with a per person expenditure of less than N$1040 a month are better off, and it is only when the monthly per person expenditure exceeds N$4,000 that the tax rate creeps up to above 5%.



Targeting the Grant, while Avoiding Poverty Traps and Dependency

The approach we suggest avoids all the problems associated with means tests, which are often applied in industrialised countries to target state assistance to the poor. In some countries, such as the German Federal Republic, the state's assistance to the poor is cut back by 1 Euro, for every Euro the family earns itself. This amounts to a 100% marginal tax and serves as a serious disincentive to a poor family to earn additional income. Furthermore in such countries the state can afford to adopt a high poverty line. In Germany, for example, a family of four in certain circumstances can receive as much as E1500 (equivalent to N$15,000) per month. This approach inevitably creates a poverty trap because unskilled people can earn as much by relying

on a state grant as they can by going out to work. There is therefore no incentive to work, and under these circumstances the grant creates dependency.

Apart from this very negative aspect, the implementation of a means test requires a sophisticated and extensive bureaucracy. Some times this can cost as much as the savings achieved by introducing a means test to prevent those who do not qualify from getting the grant.

The consortium's proposal of a universal grant funded by increases in indirect taxes also targets the poor, but without the negative consequences of a means test.

If Namibia were to introduce a N$70 monthly grant financed by an increase in indirect taxes, a poor person would lose only N$6,70 for every N$100 by which the person's expenditure increases. This is a marginal tax rate of 6,7% compared to the 100% rate in the German example used above. Because everyone gets a grant, which is funded by the wealthier who spend more, the grant is perfectly targeted without requiring an expensive bureaucracy. A small grant of $N70 is very unlikely to create dependency. On the contrary, it is far more likely to offer opportunity to the poor to improve the opportunities of earning additional income. Children can be better nourished, youth can pay for additional training opportunities or transport costs in looking for work. The poorer one is, the more support one gets from the grant.

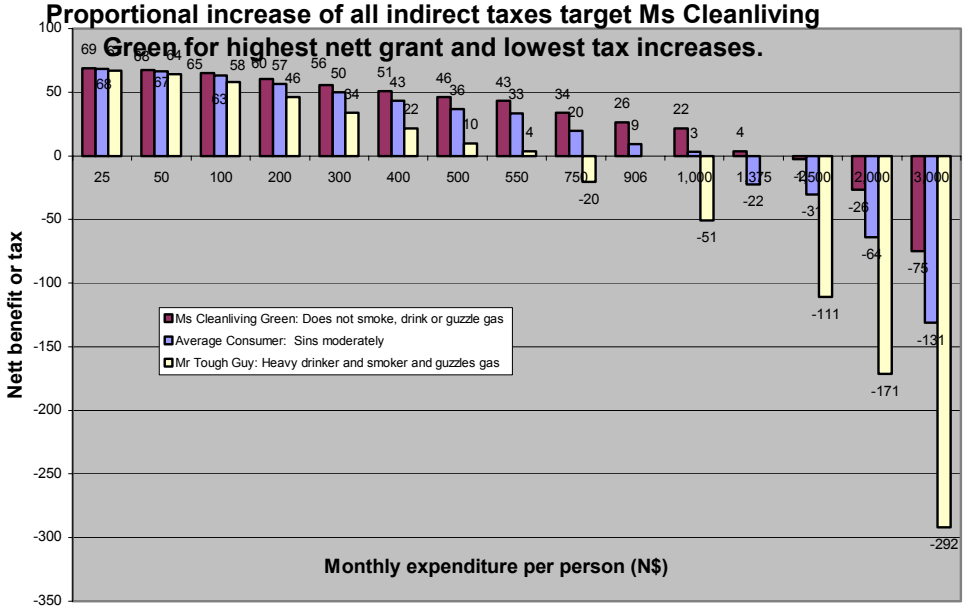
The grant will be a very effective way of targeting households for support in which the breadwinner has become unemployed because of ill health, e.g. because of AIDS.

Another great advantage of paying out the grant to individuals, or in the case of children, to the caregiver, is that it enables the grant to reach the needy within households.

For example, if a husband earns N$1,900 a month and keeps N$1,100 for himself and gives the rest to his wife and three children, he himself will pay as much in tax as he receives from the grant. However, his wife and three children, with a per person expenditure of N$200 per month, will benefit by N$56 per person per month (or N$224 together) from their grant. This system, in contrast to any other system, has

the great advantage of being able to address inequality in power relationships within households by automatically targeting those who get the least, to benefit most from the grant. This would be greatly assisted if the grant could be delivered in the form of electronic money to a smart card which can only be accessed by the caregiver and if it is possible to store the money on the card if required.

Figure 5
Proportional increase of all indirect taxes target Ms Cleanliving Green for highest nett grant and lowest tax increases.



Another advantage is that the system distinguishes between people on the basis of how they spend their money. If it should be possible to get agreement form SACU to fund the grant by proportional increases in excise levies on tobacco and alcohol, those who purchase these items will subsidise the grant to a greater extent than people who do not. (See Figure 5) This supports the case for levying increased excise taxes to fund the grant. However, it must be borne in mind that excise taxes are levied within SACU, and cannot be unilaterally altered by individual countries.

The Dynamic Economic Consequences of a Grant

For the purpose of alleviating poverty, a N$100 per month grant would be preferable to a N$70 amount. However, the macro-economic consequences of the larger amount are more difficult to predict because of the higher tax burden on the affluent. If

implemented today, it would be more prudent to start with a lower monthly grant and evaluate the macro-economic impact over a reasonable period. If there is no reason for concern, the grant can be increased. If a grant is only implemented in three to four years' time, it would be possible to start with N$100 per month. The real cost of such a grant then would be much lower and would be similar to the cost of a N$70 monthly grant in 2002.

There is also a case to be made for extending the grant to Namibians five years and younger. However, this may be administratively very difficult to implement. The biometric identification system foreseen for Namibia, similar to the HANIS system implemented in South Africa, should be used for every Namibian that receives the grant. This will prevent fraud. However, if one uses fingerprints, such an identification system cannot be implemented in the case of younger children. The grant could well, as is the case with the existing targeted poverty grant in Brazil, only be paid in the cases where children attend school to ensure school attendance and to monitor via the school who the care-giver is.

Another reason some may put forward for restricting the grant to children six years and older is that a grant for small kids may in some cases create a perverse incentive to have children.

The effects of the expenditure tax the consortium proposes to fund this grant will have much less of a distorting influence on the economy than an increase in income tax would have. We consider the expenditure tax the ideal method of raising taxes and supporting the poor. By adopting these measures, Namibia can succeed in implementing, by an indirect method, a direct and progressive expenditure tax.

It would, of course, be essential to earmark the additional amount thus raised for the grant. If the increased funds were spent elsewhere, the taxpayers would not get a direct repayment, and this would wipe out the advantage achieved by the difference between the gross and the nett tax burden. In fact, if the increased revenues raised in indirect taxes were not spent on the grant, the nett tax burden would be as high as the gross tax burden.

The nett impact of the grant will be to create more demand in rural areas. This should stimulate economic development in parts of the economy that have been marginalised.

Should a grant of N$70 be paid out today, it would bring down the Namibian Gini codfficient from 0.68 to about 0.60. Namibia would no longer have the dubious distinction of having the highest measured Gini coefficient in the world.[5]

[5] Countries such as Brazil and Guatemala have Gini coefficients of higher than 0,6.