

3rd Workshop: Design and Financing of Social Programs, LSE, February 27-28 2012

The third workshop on the Design and Financing of Social Programs was held at the LSE at the end of February 2012. This event was sponsored jointly by the LSE Asia Research Centre and the International Growth Centre. Since the last meeting in August 2011 there have been three main developments:

- Completion of the paper on Mexico by Santiago Levy and his colleagues: “End of informality in Mexico?: fiscal reforms for universal social insurance;”
- Completion of a general paper by Ahmad and Best, building on Santiago Levy et al, and laying the basis for the cross-country empirical and theoretical work to follow;
- Preparation of terms of reference for empirical case studies: Pakistan (IDEAS/ARC), Indonesia (JICA), Argentina and Brazil (CEPAL); and discussion of possible extensions to Middle Eastern and Southern European cases.

Ahmad and Best corroborate many of the insights of the Santiago Levy paper in their more general formulation. However, they focus on the tax design issues and show the interactions between taxes in handling informality. While VAT remains a mainstay of the tax system, its design matters. A simple VAT, with moderate rates, would generate information that could be used to enhance the probability of detection of informal activities. The interactions with the corporate income tax (CIT) are important, and again the design of the CIT matters. The income tax plays the major role in redistribution. But the main feature, reflecting the work by Levy, is that “holes” in the VAT for distributional purposes seldom provide adequate protection for the poor, lose revenues, generate incentives for rent-seeking and corruption, and more importantly lose the information needed for better tax administration. Ahmad and Best also make a case for a limited role for the payroll tax or defined benefit insurance contributions, in providing benefits for formal sector workers.

Ahmad and Best also corroborate the Levy contention that social policy can provide compensation for the poor and vulnerable (urban) middle classes who might be adversely affected by the tax reforms. Excessively targeted benefits may not provide such protection, and also opens up the possibility of “capture and clientelism.” In multi-level countries, intergovernmental transfers may also play a role in the “political economy” of facilitating the passage and implementation of a package of

reforms. These features are clearly important in the Pakistan context, and an agenda of reforms was laid out by Ahmad, Best and Channa—this formed the basis for discussions with the Cooperative (Haris Gazdar) and IDEAS (Reehana Raza and Anjum Nasim).

Dr. Izuru Kimura (JICA) presented the Indonesian case. Again, the subnational level design issues predominate. A case is also made for Indonesia to make better use of its demographic bonus and enhance growth to prepare for an ageing of the population. The Indonesian Ministry of Finance subsequently endorsed this proposal later in March, when Dr. Kimura and Ehtisham Ahmad visited Jakarta. Collaborating agencies are being contracted by JICA.

The subnational perspective was also central in the other Latin American cases presented by Juan-Pablo Jimenez (CEPAL) and Giorgio Brosio (Torino). Again, the work is just beginning and collaborators in the countries have been contacted.

A parallel research agenda (by Jose-Luis Viveros, ZEF) on the state of Chiapas in Mexico also raised some interesting issues about the incentives of local officials to devote less of their resources on social protection issues than would have been the case if they had full responsibility for Oportunidades. While the program is seen to effectively provide minimum benefits, overall effects are less clear. Financing issues are seen to be important. The research is aiming to address these issues jointly for Chiapas, and will be a useful supplement to the Levy assessment.

Distortions can also come about through an inappropriate design of social benefits—as seen in some GCC countries—where the minimum wage for nationals acts as a tax on employment of nationals borne by the employer. Rosalia Vazquez-Alvarez (Dubai Economic Council) provided a wide-ranging review of the issues. With fragmented labour markets, the issue of informality looms large in the Arab countries, as the effects of the rising levels of unemployment and the demographic bulge begin to have repercussions.

In a similar vein, both inappropriate levels of benefits, as well as holes in the tax system, plague countries in Southern Europe—and Greece would be a good case to examine. Alex Mourmouras presented a theoretical assessment of informality and corruption that nicely encapsulates some of the issues that are relevant across countries.

In sum, the project continues to make progress—with case studies, integrated modeling and policy assessments. The next meeting will likely take place when there are more empirical and policy assessments for specific countries in the study, likely later in 2012.