

A Targeted and Affordable Universal Income Grant for South Africa

by
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1. Introduction

In its report, *Transforming the Present, Protecting the Future*, released in March 2002, the Committee of Inquiry into a Comprehensive System of Social Security for South Africa made the recommendation that a universal income grant of R100 should be phased in during the next three to four years. It did provide an overall financial framework to show that this, and its other equally crucial recommendations concerning in particular the health and pension systems, would be feasible given the goals government has set for itself². However, although it had studies done on the specific financial implications of an universal income grant, and referred to the results of these studies in passing, it respected the view of the Treasury that the detailed questions of how to finance such a grant was outside its brief (RSA, 2002, 134) and should be left to them.

As the member of the Committee responsible for one of the reports estimating the additional burden that such a grant will impose³, I regret that we have taken this decision. For the reality is that one cannot decide whether one is for or against an income grant without knowing what the additional tax burden is that it will impose on the South African economy and without knowing whether the grant is well targeted to benefit those who are destitute.

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² See Chapter 14, "Financial Framework for Comprehensive Social Security" in RSA (2002). Also see Baberton (2002) for a critical discussion of this chapter.

³ See Le Roux (2001), the July 9 version of my unpublished paper in which most of the arguments put in this paper were first developed. This paper was made available to Treasury. For two reasons the estimates made in that paper of the net additional tax burden when financing a universal income grant are somewhat lower than those presented in this paper. Firstly, it was assumed there would be a 95% and not a 100% take up of the grant. Secondly, that paper unrealistically assumed that everyone's expenditure would increase by the full value of the grant, rather than only by the net benefit they receive (see below for the assumptions made in this paper). Nevertheless, the arguments that paper developed as to the relative cost and benefit of different financing options for a grant and the relative cost of different levels of grants hold, even though the actual estimates have to be adopted upwards by roughly about 1% in the case of the VAT estimates to be in line with those presented in this paper.

If the grant is financed in a fashion that enables everyone, regardless of how affluent they may be, to get the full benefit of the grant (in other words, if the grant is **not recouped** from the high income groups by increases in their taxes), and if one accepts the cost estimates of delivery of the grant made by Treasury, a universal income grant would in year 2000-2001 have increased our tax burden by about R60 billion a year – an amount much higher than the entire education budget – a very hefty bill indeed. Since it is these type of cost estimates based on work done by economists such as Van der Bergh (2002) and Borat (2002) that are being used in the debates within the ANC and between the ANC and its partners, it is no wonder that many, although possibly in principle in favour of a universal grant, have decided not to go this route.

However, if one only looks at the cost of paying out the grant only to those not yet entitled to any other grant, if one for the time being ignores the delivery costs of the grant, and if one recoups the grant from those who are more affluent by increases (or by the forfeiting of decreases) in indirect taxes such as the fuel tax, the excise levies and value added tax, the net additional burden imposed on the tax payers by the grant itself will be only about a quarter of this amount, or about R15 billion.⁴ If the cost of delivery can be kept low, and that is a question to which we will return, this is clearly an option far more affordable than that which has up to now been on offer to the politicians.

What is more, as I will show in this paper, a grant thus financed will in effect be targeted to give most help to those most in need, without creating the poverty traps so common to means tested grants. For the average consumer the net impact of a universal grant combined with an increase in indirect taxes is in effect the same as giving an anti-poverty grant which increases by about 9% for every Rand monthly expenditure is below a break even point of about R1080. Above this break even point the net impact for this average consumer is the same as imposing an expenditure

⁴ This net additional tax burden will be higher if part of the increase is financed by increases in income tax, as is in fact done by Meth (2002). The calculations in this paper are based on the assumption that the affluent maintain their expenditure and pay the additional tax out of savings. If, however, they should cut-back their expenditure so that the total amount they spend after the tax increases is the same as before, Vat will have to increase by 7.8% (rather than 7.3%) and other taxes proportionally to finance the grant. Since more will now be recouped from the lower income groups, their net benefit, and also the net cost, will now be R14.2 billion. If half the increases in taxes are absorbed by spending less and the other half of the increases financed out of savings, the increase in Vat will have to be 7.5%, and the net cost will be R14.8 bil.

tax which increases by round about 9-10% for every Rand a person's expenditure increases.

However, those who the Minister of Finance has in his wisdom decided spend their money well, will benefit far more than those who he has judged to be spending their money badly. If one is not an average consumer, but someone who does not at all use products such as alcohol, tobacco, fuel and motorcars, on which higher excise taxes are levied, the break even point will be at about R1,500. One will only pay about 7% in tax as one's expenditure increases above this amount, or receive a grant that increases at about 7% as one's expenditure decreases below this point. The very heavy user of alcohol, tobacco and fuel, on the other hand, could have a break even point of as low as R600, and the relevant rate of increase in tax or grant will then be about 17%! (See Table 1).

Table 1⁵

The differential impact on different types of consumers of a R100 universal grant financed by increasing VAT by 7.4%, and excise taxes on alcohol and tobacco etc. and fuel taxes proportionally.

	Break even point	Effective tax rate
Ms Clean Living Green	R1,508	6.6%
Mr or Ms Average	R1,082	9.2%
Mr Tough Guy	R603	16.6%

In effect this paper shows that the net impact of a universal income grant combined with an increase in indirect taxes is to impose an expenditure tax with a progressively higher average rate on those individuals above the break-even point. This is a tax which has long been advocated by prominent economists such as J S Mill, Marshall, Pigou, Irving Fischer, Nicolas Kaldor (see Kaldor, 1955, p.11) and James Meade. An expenditure tax is impossible to implement directly, because the tax authorities have even more problems than they have with the collection of expenditure

⁵ In the illustrative calculations in this paper it was assumed that VAT will have to be increased by 7.4% and the other indirect taxes proportionally to pay for a universal R100 grant. If the affluent should have not cut their demand back at all as a result of tax increases, a 7.3% increase in Vat will be required. On the other hand, if the affluent cut back their demand so that their total expenditure will remain at the same level as before the tax (in other words, none of the additional tax is absorbed out of decreases in saving) then an increase of 7.8% in Vat, and a proportional increase in other taxes, will be needed to fund the difference. However, the break even points will only move down a couple of Rand. The results presented here thus holds true for a wide range of possible responses to the tax increases.

data than they have with the collection of income data. To know an individual's expenditure, the need to know her income, and then also how much she saved or dissaved. Countries such as Sri Lanka and India that opted for a direct progressive expenditure tax on the advice of economists such as Kaldor, found it impossible to implement. The statistics on savings and dissavings were easily manipulated to benefit the taxpayer.

This paper demonstrates that a country can indirectly implement which is in effect an expenditure tax system. The net impact of paying a universal grant to every permanent residence of South Africa and to at the same time increase indirect taxes such as value added tax, the sin taxes and fuel taxes, is exactly the same as that of a directly implemented expenditure tax. The only requirements in this case is that the country must have a well functioning indirect tax system and is able to make efficient monthly payments to all permanent residents.

The strategy of paying a grant financed by increases in indirect taxes effectively means that everyone above a break even point pays an expenditure tax at an increasing average rate. And for those below the break-even point there will in effect be a progressively larger net grant, which will increase to a maximum of R100 for those who have no existing expenditure. This anti-poverty grant could also be called a negative expenditure tax⁶. In some ways it is similar to Friedman's negative income tax. But it is paid once a month (or, if the system foreseen in the section below does evolve, in future possibly even once a week) rather than once a year, and it is larger, the lower the expenditure of an *individual* within a household rather than the lower the *household* income is.⁷ It has the same advantages, though, as Friedman claimed for his negative income tax, and as is claimed for the Earned Income Tax Credited implemented in the US, in that it does not create a poverty trap by severely taxing the poor who help themselves, (often a rate of 100% or more), as is often the case with traditional means tests, including those that apply to the South African Child Support Grant.

The finding that the net impact of a fixed universal grant combined with an increase in indirect taxes sufficient to pay for this grant has the same impact as a negative expenditure tax is not only of theoretical interest. It is clearly of relevance

⁶ A negative tax is economic terminology for a grant. (Why? Negative and tax (two negatives) gives a positive, a grant. Elementary, my dear Watson!)

⁷ See van Parijs, 2000, pp. 5-6, for the reasons why a monthly universal income grant clawed back through tax increases is to be preferred to a conventional negative income tax.

for the policy debate in South Africa. As already indicated, it challenges the views of those in Treasury who only think in gross terms, and have argued that the grant will impose a burden of R60 billion. (Also see Borat (2002) & Van der Bergh (2002). But it also challenges the position of Cosatu and the BIG alliance, that have argued that the grant should be funded by increases in income tax, because of the contention that increases in indirect taxes are regressive. In fact, although an increase in indirect taxes by itself is regressive, it is shown below that the net impact of a VAT and other indirect tax increases (or the forfeiture of potential decreases) in order to pay a universal grant in fact has a progressive impact, leveling a higher average tax the higher one's expenditure is above the break-even point, and paying a higher net grant, the further one is below the break even point. (See Chart 2). For the same additional net burden imposed by an income tax increase sufficient to pay for a grant of R100, one can finance a grant of R175 if financed by increases in indirect taxes.

Given this discussion it does not follow that South Africa can readily opt for such a system. Where as the ability of the South African Revenue Services to levy indirect taxes efficiently seems to be beyond dispute, an efficient and cost effective delivery of the grants is also essential for this system to work. It would not make sense to opt for the system proposed here, if the cost of delivering the grant is high relatively to the net benefit the poor receives. Although the case in theory for the system proposed here is very strong indeed, government should not in practice commit itself to such a system before the question of efficient delivery have been investigated further.

Since it will take at least three to four years to develop the systems needed to deliver the grant effectively (see section 7 below), government could find the finances for part of the cost by not giving any further income tax reductions, such as those which have been made during the past few years, because of the expected greater efficiency in tax collection by the Receiver in Revenue. Since part of the increase in efficiency in tax collection is because of the more efficient collection of VAT and other indirect taxes, there is no reason why government should continue to give this benefit through only as further reduction in income tax rates. It be given through as reductions in VAT, or, preferably from the poor, as an income grant. Thus, although a R100 grant would in the financial year 2000-2001 have required a 7.3% (or possibly as high as 7.8% -- see footnote 5) increase in value added tax and a proportionate increase in other taxes, a VAT increase of about 4%-5% from 14% to 18% or 19%

and a proportionate increase in other taxes may, under quite reasonable assumptions, suffice in three years time to pay for a grant of R100 adjusted for inflation from 2001 to 2005. (see Chart 4). (Since it would not be possible to implement a universal income grant system immediately, government could, in the next few years, take further steps towards a universal income grant by extending the child grant).

Should government opt for the universal income grant, it would for a number of reasons be most desirable that the actual share of indirect taxes needed to finance the universal income grant is earmarked for this purpose. After all, the actual additional tax burden will amount to one third of the gross additional amount raised by indirect taxes before the increase. The effective tax burden will increase in future years if the full proportion of indirect taxes initially raised for the grant is not paid out as a grant, but used for other purposes.

Each year the monthly amount paid out should thus be adjusted upwards or downwards depending on economic growth, demographic changes and inflationary or deflationary adjustments in price levels. This would ensure that those under the break-even point would automatically benefit from economic growth, giving everyone in South Africa an interest in successful macro-economic policies. On the other hand, any other increases in the level of the grant should only be made by further increasing indirect taxes, or be foregoing potential decreases. This principle would strongly agitate against any political pressures for unreasonable increases in the grant.⁸

This introduction effectively is an executive overview of the broad case for an income grant financed by increases in indirect taxes. In the rest of this paper the following specific issues will be given more attention:

- (1) What is a Basic Universal Income Grant?
- (2) The reasons why the envisaged income grant will not create a poverty trap (as social assistance in Europe often does), but will function as a springboard.
- (3) A detailed exposition of the findings that are summarised in the introduction.

⁸ If one wishes to play safe and not undermine the future ability of the economy to grow and to increase the universal grant, there does not seem to be much scope to pay a grant much higher than R100 in 2001 prices in the initial phase. Careful evaluations will have to be made of the impact of the grant. The risk of too high a grant actually leading to lower incomes has been illustrated by Anthony Atkinson (1994) p. 14, by using a type of Laffer curve.

- (4) A discussion of the longer term scenarios should South Africa implement a universal income grant financed by increases in indirect taxes.
- (5) The reasons why a universal income grant financed out of indirect taxes would, in the South African context, be an essential part of any successful anti-poverty strategy.
- (6) The type of delivery system that needs to be developed to make cost effective payments of the grant.
- (7) The reasons why this type of system has not yet been implemented elsewhere in the world, with the exception of Alaska, where it fulfils a different role.

2. What is Universal Income Grant?

In the South African context a universal income grant is usually called a basic income grant or BIG. In this paper I use the term *universal income* to have the same meaning as *universal basic income* by Philip van Parijs, one of the chairpersons of the Basic Income European Network., with the difference that children are also entitled to an income grant (although this is paid to the care-giver who can be a child when parents are absent or dead, as in the case of Aids orphans).

By *universal basic income* I mean an income paid by a government, at a uniform level and at regular intervals, to each adult member of society. The grant is paid, and its level is fixed, irrespective of whether the person is rich or poor, lives alone or with others, is willing to work or not. In most versions—certainly in mine—it is granted not only to citizens, but to all permanent residents.

The UBI is called "basic" because it is something on which a person can safely count, a material foundation on which a life can firmly rest. Any other income—whether in cash or in kind, from work or savings, from the market or the state—can lawfully be added to it. On the other hand, nothing in the definition of UBI, as it is here understood, connects it to some notion of "basic needs." A UBI, as defined, can fall short of or exceed what is regarded as necessary to a decent existence. (Van Parijs, 2000, pp.2-3)

Van Parijs's attempt to disassociate the term basic income from basic needs, has not prevented many in the South African debate to conclude that the term 'basic' implies a grant that can meet basic needs. In order not to arouse expectations that

cannot be fulfilled, and also because of the fact that this is the term used by the committee (RSA, 2002), I have used the term *universal income grant*.

The calculations below have been made on the assumption that the 3 million children entitled to a Child Support Grant will continue to receive that grant, and on the assumption that the pensioners who do not qualify for the old age grant will receive the R100 universal income grant.

To conclude the South African income grant considered in this paper would have the following characteristics:

- Every permanent resident will be individually entitled to receive one, but may well be encouraged to claim together with others in the same household to save distribution costs.
- Those who already receive other grants, e.g. the Child Support Grant, the disability grant or the Old Age grant, receive the universal income grant, but then the other grant will be adjusted downwards by the same amount
- In case of children under 19, the grant is paid out to care giver – assumed to be the mother or the grandmother.
- There is no means test, everyone is entitled to receive the grant, rich or poor.



3. Poverty and the dole: Why the income grant avoids Europe's poverty traps.

In the context of the South African debate it is crucial to understand that a universal grant can be targeted very effectively to help those deepest in poverty most in a way that will neither create poverty traps nor foster dependency. There is no logical reason to fear that the grant will have this undesirable consequence, as is indeed some times the case with the means tested grants doled out in Europe. Nevertheless many South Africans still confuse a universal income grant with a dole, even though the difference has often been pointed out from very early on in the South African debate (see Le Roux, 1999 & RSA, 2002).

In effect the nature of the grant, if financed as here suggested, will be such that it avoids all of the traditional poverty traps and rather creates a springboard for development. It is a natural extension of the existing old age grant to those three quarters of the poor households that, because of the absence of a pensioner, do not benefit from the very successful old age grant, and it will be more beneficial for

children in poor households than the existing Child Support Grant, to which it will also be a natural extension.⁹

Before we can give a broader justification of these arguments, it is necessary to make a short but important detour, and to consider how poverty should be measured, and to then move on to the reasons why we should not attempt to imitate Europe and attempt to bring everyone up to the poverty line by paying out means tested grants. We must develop an understanding of the nature of the problem that has to be addressed, and show that part of the reason for proposing the universal income grant is precisely the rejection of dependency creating minimum income support. A universal income grant has a very different logic to that of the European social assistance systems such as the dole.

One of the most commonly used indexes of poverty in economics is household per person expenditure¹⁰. In more sophisticated analysis factors such as the education and housing of people are also considered in determining who is poor, and one thus would find people whose monthly expenditure are very low who actually cannot be considered to be poor because of other assets. However, for analysis such as this one, where the overall impact of income transfer measures are being analysed, it suffices to use household per person expenditure as a proxy for poverty.

In the measurement of poverty on the basis of expenditures three broad alternatives are usually considered. Firstly, one can look at the number of people under the poverty line. This is a rather rough and ready measure of poverty. Two countries may have an equal proportion of people under the poverty line, but in the one country they may all be just under the line, whereas in the other many may be much further under the poverty line. Clearly poverty is a much more severe problem in the second country. To deal with this problem of the head count approach to poverty, poverty is often measured in terms of the poverty gap. The amounts needed to bring the expenditure of all those under the poverty line up to the poverty line are all added together to calculate this gap.

A third option is to measure the depth of poverty. A great variety of measures have been proposed for this purpose, but the simplest one is probably the suggestion

⁹ For this reason the Committee recommended that the Child Support Grant should be further extended during the time it takes to develop the capacity to deliver the universal income grant (see RSA, 2002, p.64).

¹⁰ Usually adjusted for scale, because of the fact that two or more people can find accommodation etc at a lower per person rate than one person, and for adult equivalence to allow for the fact that it cost less to feed and clothe a child than an adult.

that one must square the poverty gap. This last type of measure is in principle preferable, because it gives greater weight to anti-poverty measures that reach people in destitution, far under the poverty line, but it is conceptual clumsy. For this reason one therefore, in practice, often measure poverty simply in terms of the number of people under the poverty line, or in terms of the poverty gap. However, when one wishes to compare different options, looking at their impact over time, one should use the third type of measure, because it favours measures that deliver most to the poorest deciles.

Measured by this standard, a grant financed by an increase in indirect taxes would be preferable to grant financed by increases in the income tax. For the same net burden that a grant of R175 grant can be financed by increases in indirect taxes, one can finance a universal income grant of a R100 grant financed by increases in direct taxes. In terms of the head count measure the results could well be similar for both options, but in terms of the poverty gap measure the indirect tax option will give significantly better results, and in terms of the square route of the poverty gap measure the indirect tax option will be dramatically better. The reason for is that a grant financed out of income tax would give the full benefit of the grant to many well above the poverty line, and does not give the same support to those below the poverty line as the larger grant which nevertheless imposes the same burden, financed out income tax increases.

When one considers the cost of dealing with poverty, the poverty gap concept is very useful, because it shows how much money would be sufficient to bring everyone under the poverty line up to the line. In the case of South Africa Borat (2002) for example, estimated that in 1999 this poverty gap was R12.8 billion and that a R100 per universal income grant to all would eliminated 2/3 of this gap. In a different study, where other indicators of poverty than expenditure was also used to determine whether households were under the poverty line or not, the Haarmann's found that virtually three quarters of the poverty gap can be eliminated by a universal income grant system (see Haarmann, 1998 & Samson et al, 2002).¹¹

A poverty line of R400 a month in 1999 is undeniably very low. Nevertheless, it is important to know that if we could have targeted income transfers

¹¹ If one uses a higher poverty line, e.g. R600 instead of R300 or R400, the poverty gap will, of course, be much larger.

carefully, another R13 billion, or roughly what was spent on pensions in 1999, would have wiped out this particular poverty gap.

It can be argued that under these circumstances South Africa should adopt a system similar to German social assistance (Sozial Hilfe) or the English dole system. Why not top up the income of all those households below the poverty line, and thus wipe out poverty with one fell swoop? If pension payments are good for the one quarter of the poor households that benefit from them, why not make dole payments to the other $\frac{3}{4}$? There may be massive poverty in South Africa, but surely South Africa is not a poor country? It can afford to help everyone in poverty to move up to the poverty line.

Although this line of reasoning may seem to be compelling, the proponents of a universal income grant believe South Africa would make a grave mistake if it should opt to go the European route. In the very attempt to help people out of poverty, many may be trapped permanently into poverty. In contrast to the pension payments, dole payments and other means tested social assistance programmes punish the poor that help themselves. (See Standing, 2002:53) A culture of “not doing anything for oneself and depending on the state grant” could very easily be created. Through the process of means tested targeting one runs the risk of creating a second class citizenry, destroying some people’s own worth and initiative. Even if in practice it was possible to administer this system in South Africa, which it is not because of the fact that unemployment levels and informal sector activity is so much higher than in Europe, I would consider means tested support to be very much a third best option to deal with poverty.

The net impact of a grant combined with an increase in indirect taxation is very different from this type of dole system. It takes into account exactly the most serious objections that conservative economists such as Milton Friedman (1962) have raised against the dole and other social assistance programmes. One in effect creates a system that incorporates all the virtues of the negative income tax approach suggested by Friedman, and overcomes its most serious shortcomings. What is more, the income is in effect raised through a progressive expenditure tax, which as Kaldor and Meade have argued so convincingly, has far less distorting impacts on the economy than income tax increases.

There are two very important differences between the system proposed for South Africa and the dole and social assistance system in Europe. Firstly, R100 a

month in 2000-2001 was only about one sixth to one quarter of the poverty line one might accept as reasonable, in contrast to the social assistance in northern Europe, which usual takes people out of poverty. If the grant was R400 or R600 per person one could still argue that some recipients might sit back and not try and do anything for themselves, thinking that they can live on the grant. At a level of R100 this surely will not be the case.

A second and more fundamental reason why the European poverty assistance programmes may well create dependency, is that one often loses 1€ in government support, for every additional € one earns oneself. For example, in German a family of four could get as much as €1,500 in support from government, but if someone in the family should go out and earn €750, this support will promptly be cut back to €750. Until their income exceeds the full €1,500 the poor household does not get any benefit at all from its own efforts. They are effectively paying a 100% tax. This clearly discourages the poor to do something for themselves.

Now we have in principle a worse problem with our child grant where a women with three children under six might receive R390 in child support when her income is R880, but if she should get an increase to R910 she under the rules must lose the entire R390, thus being much worse off (paying a tax of 1300%!). This sort of means test clearly creates a poverty trap, because the poor are worse off once they go out and earn more money! However, in the case of the universal income grant everyone will get the full grant, and will not lose anything when they start working or when they earn money in any other way. (Of course, government will through indirect taxes recoup on average about 10% as people's expenditure increase, but this would not constitute any deterrence to people to help themselves).

In the case of the old age grant, where the means test is fortunately not effectively implemented, the evidence is that much of the grant, particularly in the case where the grandmothers are the recipients, is well spent. Now one can expect a similar use of the grant in the case of the income grant, where about $\frac{3}{4}$ of the money will be put into the hands of the women. (The grant for children up to 18 will be paid out to the care-giver who usually will be the mother or grandmother, or at times one of the older daughters – when there is no adult in the household). This money will firstly ensure far more effectively than any of the existing nutrition programmes have done, that malnutrition is kept at bay. It will help facilitate school attendance. It will help the poor and unemployed to pay for training they themselves judge that they

need in order to get employment. It will help with payments of water and electricity bills. It will be far more effective and cost-efficient than any of the existing micro-financing schemes in making regular funds available to those engaged in micro and small businesses.

Clearly not all of the money will be well spent. Some of the recipients may spend it on alcohol or cigarettes, but as we have argued above and will show in more detail below, in the case of such expenditures predominating, the money will at a very low per capita expenditure level, be recouped by government. In any case, with public works and skills training programmes anything between half and two thirds of the money never reach the poor, but is spent as salaries for managers and trainers and as cost of materials. The leakage in the case of income grants should be much lower than this.

Because of the low level of the grant relative to poverty it will, together with the old age grant, only close about two thirds of the poverty gap (See Borat (2002) & Samson et al (2002)) and that only if one accepts a relatively low poverty line, but most households should be moved out of destitution over night in a way which will encourage rather than discourage self help.

4. The financing and targeting of a universal income grant: the crucial question

With regard to the affordability and targeting of the income grant, the crucial question is which type of tax is used to recoup it from the affluent. In this section I wish to show that the answer to this question determines both how the grant is targeted and what the net additional burden on society of any given level of the grant would be.

It is essential that one considers the net impact of the grant plus the taxation used to finance the grant – and this can be very different from what one would expect when one considers the tax by itself.¹² For example, the impact of a grant plus a VAT increase (or a decision to forego a VAT decrease in favour of a grant) has a demonstrably progressive net impact – helping the poorest proportionally far more, for the same net increase in the tax burden, than when a grant is financed by an income tax increase – this in spite of the fact that VAT increases taken by themselves

¹² Van Parijs, 2000, p.11 warns that gross cost calculations are misleading, and that one net to look at the net cost of the grant.

can be quite regressive. Of course we also, in addition to the immediate or short term impact of any grant and tax combination, need to consider the possible long term dynamic impacts of the chosen method of financing, as we will in fact do below in section 4.

A grant of R100 would be affordable and well-targeted if financed out of an increase in VAT, excise and other indirect taxes (or by not realising potential decreases in such taxes). Given the fact that it will take three to four years to set the capacity to deliver the grant in place, I would argue that a grant of at least R100 per person should in practice be financed partly by foregoing further decreases in income taxes, which under present practice are likely to be made because of the expected greater efficiency in tax collections during the next few years, and partly by a 4-5% increase in VAT (and a proportional increase in the other indirect taxes) in the same month as when the grant is in the end actually paid out.

This proposal is likely to be challenged both from the left, by those who would argue that the net impact of any expenditure financed out of indirect taxes is regressive, and from the right, by those who would argue that a grant of which the gross costs in 2000-2001 would have been R52 billion, would remain unaffordable, regardless of how it is financed. In evaluating these different lines of argument, I will illustrate the difference between the net impact of different types of taxes combined with a grant.

4.1 The actual additional burden imposed by a grant depends on the type of tax used to finance the grant

The fallacy of the argument, that a grant would impose a tax burden equal to the gross costs of paying the grant, can be exposed by imagining a situation in South Africa that conservatives would dread – a social democratic utopia where income is 100% equally distributed. Everyone has exactly the same income and everyone has exactly the same expenditure pattern. Now if under these circumstances everyone is paid a R100 income grant, and at the same time value added tax and excise and fuel taxes are increased by just enough so that everyone also pays an additional R100 in tax, what is the actual increase in tax burden? Assuming that there is no additional cost of collecting the higher tax and paying out the grant and that everyone spends the R100 they received, it is clear that no one will be worse off and no one better off.

There would be no additional net tax burden. The additional R52 billion in tax is promptly returned to those from whom it is collected. Under such circumstances it would be totally ludicrous to say that South Africa cannot afford an income grant financed out of indirect taxes. (It would, of course, also be a meaningless exercise, because there will be no net redistribution).

However, during the tax year 2000-2001, South Africa happened to be a society where income was highly unequally distributed. As a consequence a R100 grant paid to every man, woman and child legally resident in South Africa and financed out of an increase in VAT of 7.3% and a proportionate increase (i.e. a slightly higher than 50% increase) in excise and fuel taxes would in fact have put a significant additional burden on those with high expenditures. They would pay far more than they receive as a grant, and this excess of additional taxes over the grant they receive will impose a heavier tax burden on them. The poorer individuals, on the other hand, who cannot buy much, will pay very little extra tax on their existing expenditures, and will therefore have a net gain as a result of the grant. The lower their expenditures, the bigger this net benefit.

Now if one adds together all the costs for the state of all the additional net benefits received by the poor on the one hand (assuming that the grants are spent so that the state can recoup some of the grant through indirect taxes), and on the other, all the additional net indirect taxes and excises paid by the better off, the total in both cases would have amounted to R15.2 billion (See Table 2). It is not therefore the gross amount of R52 billion, paid in total on the universal income grant, that constitutes an additional burden on the tax payers, but only the R15.2 billion. (Actually the gross payments which government would have to make in the form of grant payments would translate to R45.4 billion and not R52 billion, because about 5 ½ million South Africans were already entitled to the old age grant and the child grant during this period). The net additional burden and the net benefit of a grant financed out of an increase in VAT, excise and other indirect taxes will thus be less than a third the gross value of the paid out grant.¹³ Two thirds of the money will be recouped by the increase in indirect taxes.

¹³ Net costs as proportion of gross costs seems to be about equal to the square of the Gini coefficient. In the case of the social democratic utopia postulated above, the Gini coefficient is zero and so is the proportion of the net to gross costs. In South Africa, with a Gini coefficient of .58, this proportion is about $\frac{1}{3}$, in the case of a Namibia, with a Gini coefficient of 0.7, this proportion is about a half, and in the theoretical situation of a Gini coefficient of 1, this proportion would also be 1. The more equal the

If the grants were financed out of increases in the marginal income tax rate, both the net benefit and the additional net burden would have been much higher. Very rough and ready calculations show that if the required additional income tax could be levied proportionally on all the better off households, the additional net burden would have been somewhere between R25 and R30 billion, with the latter estimate probably being more accurate (SeeSamson, 2002 & Le Roux, 2001)¹⁴. This is clearly far less affordable than if the grant is so financed that the net burden is about R15 billion.

Finally, if the additional costs of the grant were financed out of increases in company taxes, there would have been no targeting at all of the grant. Every recipient would have received the full benefit of the grant. However, in terms of this scenario, the net additional burden of the grant would have been the full additional cost of R45.4 billion – an amount which would require a tripling of the taxes on companies – clearly an unsustainable proposition which no one has seriously proposed.

Table 2
Annual Expenditure and Income (R bil) on R100 universal
income grant financed by an increase of 7.3% in Vat and
a proportionate increase in excises and in value added tax.
Additional Vat, Excise & fuel tax

Add annual VAT etc R bil	Paid as result of increase	Paid when Grant is spent	New Grants paid out R bil	Total An-- nual Grant R bil	Annual Net Cost R bil	
2.4	0.8	1.6	7.1	7.9	4.7	
2.5	1.3	1.2	5.9	7.1	3.4	
2.7	1.6	1.1	5.5	6.7	2.8	
2.7	1.9	0.8	4.7	5.9	2.0	Total
3.0	2.3	0.6	4.3	5.5	1.3	Net
3.2	2.8	0.4	3.8	4.8	0.6	Benefit:
3.7	3.4	0.2	4.1	4.1	0.5	15.2
4.4	4.4	0.0	3.5	3.5	-0.9	Net add.

distribution of income, the less the effective redistribution as a result of a universal income grant financed by an increase in indirect taxes, and the higher the indirect tax increase needed to finance a reasonable net transfer to the poor. The grant system proposed here thus only have a significant impact in countries with relatively high Gini coefficients.

¹⁴ To actually make an at all reliable estimate of the net impact of increases in income tax, one needs to have far more sophisticated models, similar to the models (TAXMOD, POLIMOD) developed by Holly Sutherlands in the micro-simulation unit in the Department of Applied Economics, Cambridge and used by Sir Anthony Atkinson, 1994, to estimate the impact of a basic income financed by flat income tax.

7.2	7.2	0.0	3.4	3.4	-3.8	VAT etc
13.6	13.6	0.0	3.1	3.1	-10.5	-15.2
45.4	39.3	6.0	45.4	52.0	0.0	

The real additional net burden of a grant thus depends not only on the level of the grant, but on the type of tax through which it is recouped, and on how unequal income and expenditures are distributed. Because it is targeted to benefit only the poor, a grant financed out of an increase in VAT and a proportional increase in excise duties and other indirect taxes will have a burden of about R15.2 billion. Such a grant will thus be as affordable as the old age grant, but its benefits will be much wider spread, because the old age grant reaches only about 25% of the poor households, whereas a universal income grant financed out of an increase in VAT and a proportional increase in excise duties and other indirect taxes is well targeted to benefit all the poor, with the poorest of the poor benefiting most in absolute and proportional terms.

The net additional burden of a well targeted universal income grant is only a few billion Rand more than the net cost of old age grants in the financial year 2000-2001. This is a significant change in government expenditure, but the actual burden it poses is one third of what the alarmists claim that it would be – if the political will should be there, it is affordable.

What has become particularly clear from the preceding discussion, is the importance of distinguishing between the net and gross burden imposed by the different options. The failure of the Committee's Report to discuss this in any detail has meant that even some of the usually perceptive commentators do not seem to comprehend the importance of this difference.¹⁵ This has also given the opportunity

¹⁵ See Baberton (2002), pp 11-12. There is no logic in Baberton's argument that "By extension this would mean that highly paid civil servants is the best form of government expenditure because of its low 'net burden' on the fiscus"! The net burden will still be high, but it will be lower than the gross burden – and in costing options it is the net burden rather than the gross burden that ought to count. The argument that the consideration of the net burden would mean that the employment of highly paid civil servants is the best form of government expenditure is facetious. It is the same logic as arguing that the when one buys on a sale, the crucial consideration is how much one "saves" on the pre-sale price, rather than what one in the end pays.

Clearly one must be sure that the money will be clawed back before working with a net burden, but one needs to acknowledge the different claw back possibilities of different financing regimes. If under one regime one clearly does not claw back any funding and

to those who are opposed to the income grant to bandy about gross estimates rather than admitting that the actual additional fiscal burden would, if the grant is financed by increases in indirect taxes, be only one third of this gross amount.

under another one is likely to claw back $2/3$'s of the gross costs, this is of central importance in deciding on the route one is likely to take.

Baberton is, of course, correct when he argues that one should not compare gross costs of one programme with the net costs another. But if wants to compare apples with apples one cannot, as the preceding section has shown, compare gross costs with gross costs. One has to compare net costs with net costs.

4.2 The targeting of the grant.

4.2.1 A South Africa with an amazingly efficient tax bureaucracy taxing the affluent to give progressively higher grants to the poor.

Let us imagine that in South Africa we have an extremely efficient and omniscient bureaucracy that decides to avoid the usual pitfalls in dealing with poverty. They decide to give support only to those individuals that have an expenditure of below about R1080 per month, and to increase this support by about 9% for every Rand that the per person expenditure falls. The deeper the poverty, the higher the support given, up to a maximum of R100 a month for those who cannot afford to buy anything at all. On the other hand, the bureaucrats decide to levy a tax of on average close to 10% on all individuals for every Rand of their monthly expenditure exceeds this break-even point.

These highly efficient bureaucrats adjust the credits or tax every adult receives from month to month. In the month that expenditures are high, one has to pay a tax. In the months they are low, one receives a credit. The higher your expenditure, the higher the tax you pay, the lower your expenditure, the larger your credit payment, accurately calculated to the closest cent, even though the individuals themselves may not know their actual expenditure!

Our bureaucrats are also gender sensitive. They realise that there are power struggles within households¹⁶, and therefore treat everyone separately. A husband pays tax if he has a high expenditure. The wife gets a credit, if her expenditure is low. The only people treated *a priori* as a collective are children and the care giver responsible for them, with the assumption that the mother is the care giver, but others, including children in the case of child headed households where parents have died, can be accepted as the care givers.

If one adds up the additional the total net benefits received by all those with a per person expenditure below about R1080 (excluding the children who were entitled to a child grant and the pensioners entitled to an old age grant), we find that the total annual net cost of all these grants is R15.2 billion - after allowing for the fact that

¹⁶ This meets the concern of people such as the Speaker of the Assembly, Dr F Ginwala, that a grant paid to a household would not reach those most in need. Also see Wittenberg, M (2001), who stresses the conflictual nature of intra-household allocation of resources.

government recoups part of the grant through indirect taxes when it is spent. Similarly, if we add up the annual tax paid by all those with a monthly expenditure above about R1080, we find the total tax income is R15.2 billion, exactly the amount needed to pay for the grant!

What our highly efficient bureaucracy have in effect done is to pay a **progressive anti-poverty grant** to the poor, financed out of a **expenditure tax** on the affluent. This is a very effective way of dealing with poverty. Even a disciple of Milton Friedman will acknowledge that it is better to take every individual's monthly expenditure as a proxy for poverty, rather than household income. If the husband hogs all the income, he may well pay a significant expenditure tax, whereas the wife may get a significant anti-poverty grant. And clearly it is far more sensible from the point of view of the poor that the payment is made monthly rather than annually.

In the economic literature there is, since the days of Kaldor and Meade, also no dispute that an expenditure tax is in principle far less distortionary for economic activity than an income tax.

The problem with the preceding story is, however, as Sri Lanka and India discovered, that an expenditure tax is virtually impossible to implement in practice. Even a country such as Sweden, with a highly efficient tax administration decided, after a commission of inquiry, that they could not implement an expenditure tax in practice, even though they admitted it to be a better tax in principle. Hence we find that today no country has a progressive expenditure tax on individuals – instead countries have opted for the regressive Value Added Tax on goods and services in addition to a progressive income tax.

A monthly levied expenditure tax to finance a progressively larger anti-poverty grant may thus well be an excellent idea in theory, but in practice it surely cannot be implemented? What we have postulated in this section is utopian, or is it?

4.2.2 Implementing what is effectively a progressive anti-poverty grant financed by a progressive expenditure tax in practice: Combining a BIG with an increase in indirect taxes.

In actual fact, exactly what we envisaged in the preceding section can be achieved relatively easily in an indirect manner. This indirect way does not call for a

more efficient bureaucracy than what we already have. In 2000-2001 we could have had exactly the same results as described above, with the monthly adjustments and sensitivity to the gender struggles, if we had paid a R100 BIG to every South African, and at the same time increased VAT by 7.3% and simultaneously increased excise taxes (e.g. on alcohol and tobacco) and fuel taxes by the same proportion (i.e. by about 52%). In this section we will illustrate the equivalence in impact of such a measure to a progressive negative expenditure tax.

(As we have already indicated in the introduction, in practice the payment of a universal grant can only be effectively implemented by 2005, at which stage a VAT increase of only 4-5% and a proportional increase in other indirect taxes will be needed if expected increases in the efficiency of tax collection during the next few years is not given through in further income tax reductions, but earmarked for the income grant).

Table 3
Benefit and costs of a monthly income grant of R 100
Combined with an increase in VAT of 7.4%
and proportionate increase in excise and levies.

Cumulative Population Distribution	Monthly Per capita expenditure	Monthly Income Grant	Percentage vatable expenditure	Monthly Add VAT, Exc & levy	Recouped from grant	Monthly Net benefit	Net Benefit %	
1	Cumulative	100	85%	10	19	90	80%	
2	28.9%	197	100	85%	17	21	83	42%
3	41.8%	272	100	85%	24	19	76	28%
4	53.1%	364	100	85%	32	17	68	19%
5	63.7%	477	100	85%	42	15	58	12%
6	73.0%	640	100	85%	56	11	44	7%
7	80.9%	881	100	90%	81	5	19	2%
8	87.6%	1323	100	90%	122		-22	-2%
9	94.1%	2127	100	95%	208		-108	-5%
10	100.0%	4416	100	95%	431		-331	-7%

From Table 3 and Chart 1 we can see how the net benefit received by the average individual receiving a universal grant of R100 put paying higher indirect taxes, depends on his or her level of expenditure during a particular month in 2000-2001. A person with no expenditure at all, is getting the full benefit of the R100 grant. However, after that the net benefit decreases as expenditure increases. The net

benefit is identical to what it would have been if we could have implement negative expenditure tax hypothesised in the previous section.

The combined effect of paying a R100 grant to every permanent resident of South Africa by increasing indirect taxes is exactly the same as instituting an expenditure tax, where

$${}^{\text{ExpTax}} = t\text{Exp} - \text{Grant}$$

The ${}^{\text{ExpTax}}$ changes into a grant (or a negative expenditure tax) once expenditure is below the break even point. Initially the grant every individual receives is equal to $t\text{Exp} - \text{Grant}$, but when this is spent, government recoups part of the grant with the result that the net cost for government per person receiving a net grant is only

$${}^{\text{NegExpTax}} \text{NetCosts} = \text{Grant} - (t\text{Exp} + (\text{Grant} - t\text{Exp})T)$$
 with $\text{Grant} > t\text{Exp}$,

The Grant is the monthly universal income grant paid to everyone, Exp is the per person monthly expenditure and t is the expenditure tax rate paid on existing expenditures and T is the tax rate paid on the net grant received (see Table 4)¹⁷.

Table 4
Expenditure Tax Rates (t & T) according to
type of consumer and expenditure level

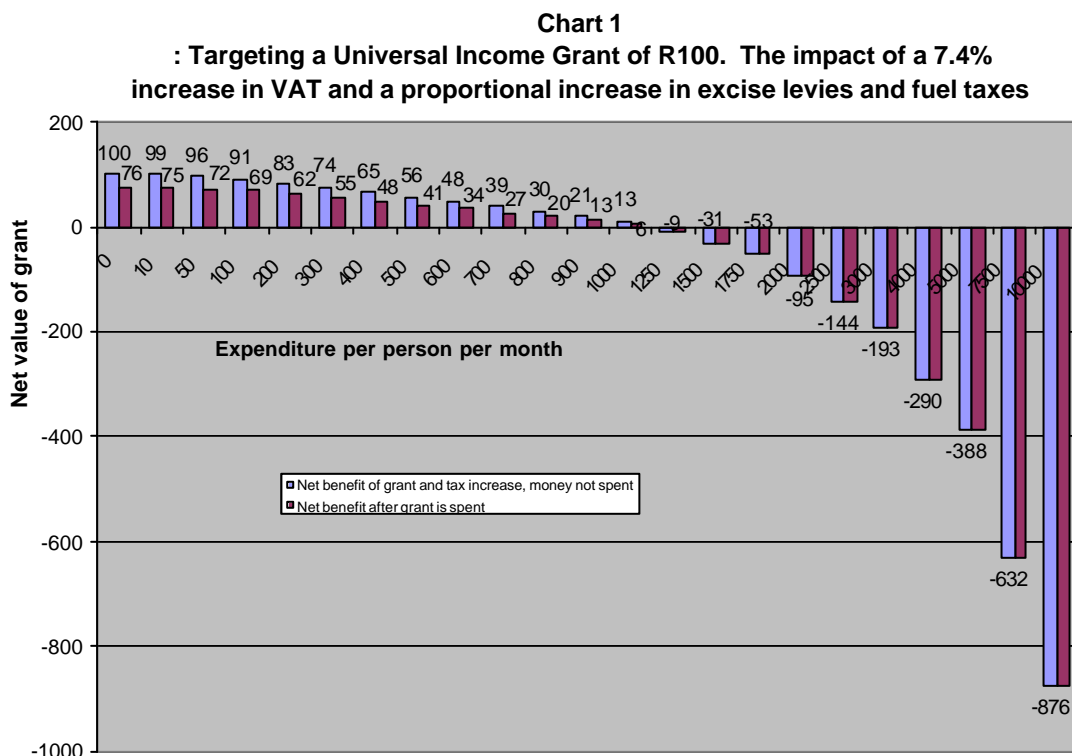
Monthly Expenditure	Vatable Expenditure	Ms CleanL. Green		An Average Consumer		Mr Tough Guy	
		t	T	t	T	t	T
<500	0.850	6.3%	18.2%	8.7%	25.3%	15.7%	45.4%
<2000	0.900	6.6%	19.2%	9.2%	26.8%	16.6%	48.1%
>1999	0.950	7.0%	20.3%	9.8%	28.3%	17.5%	50.7%
Break even-point		R1508		R1080		R603	

In theory it would be possible, if one knows the exact level of expenditure, and the type of goods bought, to calculate exactly the net grant to be received or tax to be paid by each tax payer. Exactly the same final results as were calculated in Tables 1 & 2 and Charts 1-3 for the case of a grant combined with an indirect tax increase are obtained if the expenditure tax rates in Table 4 are applied directly. (In real life one

¹⁷ The tax rates t and T are progressively higher, for higher levels of expenditures, and for every individual they are also higher, the larger the proportion of expenditure spent on alcohol, tobacco and fuel (see Table 3). In real life there will not only be three steps, but a continuum of increases. These three categories have been adopted for simplicities sake, and they give a good approximation of what actually happens. To calculate the total income and expenditure for the state, one can simply use the average consumers tax rates, apply this to the average expenditure per decile, and multiply the results with the number of consumers in each decile.

does not, of course, only have three types of consumers, but a vast spread in between, with many different expenditure tax rates applying.)

To calculate the expenditure taxes and grants directly in real life would require knowledge about expenditure that is simply not attainable. But we do not, with the indirect system, need the super-efficient omniscient bureaucrats to discover what expenditures the individual has actually made. In fact, the individual her/himself does not even need to know her or his expenditures. All we need is a tax authority that efficiently collects the required VAT, the fuel taxes and the excise taxes on cigarettes, alcohol etc. The individual then automatically pays more tax on existing expenditure, and the higher the expenditure, the less he or she benefits from the grant. When the existing expenditure exceeds about R1080 per person for the average consumer, the net impact of the grant and the tax increases is that the individual is worse off – and now effectively pays an expenditure tax, which increases for individuals with higher levels of expenditure. (We will discuss of the case of the Mr Tough Guys and Ms Clean Living Greens below).



Once the individual also spends the received grant (and it is assumed all of the net grant is spend), further indirect taxes are paid on the bought goods. This

means that the government recoups even more of the paid out grant. Assuming that all individuals have the same average expenditure pattern, even the person who started off with no other expenditure at all, in the end, once the grant is spent, only costs government R76, if he has the average consumption pattern, rather than R100, for the simple reason that R24 is recouped by government in VAT and other taxes (See Chart 1).

This net cost after having spent the benefit, constitutes the actual cost of every grant to the fiscus – this is the additional resources that have to mobilised to pay the grant out. When we multiply each net cost with the number of people at that level and add it all together (again excluding the more than 5 million already entitled to child grant or already receiving an old age pension), we find that the net additional burden for government is only R15.2 billion, as it would also have been if we could in practice directly have implemented the negative expenditure tax formula presented below, instead of going the round-about way of paying grants and recouping them by tax increases. (The net cost and the net benefit are equal to each other because in the simulation model used here the Vat and other indirect taxes were adjusted until the additional net income they would bring in for government would be equal to the additional net costs of the grant).

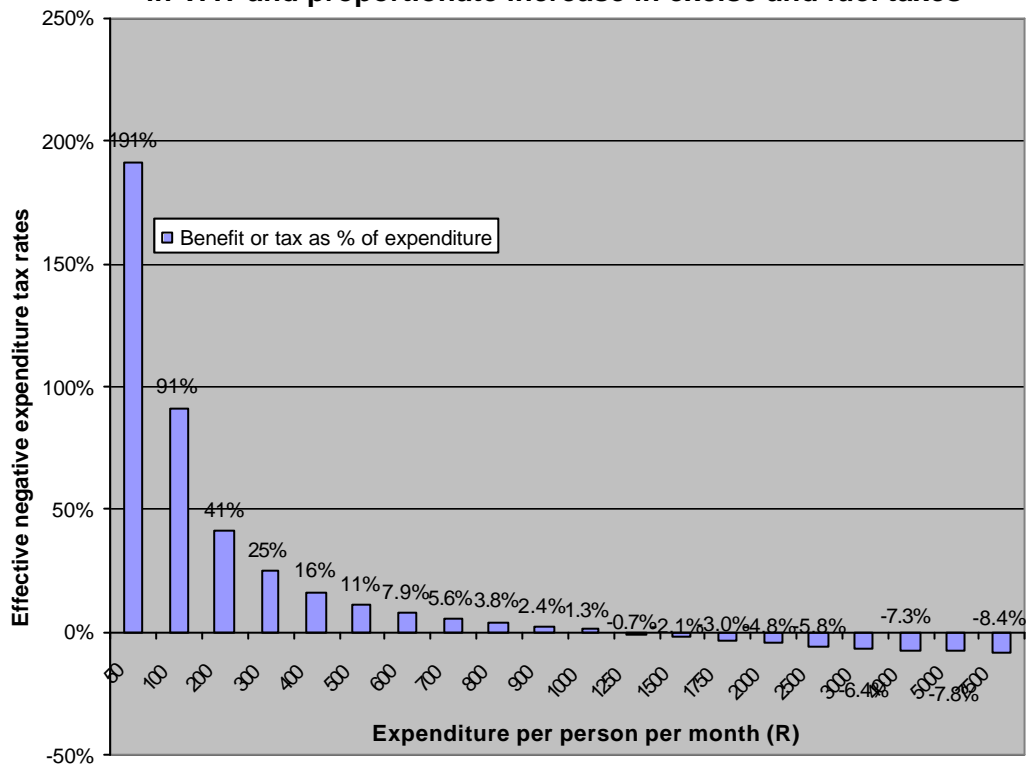
Although VAT by itself is a regressive tax because the poor spends more of their income than the wealthy, the net impact of earmarking a VAT increase (or a VAT decrease foregone) for a universal income grant for everyone has the impact shown in Chart 2 – the further one's expenditure is below the break-even point, the larger the net grant one receives in both absolute and relative terms.

The net effective tax burden will also increase from very low levels reaching about 8% with an expenditure of R5,000 per person per month. Although a range of indirect taxes has been increased by a half, the more than 80% of the people who had an expenditure of below about R1080 per person per month will be better off, if, of course, they receive the R100 grant and have the average consumption pattern.

What is in fact happening is that more than R15 billion is being redistributed from those above the break even point to those below this point. For those close to the break even point the benefit and burdens are low. It is primarily the more affluent, with high incomes, that pay a monthly grant or remittance to the very poor. Such a payment of a monthly remittance is not something new in South Africa, but up

to now it has often been those with relatively low incomes, who manage to get formal sector employment, that had to pay significant remittances to even poorer relatives. This new system ensures that the brunt of the cost of support for the poor is carried by the more affluent, and that the poorest benefit most, regardless whether they are fortunate to have a relative in formal employment or not.

Chart 2: The Progressive impact of a R100 BIG financed by a 7.4% increase in VAT and proportionate increase in excise and fuel taxes



From an analysis of the impact of this system (See Table 3, and Charts 1 & 2) it seems reasonable to conclude that, after the initial jump of 10% in price levels, there will be only very limited inflationary pressures when we have a 7.3%- 7.8% increase in VAT and a proportionate increase in other indirect taxes together with a grant payment of R100 to all South Africans. After all, the position of four fifths of the population will improve rather than worsen, in spite of the once-off increase in prices when taxes are increased.¹⁸

¹⁸ If the grant and tax increases are introduced simultaneously, it will be clear that the vast majority of workers are in fact better off, and this would mean that there should not be broad pressures for

4.2.3 The problem of targeting a grant by increases in income tax

It was argued above that the net burden of financing a grant out of income tax will be at least double that of a grant financed out of increases in indirect taxes. The reason for this higher cost of an income tax is that higher net benefits are paid out – part of the grant is not necessarily recouped by income tax increases, even if a person's income and expenditure goes up. Those who live off dividends (on which no income tax is paid) as well as the large number of people active in the informal sector, and the far too many involved in illegal and criminal activities, and also those individuals in the formal sector with incomes below the tax threshold, will all get the full benefit of the grant even though they may have monthly expenditures of as high as a R1000 or even R2000 or more per month. For these people, the scenario of paying for the grant out of income tax increases is much to be preferred to one where the grant is paid for out of increases in VAT and excise and fuel taxes, for they will all get exactly the same net benefit as those who have no expenditure at all.

The problem of financing a universal income grant out of increases in income tax, is that this does not guarantee vertical equity (richer people living off dividends get the full benefit of the grant, whereas poorer income earners with big families pay back part or all of the grant), nor horizontal equity (people with the same income in the informal sector get the full benefit of the grant, those in the formal sector have to pay back a large proportion or all of the grant).

There is, of course, a greater net benefit when the income tax route is chosen, far more people get the full benefit of the grant – and correspondingly a greater burden too, but this benefit is not well targeted to deal with the depth of poverty – people with high monthly income and expenditures could well get the same net benefit of R100 as those with no expenditure at all.

If we should decide that society should be willing to accept the net additional tax burden of at least R25 billion imposed by a R100 grant that is recouped by income tax increases, we could for the same net burden afford a grant of about R175 and recoup it by increases in indirect taxes. A R175 grant thus financed would clearly mean a much larger net grant for the very poor, but many of the better off who do not

increases in wages. However, more work needs to be done on the impact of the increase in fuel prices etc. to be confident of this conclusion.

pay income tax, but who cannot avoid paying income tax, would be worse off under such a scenario. Those in destitution will in fact, for a given tax burden, always benefit more from a grant targeted by increases in indirect taxes, rather than from a grant financed out of increases in income tax (see le Roux, 2001).

4.2.4 Unintended but not necessarily undesirable consequences: Giving Ms Clean Living Green a higher net benefit.

Let us return to our highly efficient and omniscient bureaucrats, and assume that they, in spite of strenuous objections by the anarchists from the left, decide to favour clean living individualists of all persuasions.

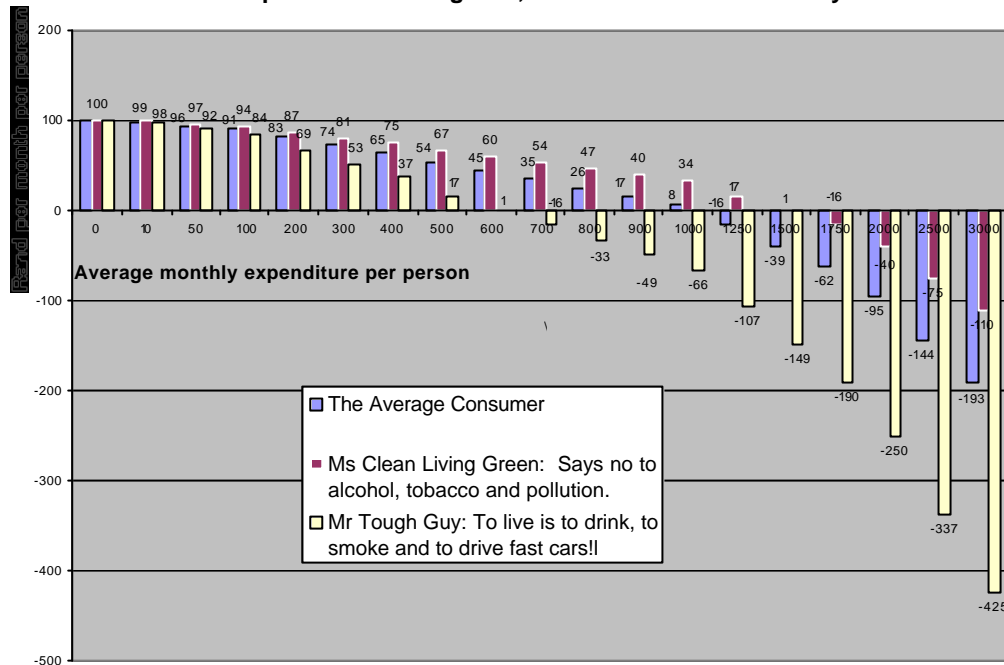
Although everyone with zero expenditures get a R100, the non-drinking, non-smoking and non-petrol consumer has her grant decreased by less than 7% with increases in expenditure, which means that these individuals keep on getting a net grant up to a monthly expenditure of about R1500 (rather than the decrease of more than 9% and a about R1080 break-even point which would apply to citizens with the average mix of sins).

The heavy drinker and smoker who also drives around in a gas guzzling car, is severely penalised. His grant, which is also R100 when he has no expenditures and therefore cannot sin, decreases by about 17%, so that he already starts paying tax instead of receiving a grant at an expenditure of about R600 a month! What is more, not only does he start paying tax at a much lower threshold, but his tax increases at a rate of 17% per month instead of the 9-10% of the ordinary taxpayer, and the less than 7% of his green and clean living neighbour or partner. (See Table 4 for the precise levels of rates of tax implemented on the different types of consumers at different levels of expenditure).

The bureaucrats vigilantly monitor ones behaviour from month to month – when the sinner decides to live cleanly, he immediately gets rewarded, and when Ms Clean Living Green sins, she is immediately punished. The direct expenditure tax at rates presented in Table 4 above, is implemented on every individual. In fact, there are a whole continuum of different tax rates between the very high tax rates applicable to Tough Guys and Galls and the very low rates applicable to Mr and Ms Clean Living Green. Our omniscient bureaucrats, knowing exactly what mix of sinful and

approved expenditures each individual has, applies the specific rate applicable, and pay out a net grant or levy a net tax accordingly.

Chart 3: Discriminatory net benefit of a R100 Grant
The impact of increasing VAT, the sin taxes and fuel tax by half



Exactly what has been described in the preceding paragraph, will in fact happen automatically, without knowing any individual's pattern of expenditures, if the grant is financed by increasing VAT, excise taxes and fuel taxes by half (see Chart 3). The reason for this moralistic bias of such proportionate increases is that the excise taxes and fuel taxes are already much higher than the ordinary VAT rate, and a 50% increase in them would thus impose a higher additional burden than merely a 50% increase in VAT. This would thus penalise those who disproportionately spend on these goods – and the more they are inclined to spend on the goods which our Minister of Finance has burdened with high sin taxes, the greater the effective expenditure tax they face. (Exactly how bad the impact for Mr Tough Guy would be, depends on how tough he is, but at worst it could be about as bad as is shown in Chart 3). Those who have no expenditure on any of these goods, will on the other hand, receive a much higher net grant up to a much higher level of expenditure, and will pay a lower effective tax rate once past this high break even point.

When I proposed the across the board proportional increase in all indirect taxes in July last year (see Le Roux, 2001), the intention was to fund a universal

income grant without having to increase VAT too much. I only noticed that this would favour Ms Clean Living Green and punish Mr Tough Guy when I was experimenting with the data for the BIEN September 2002 conference in Geneva (see Le Roux, 2002).

Given the often expressed fears that many will misuse the grant by wasting it on alcohol and cigarettes, this is clearly a significant finding. The net impact of the proposed increases in indirect taxes and the universal grant is that it will recoup money from all the Mr Tough Guys and Ms Tough Galls, except for those who have an expenditure less than R600 per person per month. Some may complain that Calvinism was resurrected in the paper I presented in Geneva (Le Roux, 2002). The consequence of financing a BIG out of a proportional increase in indirect taxes, is that one of key objections many raise to a universal grant is dealt with very effectively.

5 The Dynamic Consequences of an Income Grant

I have shown that a universal income grant financed out of VAT, excise taxes and the fuel tax would have exactly the same impact as a negative expenditure tax. The net impact would have been such that the additional tax burden would have been about R15 billion. This should have a very significant impact on in helping to counter extreme poverty. Both its poverty impact and its dynamic impact on the economy will be similar to the existing old age grant, of which the net cost in 2000-2001 was about R11-12 billion. With regard to poverty, the important difference is that all impoverished individuals will benefit from this, and not only the about one quarter to one third of people who have close links to those receiving old age grants.¹⁹

This paper has shown that an income grant financed out of indirect taxes is identical to an expenditure tax on those above the break-even point and to a negative

¹⁹ With regard to the old age grant system the White Paper (1997:49) remarked: “The impact of a grant income on household income for people in poverty is dramatic. The majority of people in poverty who are not white live in three-generation households and the grant is typically turned over for general family use. In 1993 there were 7,7 million people that received a state grant. For black South Africans, each pensioner’s income helped five other people in the household.” Impressive as these statistics are, one should realise that there at least double as many very poor people who have no link at all with those receiving old age grants. About one quarter of all poor households contain a person with an old age grants, and at best about a third of all poor people can get some support, often at very low levels, from people receiving old age grants. The old age grant system has a massively positive impact on those households where there are recipients, but far too many poor households are excluded from these benefits.

expenditure tax or progressive anti-poverty grants paid out to those below this point. Such a tax should not cause any serious economic distortions. There is consensus in the literature that an expenditure tax is far less distortionary for an economy than an income tax. As indicated in the discussion above, and as can be seen from Chart 2, the average effective tax rate increases from one of 2.1% on a R1500 per person per month expenditure, to one of 6.4% at R3000 a month, to over the 8% per person monthly expenditure exceeds R7000.

The assumption we made when calculating these rates was that those who benefit from the grant would spend the entire grant, whereas those who have to pay an additional tax, would cut back on their savings, and maintain their expenditure at the level it was before the tax. Given the levels of income and expenditure tax increase, it can be argued that this is quite a reasonable assumption. On the other hand, one may also find that at the higher expenditure levels there is some cut back in the level of expenditure, which would then mean that a further increase in indirect taxation will be needed to find the funds, which could lead to a further reduction in expenditure levels. But even if the better off keep their expenditure level constant, this would mean that VAT will have to increase by 7.8% rather than 7.3%. The net burden this tax would impose on the rich will, in the latter case, be somewhat less than with the lower rate, but there the deadweight losses will be higher.

It must be kept in mind, though, that these calculations were made for illustrative purposes, and, as was stressed at the outset, it is not proposed that the grant should be implemented by implementing these increases. Instead it was proposed above that there should, during the next three years, be no further income tax reductions because of increases in the efficiency of tax collection. Instead we should earmark this additional funding for the universal income grant (for, example, by raising the age at which the child grant is paid out and paying out more child grants in the mean time). In three years time, a 4% to 5% increase in VAT and a proportional increase in the other indirect taxes will then suffice to pay for this grant.

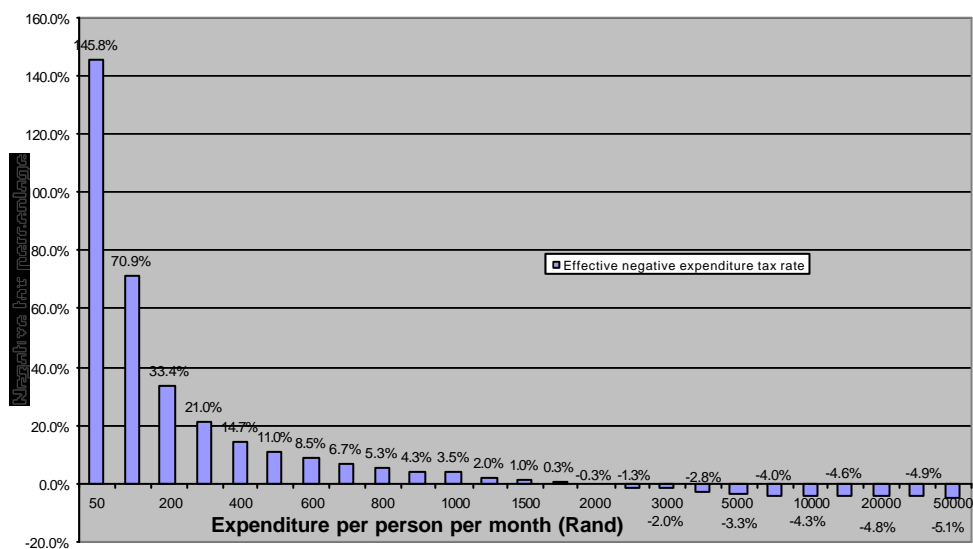
As is clear from Chart 4, this would mean that the average consumer would only start carrying a net tax burden at R1750 per person per month expenditure, with an effective tax rate of about 2.8% at R4000, and a maximum of about 5% reached at the extremely high rates of per person expenditure of R20,000 per month.

It is possible that the redistribution of R15 billion in saving from the affluent to the poor will stimulate the economy, partly because of the different composition of

expenditures by the poor, and partly because of the macro-economic demand effect of a somewhat higher level of overall expenditure. In my mind there is no doubt that the demand at the local level will stimulate local development, as in fact is already happening as a result of pension payouts in the rural areas. It is, however, more difficult to prove that the overall economy will be stimulated by such a redistribution. Some would argue that the increase in effective demand would provide a Keynesian stimulus to the economy. Others would contend that the resulting lowering in savings would lead to higher interest rates and lower investment rates. Different economic models, with different assumptions, will reach diametrically opposing conclusions.

In addition to the possible positive macro-economic consequences because of the stimulus of the local economy, this type of grant could, if cleverly introduced to the different sectors of society, also lead to an increase in confidence in the long term in the South African economy. If probably implemented, it could create an all round perception that government, in contrast to the governments of most developing countries, is very effectively and innovatively dealing with extreme poverty and destitution. A factor that is often regarded by investors as a potential long term threat to the South African economy (the apparently intractable problem of dealing with extreme poverty and destitution), will now disappear from their radar screens.

Chart 4: Effective negative expenditure tax rate of R100 BIG combined with 4% increase in VAT and a proportional increase in other taxes.



In the end the impact of the introduction of an income grant may depend more on how it is perceived by the poor, by the investors and by the workers, than on economic factors such as its potential demand stimulus or its potential impact on savings and investment. As has been so clearly illustrated by one of the winners of this year's Nobel Prize, Daniel Kahneman, economic theory often makes incorrect predictions of how people will behave. How this grant is presented and implemented (what Kahneman would call the framing of the proposal) may in the end be more significant in determining its impact than any of the factors that economists traditionally consider to be important. Insights from cognitive psychology may well be of greater importance in predicting the outcome of this policy option, and in providing insights in how it is to be introduced, than what the conventional economists would be inclined to admit.

The grant could, if correctly framed and implemented, also have an impact on crime levels. By this it is not meant to imply that many of those who make a living from crime will reconsider their life style once a universal grant is introduced. However, their ranks may not expand at the same rate in the future as it has in the past. The desperately poor will no longer be in the situation where they can at times only survive by resorting to petty crime. Once this first step into criminal activity is taken, people who otherwise might have been productive citizens slowly but inexorably move into a life style that they themselves would not have chosen at the outset.

The introduction of the required delivery system for the payment of grants, will also deprive many criminals from one of their most lucrative trades: cash heists. Once electronic money, carried on a smart identity card protected by your fingerprint and a pin number becomes the norm – as will have to happen if the income grant is to be distributed effectively – the opportunities for cash heists will rapidly diminish. South Africa would jump into the 21st century faster than most, with electronic money becoming the norm. Crime will not pay the same high dividends, as is presently the case, and will lose much of its glamour.

The evidence is unambiguous that the successful introduction of a universal income grant will deal effectively with destitution and will significantly reduce the poverty gap. All other predictions about the impact of the grant are in the realm of speculation. If the policy is correctly framed and very efficiently introduced there is

every reason to expect, though, that it could have a markedly positive impact on the economy.

But even if the introduction of a universal income grant financed as here proposed does not have any of the other possible benefits here foreseen, there is no doubt that it will move many millions of people out of destitution. In a country such as South Africa, where those in the top quintile live so well, this in itself is in my view a sufficient justification for the introduction of a universal income grant.

6. The Universal Income Grant is an essential element of any anti-poverty strategy.

In the South African context a universal income grant is not simply a possible alternative strategy for dealing with poverty. If we are truly committed to eliminating extreme poverty and destitution by 2015 and to half the number of people in poverty, this is the only route by which this goal can be realised. By this it is not meant that a number of other strategies such as small and micro-business, skills development and public employment projects cannot also play an important role, but they cannot within this period change the face poverty as dramatically as a low level income grant could. Some of these projects have also, up to now, been singularly unsuccessful in delivering what has been promised. (See Van Broembsen,2002, for a critique of the small business strategy).

Given the fact that a South African universal income grant, if it is not to harm future economic growth, will have to be somewhere in the R100-R150 range in terms of 2001 prices, this means that the grant will not be able to wipe out poverty. But the poverty gap should be brought down significantly (see Samson et al,2002).

The grant will rectify some of the terrible consequence of income poverty – as evidence in the case of the Old Age Grant has amply demonstrated, there should be a marked impact on levels nutrition (Duflo, 2000) and clearly more people will be better dressed and better housed. But it is not only income poverty that will be addressed. Capability poverty, which is at times the consequence of bad nutrition, and often the result of inadequate schooling and training, will, if the evidence from how the old age grant is being spent is anything to go by, also be tackled. What is more, those who are unemployed and far from centres of employment will now be able to afford the transport to actively search for work. And those who are engaged in

small business activities or aim to establish themselves as small farmers, will be able to address asset poverty – they will have a regular monthly income (which can be R500 in the case of the average black household) which can serve as security for entrepreneurial activities.

Public Works programmes if well run could be very important in eliminating poverty in households where there are some fortunate enough to get such employment. However, in the foreseeable future it would be a massive task to provide 200,000 such job opportunities. Skills training, if well run and if the skills are provided in jobs where there are actually opportunities, can also have a significant impact in the case of some households, but none of these two options can have such a wide reach as a universal income grant, and none of them can be as well targeted to benefit those in destitution as an income grant financed by increases in indirect taxes. Many of the programmes being run under these two rubrics can be shown to be very costly and ineffective, given their objectives, and they should be revamped or discontinued. The more successfully programmes should be expanded as rapidly as is possible. However, they will not be able to deal with more than a small part of the problem. They should be seen as compliments to and not substitutes of a universal income grant.

Although the “efficiency in dealing with poverty” argument for a universal income grant is also made in the case of Europe and USA, the expectations there are of a grant “sufficiently high to live at what might be considered the no-frills respectable economic level” (Wright, 2002:5). There the prime concern is not to deal with poverty, but to realise philosophical and political goals.

The main argument for UBI is founded on a view of justice. Social justice, I believe, requires that our institutions be designed to best secure *real freedom* to all (Van Parijs, 2000a:7).

“... the position proposed here is that a basic citizenship income is justifiable on the basis of two principles Each person should have equal opportunity to pursue a conception of the good life. ... Each individual should have an equally good opportunity to pursue his or her idea of occupation” (Standing, 1999:357).

A generous, unconditional basic income which would allow employees a meaningful exit option from the employment relation directly transforms the character of power within the class relations of capitalist society (Wright, 2002:7).

In the South African case it is not possible to afford a grant anywhere close to the levels envisaged in these quotes. Nevertheless, even at this low level, the grant will have some social justice benefits and will also have some impact on the class struggle. In spite of the minimum wage legislation there are undoubtedly still many domestic workers who are working for only a couple of R100 a month – something they simply have to do if they have children and have no other support. Once a universal income grant is available, the decision to work for a wage, will be a decision about which there is some choice. “Capitalism between consenting adults is much less objectionable than capitalism between employers and workers with little choice but to work for wages” (Wright, 1999:15).

The Child Support Grant also targets many of the poorer households. However, it does create a poverty trap, as we have indicated above, it does not offer more help to the poorest children and it arbitrarily excludes children older than six, at a stage when the cost of getting to school and being dressed for school needs to be faced. To extend the Child Support Grant to all children under eighteen would do away with many of its problems. It cannot, however, be so well targeted as grant proposed here. In poor households the grant is in any case also used for the survival on adult members who are struggling, and a child in a very poor household does not get at all the same benefit as one with a mother who just meets the requirements of the means test, but find herself in a household where there is employment and/or old age grants. It will not be possible to recoup such a grant by increases in indirect taxes, because that would place a net burden on many poor people not attached to children. Nevertheless, from the point of view of targeting poverty the Child Support Grant is the second best alternative to a universal income grant financed by indirect taxes. There are also very significant costs and inefficiencies associated with the means test, which is often implemented in a way that exclude those most in need. Until it is possible to deliver such a universal grant effectively, the best strategy in combating poverty will nevertheless be to extend the existing child grant by pushing up the age limit and simplifying the means test.

7. The delivery of the Grant

At present there are about 11 million households and 44 million individuals in South Africa. Although everyone is entitled to a separate universal income grant, children will not receive the grant directly, but will have it paid to their care-giver. The others in the household could also opt that their grant should be paid to the care-giver, but many will, of course, claim the grants separately. This would mean that monthly probably about 20-25 million payments will have to be made. This figure is more than 10 times the number of pensioners being paid each month, and even if all the children entitled to the Child Support Grant were receiving it, this would nevertheless a four to five times increase in the number of payments that need to be made per month.

The administrative and logistic problems that will have to be faced will be immense. How does one ensure that only South Africans and those who are permanently registered in South Africa receive the grant? How does one make sure that one does not have double or triple to the same person, who may even be claiming in different but adjoining provinces for the grant? Monthly up to R2.5 billion will have to be paid out as grants. Given the large number of heists that are already taking place, it is to be expected that this will lead to further unwanted interest from criminals?

Given the fact that the net costs of the grant itself would amount to only about R15 billion, even though the gross additional payments will exceed R45 billion, the question of what the delivery costs will be, are quite crucial to the viability of the project. A 20% cost on the gross additional grants would amount to a cost of about R9 billion, which would mean that the money paid out to the institutions delivering the grant would be more than half the net benefit people receive. This would undermine one of the strongest arguments for a universal income grant – viz that it reaches those most in need of help rather than, as is so often the case, to go to the middle men and women who are supposed to help the poor.

Eventually the cost of delivery may not constitute a serious problem. Once every South African has a Hanis smart card as an ID card, it would be possible to register people for the grant at any financial institution by using this card combined with a fingerprint reader. It will be possible, I have been assured by those in Home Affairs responsible for this project, to control centrally that no one registers more than twice. (It is not clear yet, though, what is to be done in the case of children under 16, who will not have a Hanis card – should the age for registration be extended

downwards. Of course, children will not be able to claim, but before they payments can be made to their care-giver, there has to be a system of registration which can avoid dual or triple registration). In the end every South Africa will have to have a Hanis card if this system is to work. In the case of young children, footprints may have to be used instead of fingerprints.

The Hanis card will also have a wallet and facilities for debit and credit cards. Now if every spaza shop even in the remotest areas should acquire the machines which can read fingerprints and connect with a bank (even by using solar electricity combined with dynamo systems, and communicating via the cellular phone system), it may be possible to make the payments electronically. As is envisaged in Nepad, South Africa will have to jump the digitally divide and move in to the era of electronic money very rapidly. Monthly, on the day that the claimant has his or her birthday, the electronic money can be downloaded – and kept electronically on the wallet or use for purchases – with the fingerprint protection in addition to a pin number being afforded to whomever would so prefer.

This system would take massive initial outlays, but once it is in place, it should be able to deliver the grant at a cost not more than 5% of the gross amount, and possibly at one as low as 2 ½ %.

At the moment much of this sounds like science fiction, but those in the know in the Reserve Bank and elsewhere argue that this all is already possible today. What would be needed before government could seriously consider the introduction of a universal income grant is to have an depth investigation of the future options available for the effective delivery of a grant. Only if it can be shown beyond all reasonable doubt that this can be done, can it commit itself to what otherwise seems to be the ideal policy measure to deal with destitution and poverty.

8. The reasons why this type of system has not yet been implemented in any other country in the world.

South Africans often ask why we should opt for a universal income grant when no other country (except for the state of Alaska, and then for reasons unrelated to poverty issues (See Goldsmith, 20020)) have opted for such a programme. Even one of the major proponents of a BIG, Philip van Parijs (1995), have argued that developing countries cannot effectively implement a universal grant, and should rather opt for a more limited means tested targeting.

In Europe there has been strong pressure for a universal income grant. However, because of the existence of social assistance measures which ensures that everyone there lives above the poverty line, serious proposals to adopt an income grant because of the fact that it does not create poverty traps as the existing systems do, have had to be rejected on cost grounds. For example, as Anthony Atkinson (1973:8) pointed out when the Meade Commission's proposal that the UK should opt for a universal income grant financed by increases in VAT was rejected:

The problem with introducing such a scheme in Britain is that the introduction of a social dividend guaranteeing an income at the level of the present supplementary benefit scale would involve a substantial cost. According to the estimates given in a recent article by Meade, for example, the basic rate of tax would have to exceed 50 per cent. (J.E. Meade, 'Poverty in the Welfare State', Oxford Economic Papers, November, 1972, pp.289-326. This, and other considerations, led the government to conclude that 'a complete merger of income tax and social security – whatever its theoretical attractions – is impracticable'

What I find strange is that no one, in the wake of the Meade report, seems to have investigated the potential of grants below the poverty level in the case of developing countries. What is more, if my memory serves me correctly, the report did not show that the combination of a grant plus VAT increases effectively targets the grant to benefit the poor and tax the rich. Because of this, no one seemed to have drawn the conclusion that the strategy suggested may be suitable for developing countries, even though the grant level would have to be well below the poverty line. The assumption is, as is evident in van Parijs's conclusions, that developing countries cannot afford to have grants that are not targeted, and that the only method by which they can be targeted is by the traditional means tests implemented welfare departments.

At the moment the European country which seems to be taking the idea of a basic income most seriously is Ireland, where a Greenpaper on this issue has recently been published (see Healy & Reynolds, 2002). However, again the cost factor is militating against the grant being accepted in practice.

In the South African case, because there is no pre-existing system, a grant of R100-R200 is acceptable also to the left, even though a R100 is about one quarter to one sixth of what should be a minimum poverty line. Most people realise, as also can be seen in Chart 2, that this will significantly improve the situation of the many

millions of South Africans in the four deciles.²⁰ Had there been insistence here on a grant of R600, it would have been necessary to push VAT up to a level of 48% to finance this expenditure – an increase which would lead to a very high tax even on those in relatively low expenditure categories (See Chart 5). It would clearly not be possible to implement this type of tax increase without very negative consequences of the economy. What is more, although the people with low expenditures will get a net grant of close to R600, more than half of this would go back to government once they spend it – it will effectively still leave many people well below the poverty line. South Africa is not yet caught up in the European system of high minimum grants, and has the option of going this more rational alternative route of providing a lower grant that can wipe out destitution, and will significantly reduce the poverty gap.

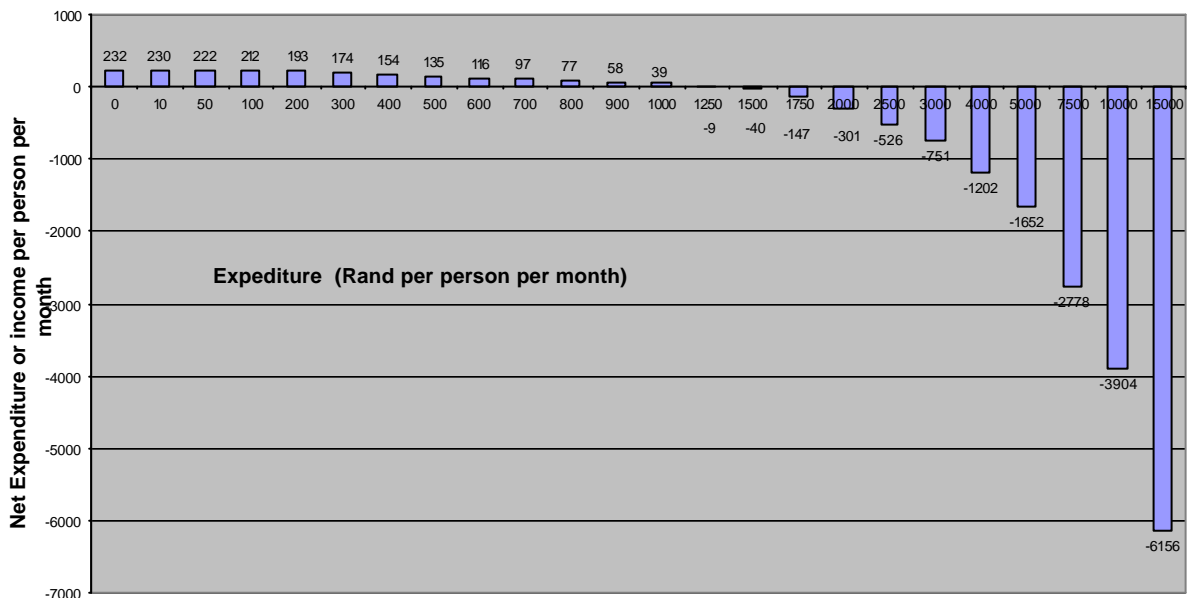
For two reasons we are in any case not likely to go the European route in future. Firstly, even if government were inclined to opt for the European type of solution of a means tested grant for all, the scale of the problem is such, with so few people being in the formal sector and so many either unemployed or in the informal sector, that it would simply be impossible to implement the type of means tested targeting the north European social assistance options require. Even a much larger and more efficient welfare bureaucracy than what one has in the case of Europe, will not be able to cope with the problems these countries have to face. Secondly, our government has expressed strong reservations against dependency creating grants. Unfortunately because of the fact that the option of properly targeting a universal income grant has not been put to government, this sentiment has also lead to a blanket criticism of universal income grants, regardless of how it is financed, but once the nature of a well-targeted universal income grant is fully understood, this is a sentiment that would lead to support for option of a universal grant financed by increased in indirect taxes.

In the sixties, when Friedman first proposed his negative income tax, there was an alternative proposal that the USA should rather go the route of paying a universal grant and fund it by increases in the VAT. Again, however, there was no explicit discussion of the fact that this would in effect mean a progressive grant for the poor below a break-even point and a progressive expenditure tax for the affluent. These proposals never seemed to have entered the main stream discussions, though,

²⁰ Those who reject a R100 per person per month as paltry (“Why bother about this, it is peanuts?”) are out touch with the situation of the poorest 25% of our population.

possibly because of the fact that the Supreme Court have decreed that it would be unconstitutional for the Federal Government to implement a VAT tax. (When direct taxes were still restricted under the US Constitution, the problem was circumvented when the Supreme Court “obligingly declared the income tax to be an indirect tax” (Atkinson, 1977:591). Although there is surely a stronger case to argue that VAT is not a sales tax, the Supreme Court has this time not engaged in “the economics of clever lawyers in a tight place”(ibid.) to get VAT accepted as a Federal tax. As a consequence the route proposed in this paper cannot be taken in the USA.

Chart 5 Net government expenditure and income per person of a BIG of R600 with a VAT increase of 34% and a proportional increase in other indirect taxes



A negative income tax, or what was effectively a progressively higher grant or tax credit the lower household income, as proposed by proposed by Milton Friedman, was seriously considered in the USA and also got much attention in the UK. In most proposals it was again pitched at a level high enough to ensure that the recipients would be above or close to the poverty line. This made it very expensive, and also lead to a reduction of work effort by some recipients (particularly the spouse, although at the same time it lead to an increase in the participation rates of African American men) in the extensive experiments that were conducted. In the end the concept was modified, and the USA opted for an Earned Income Tax Credit (see Standing, 1999:306-307). The income tax rules were amended to require government

to pay an annual credit according to a specific scale to low income earners who have a child or children. This has become a very important method of enhancing the income of the poorer households in the USA. A similar system (Working Families' Tax Credit) was adopted in the UK, where the requirement that there must be children in a household before the grant is paid out, will soon be scrapped. France also recently opted for a similar approach when Prime Minister Fabius introduced the *prime pour l'emploi*.

These countries have all accepted the arguments of Friedman and other economists that traditional means tests create poverty traps, and have opted to help the poor in a way that will not discourage them from also doing something for themselves. Particularly in the United States the Earned Income Tax Credit has led to a very significant redistribution of income to the low income earners in a way which does not punish initiative by the poor themselves. These measures do not, however, address poverty when people are unemployed. It would, for this reason, not be sensible to introduce a similar system in the South African context. Here, because of our much, much higher rate of unemployment, most of the really poor families do not have anyone in formal employment, and they will thus not benefit. A system like this would give support to those who are already relatively better off. It is thus not a system which can be contemplated here.

The alternative proposed here is particularly suitable for developing countries with high income inequalities²¹, with an efficient indirect tax system, and with the ability to develop the systems to deliver this grant **only** to the citizens of the country and other permanent residents. One of the reasons why the possibility to target support for the poor by a universal income grant financed out of an increase in indirect taxes has not been properly investigated before is surely that very few countries combine these characteristics. In fact, it is only recently, with the development of the smart card which can contain biometric details of every citizen, and can also include a wallet, that this type of system can be seriously contemplated. South Africa and Brazil are probably among the few countries where these conditions

²¹ It is essential that there must be a sufficient number of high income earners in the top three household deciles to make it possible to finance a grant which can address destitution by relatively moderated increases in indirect taxes. In a country such as Rwanda calculations I have done shows that one will at this stage of its development have to have a very high increase in indirect taxes (because of the small base of high income earners) in order to raise sufficient funds to pay a meaningful grant.

are met, and it is thus not surprising that these are the countries where the option of a universal income grant is now on the agenda.

Even in these countries it will require a very concerted effort to effectively implement this type of system. But that puts an additional obligation on South Africa to consider taking up the pioneering task of introducing this system. South Africa is one of the few developing countries that has the communications infrastructure and the technical know-how needed to jump the digital divide and put in place the systems needed to deliver electronic money effectively even in the deep rural areas. We already have a relatively efficient Revenue Authority in place. The proposal I have put forward in this paper is in line with government's intention to deal effectively with poverty and it is complimentary to NEPAD. South Africa has a unique opportunity to implement a very innovative and effective social security system that can eliminate destitution over night. Clearly more work ought to be done before South Africa commits itself to this option, but this is an option which in our context justifies very serious attention.

9. Summary

This paper has argued that there are a number of reasons why it is important to understand the equivalence of a universal income grant financed combined with an increase in indirect taxes with a directly imposed progressive expenditure tax on individuals above the break even point and a progressively larger antipoverty grant below the break even point. Firstly, it is then easy to understand that the actual burden imposed by a universal income grant and the eventual benefit received if the grant is combined with indirect tax increases is only one third of the gross cost of the payments made. Secondly, it can be clearly illustrate, once one considers the net impact, that it is progressive – the affluent progressively pays more, and the poor progressively benefits more. This in spite of the fact that Cosatu and the BIG alliance rejected the financing of the grant out of indirect tax increases, on the basis of the argument that this would be regressive (an objection which would be true if one looks at indirect tax increases by themselves). Thirdly, it has been known for many years that an expenditure tax increase is far less likely to distort the economy than increases in income taxes or company taxes. Fourthly, for the very same reason put forward by Friedman in defence of his negative income tax, the progressively larger grants for those with lower expenditure (or the negative expenditure tax) is far

less likely to create a poverty trap than most means tested grants. There is no doubt that the old maintenance grant created dependency, and that the existing Child Support Grant also gives perverse incentives, but a universal grant is far more likely to be a springboard rather than a trap. Finally, a grant paid out to individuals (except in the case children, where the payments are made to the care giver) where the net benefit or burden of the proposed grant combined with indirect tax increases depends on expenditure rather than on family or household income, is in fact targeted to be of greater benefit to those within households, often the mother and the children, who often receive a relatively small proportion of family income.

Given the recent technological developments it might soon be possible to implement the system here proposed. It would be sad if South Africa should not give more serious consideration to this historic opportunity to be a pioneer because it feared dangers of dependency in the case of grant which ought to be springboard for development, and because it worked with gross costs, and failed to understand how well a grant financed by indirect taxes can be targeted to benefit the poorest most.

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