

# Expert Panel on Basic Income Support

## Supplementary Modelling Report

13 December 2022



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# Overview

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# The Modelling Team

- **Prof (adjunct) Alex van den Heever**: Panel Chair – Holds the Chair of Social Security Systems Administration and Management Studies at the Wits School of Governance
- **Prof Margaret Chitiga-Mabugu** - Dean of the Faculty of Economic and Management Sciences, University of Pretoria (CGE modeller)
- **Prof Jan van Heerden** - Professor of Economics in the Faculty of Economic and Management Sciences at the University of Pretoria (CGE modeller)
- **Prof Michael Noble (CBE)** - Director and Senior Research Fellow at the South African Social Policy Research Insights (SASPRI). He is Emeritus Professor of Social Policy at the University of Oxford in the UK, Emeritus Fellow of Green Templeton College at the University of Oxford. He is a Research Affiliate, Centre for Microsimulation and Policy Analysis, at the University of Essex.

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# Background

- This is the second of two analyses of a basic system of income support for income-compromised adults in South Africa
- In 2021 the BIS Expert Panel examined the social and economic implications of a Basic Income Support grant (BIS) at scale
- The purpose was to understand the economic, fiscal and social outcomes of a standard version of a support grant
- The key features of the modelled versions of the BIS involved a grant allocated to income-compromised adults from the ages of 18 to 59
- Two models were used - a microsimulation model and a computable general equilibrium or CGE model
- The results indicated that it was possible to implement a grant of this nature with economic growth protected, a balanced budget approach and important redistributive effects

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## Flowing from this analysis it was concluded that...

- The **SRD arrangement posed limited economic and fiscal risks** and should be made permanent
- To **minimise behavioural impacts on the tax system**, it was proposed that a phased approach be adopted for the progressive enhancement of the SRD benefit over time with the objective, together with the overall social assistance framework, of eliminating poverty at the upper bound poverty level (UBPL)
- An **entry-level version of the grant**, the BIS, should be considered with the starting benefit value set at the LBPL

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# As the initial report focused on the **strategic outcomes of a large version of the BIS**, it did not examine in detail the medium-term options for the grant

- The practical medium-term considerations for Government, however, need to prioritise the stabilisation of the SRD Grant, together with adjustments to keep pace with inflation and to build in some progressive improvement
- This iteration of the Expert Panel therefore focuses exclusively on the SRD Grant as implemented to understand the economic, fiscal and social implications of making it permanent

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# Focus of the analysis...

- **The COVID SRD Grant**
  - financing options, on the assumption that the outlay would need to be fully financed out of new taxes
  - economic implications at national and provincial levels, including household consumption and sectoral output changes
  - poverty and inequality outcomes at national and provincial levels
- **A wage subsidy approach** targeted at the lowest income categories in employment
  - financing options, on the assumption that the outlay would need to be fully financed out of new taxes
  - economic implications at national and provincial levels, including household consumption and sectoral output changes
  - poverty and inequality outcomes at national and provincial levels

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# What do we need to understand?

- ***Social grants are government transfers to households which effectively reflect a redistribution of income from high-income households to low-income households***
- The redistributive nature of such grants however raises concerns about the impact they may have on economic growth and the possible incentive effects on those who must pay for the grant
- Consistent with such concerns are policy prescriptions that argue for growth strategies to be prioritised that directly address unemployment as the central lever to alleviate poverty and income inequality
- Such approaches keep redistributive strategies, such as social grants, to a minimum until such time as growth has provided fiscal space for greater social generosity
- Conversely, it can be argued that social grants, up to an optimal threshold, yield positive economic and social outcomes
- In this view, suboptimal transfers below such a threshold systematically distort growth capabilities downward, resulting in structural unemployment, permanent strata of extreme poverty and structural income inequality

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- **As was noted in the first Panel, evidence is emerging in favour of the second argument**, suggesting that narrow growth strategies result in less sustainable growth over time (Halter, Oechslin, & Zweimüller, 2014; OECD, 2021; Ostry, Berg, & Tsangarides, 2014; Piketty & Saez, 2014)
- However, policy strategies are invariably shaped by the **local context**
- **What works well in one setting may not work well in another**
- South Africa, for instance, can be classed as a **small open economy**, limiting the opportunities for the competitive expansion of manufactured products, both for domestic and international consumption
- Redistributive strategies that would work well in Brazil or India **may therefore prove counterproductive in South Africa**
- What appears settled in the international research, is **that positive redistribution is necessary to address the systematic distributional failures of all market economies**
- **Such strategies are not anti-market**, but rather mitigate their harmful features while simultaneously expanding an economy's long-term growth capabilities

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# Key questions...

- The question, therefore, is not whether there is a trade-off between growth and redistribution, but rather whether it is properly understood how to progressively deepen redistribution in a sustainable way that is sensitive to the domestic context?
- The primary question before this iteration of the Expert Panel, therefore, is whether it is possible to implement income redistribution in the form of the SRD Grant on a permanent basis in such a manner that economic growth and public finances are protected?

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# In addressing the primary question, the following additional questions also need to be considered...

- Assuming a balanced-budget approach to financing the transfers, what is the optimal mix of financing options?
- How are poverty and inequality affected by the transfers, both nationally and provincially?
- What are the effects by economic sector of the transfers, both nationally and provincially?
- Are the outcomes of the SRD Grant likely to be replicated for real improvements in the benefit value and eligibility criteria?
- How do government funded employment strategies compare to social transfers?
- What happens when we combine social transfers with employment strategies?

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# The models

- Following the approach used in the original analysis in 2021, a microsimulation model is used in conjunction with a CGE model
- There are however some important differences in this iteration
  - First, the microsimulation model has been updated to allow for more discrete tax options to be examined
  - Second, a different CGE model is used which can examine a more disaggregated breakdown of households by income and provide results by province

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## Health warning...

- *“The use of models for policy analysis however comes with a health warning. Economic models only provide broad indications of how aspects of the economy may react to policy designs and are as good as the model designs and assumptions. They cannot however be used as projections or even firm indications of a holistic economic response.” (BIS Expert Panel, 2021, p. 144)*
- *“Model results should therefore always be interpreted, with consideration given to how features of the real-world economy that cannot be accurately modelled may qualify the model results.” (BIS Expert Panel, 2021, p. 144)*

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# The simulations

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# Key variables

- **Number of beneficiaries assumed:** 13.1 million
- **Grant value:** R350
- **Means test:** R624

**Table 4.1: Shares of grants given to the different household groups (Percentage (%))**

	D1	D2	D3	D4	D5	D6	D7	D8	D9	D10	Total
<b>Share</b>	14.9	21.9	16.4	12.5	11.1	6.5	6.0	4.9	3.4	2.4	100

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# The Simulations

- CGE Sim 1** The SRD Grant outlay of R50 billion is financed primarily using an increase in VAT in the early years of the simulation
- CGE Sim 2** The SRD Grant outlay of R50 billion is financed entirely through an increase in the PIT of the top three deciles
- CGE Sim 3** The wage subsidy (WS) outlay, equivalent to R50 billion, is financed entirely through PIT increases on the top three deciles and allocated to the bottom four occupational groups (domestic workers, elementary workers, operators and skilled agricultural workers)
- CGE Sim 4** The SRD Grant outlay of R50 billion is combined with a wage subsidy (WS) at 50% of the cost of the SRD Grant (R25 billion), both of which are financed entirely through PIT

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# Results

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# Social outcomes

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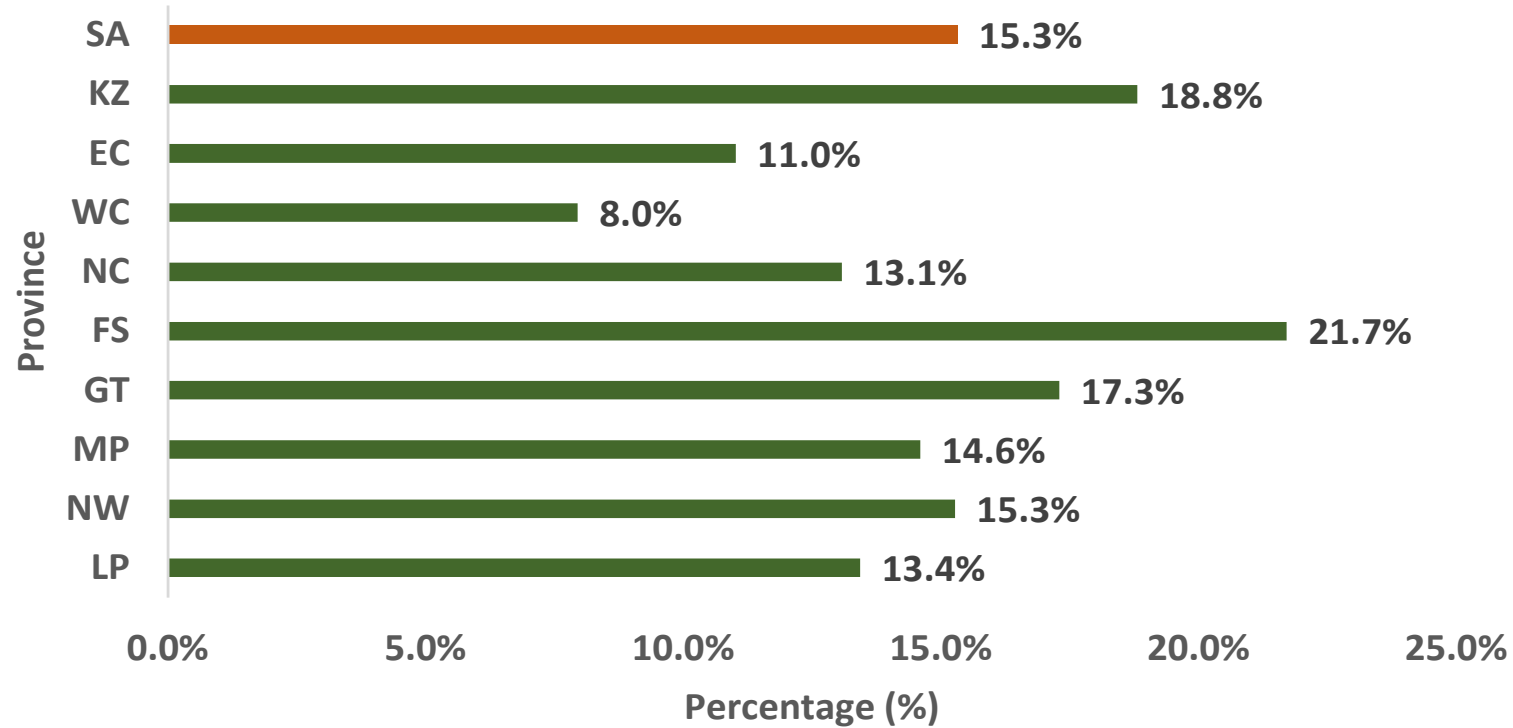
# National and Provincial LBPL Outcomes (for second year of simulations - 2023)

Province	Baseline	CGE Sim1	CGE Sim2	CGE Sim3	CGE Sim4
LP	42.8%	38.4%	37.1%	39.5%	37.1%
NW	43.4%	37.8%	36.8%	38.3%	36.4%
MP	31.3%	27.1%	26.7%	27.3%	26.4%
GT	23.0%	20.7%	19.0%	20.8%	19.0%
FS	27.9%	22.0%	21.9%	22.6%	21.0%
NC	33.7%	29.8%	29.3%	30.3%	28.6%
WC	22.6%	20.9%	20.8%	21.3%	20.3%
EC	47.8%	43.0%	42.5%	44.7%	42.3%
KZ	35.7%	29.5%	29.0%	30.2%	28.4%
SA	32.7%	27.9%	27.7%	29.1%	27.4%

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# Percentage National and Provincial Reductions in the LBPL for CGE Sim2



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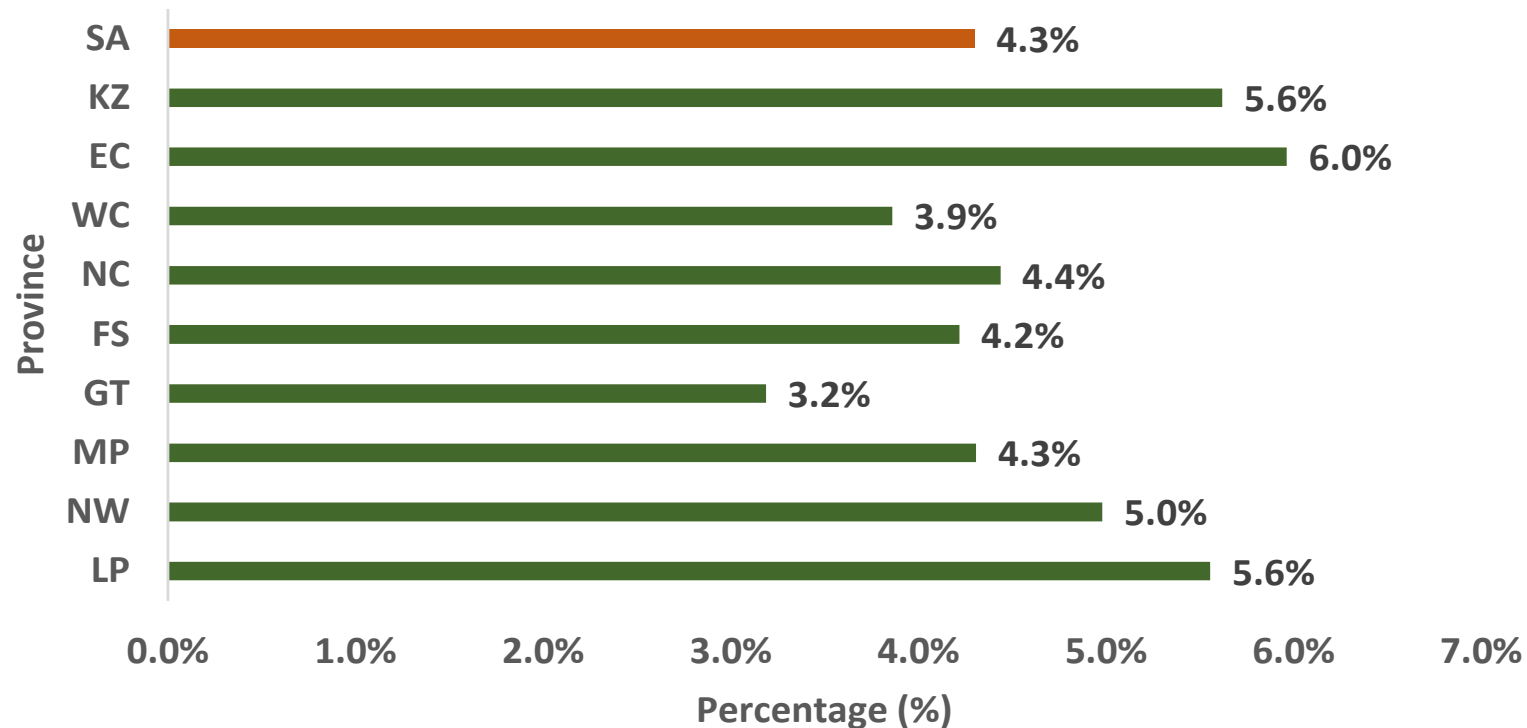
# National and Provincial Gini Coefficient Outcomes

Province	Baseline	CGE Sim1	CGE Sim2	CGE Sim3	CGE Sim4
LP	0.62	0.59	0.59	0.60	0.59
NW	0.64	0.61	0.60	0.61	0.60
MP	0.64	0.62	0.62	0.62	0.62
GT	0.62	0.60	0.60	0.60	0.60
FS	0.61	0.58	0.58	0.59	0.58
NC	0.65	0.63	0.63	0.63	0.62
WC	0.60	0.58	0.58	0.58	0.58
EC	0.65	0.62	0.61	0.62	0.61
KZ	0.61	0.58	0.57	0.58	0.57
SA	0.64	0.61	0.61	0.61	0.61

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# Percentage National and Provincial Reductions in the Gini Coefficient for CGE Sim2



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# Disposable incomes

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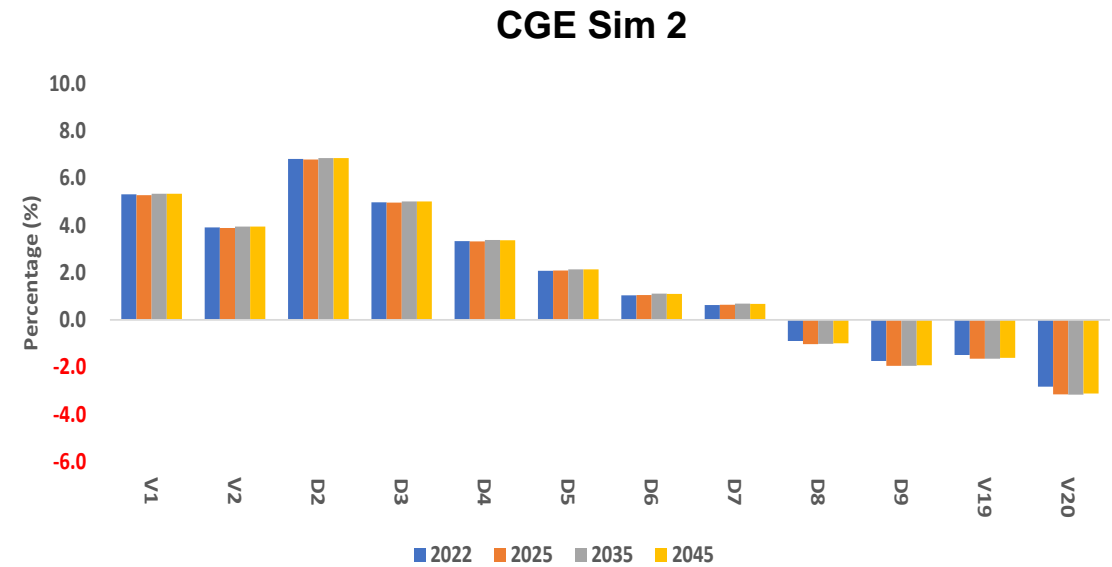
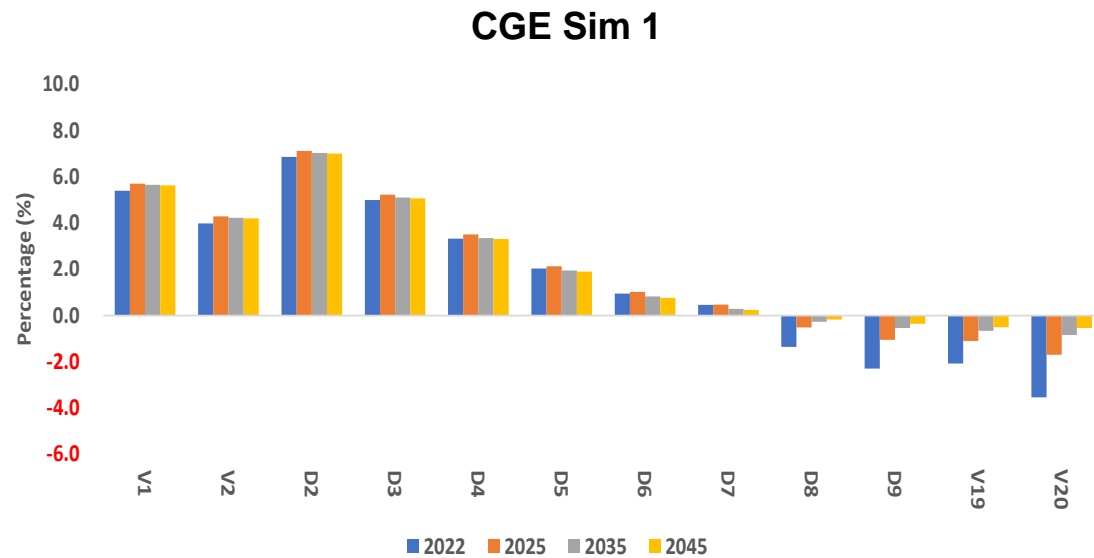


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# Disposable Income: Variations from the Baseline for the Years 2022 to 2045



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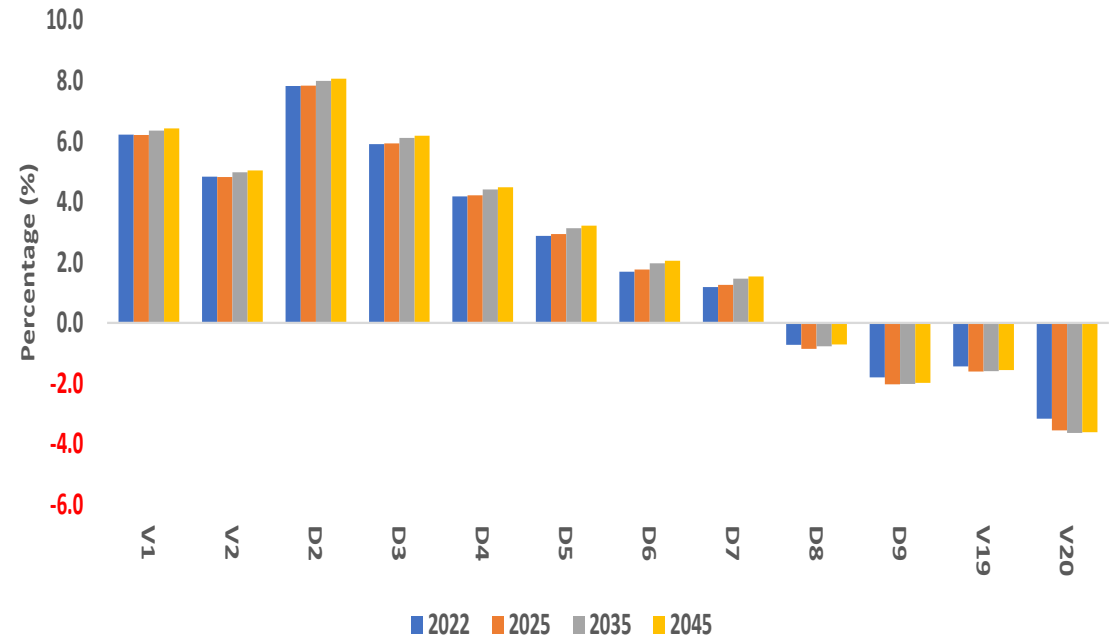
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# Disposable Income: Variations from the Baseline for the Years 2022 to 2045

CGE Sim 3



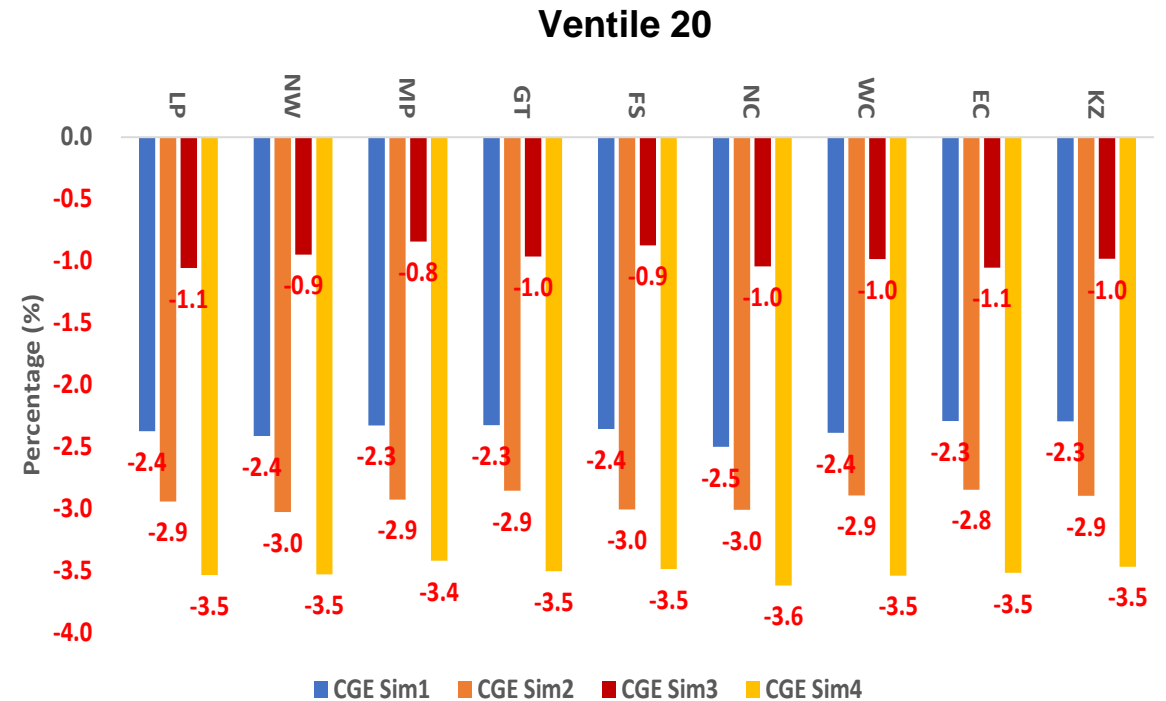
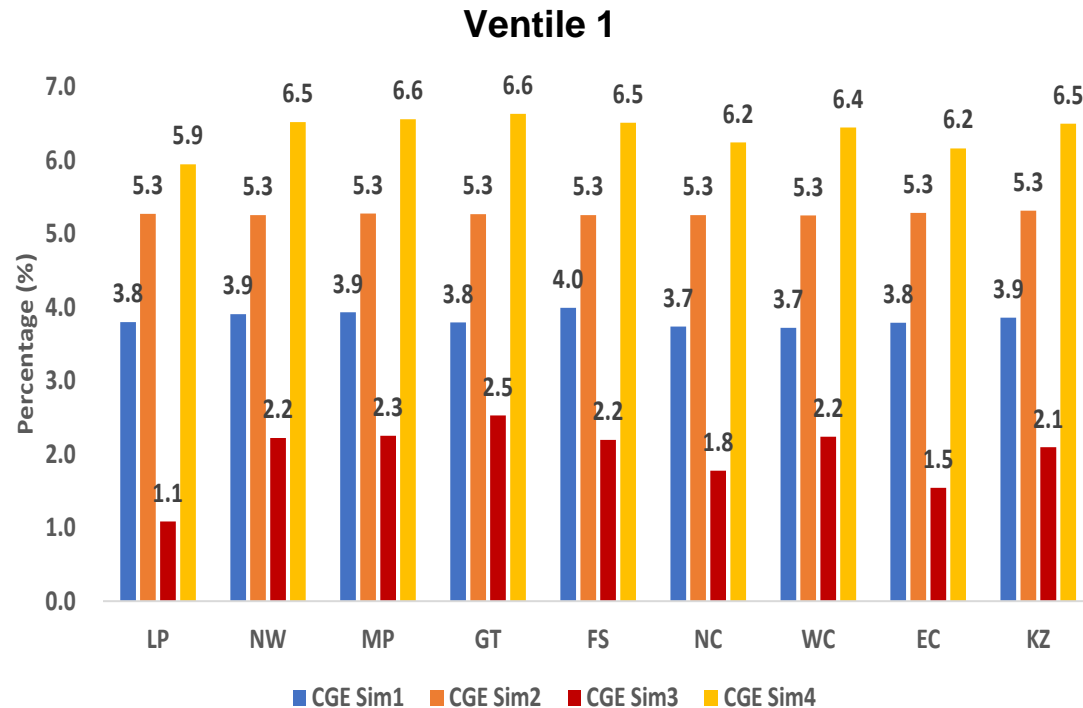
CGE Sim 4



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# Disposable Income: Variations from the Baseline for the Year 2035 for Ventiles 1 and 20



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# Conclusions on social outcomes

- The reduced poverty and inequality outcomes are material for all four simulations, with the weakest results for the wage subsidy simulation, or CGE Sim3
- Of the standalone SRD Grant simulations, CGE Sim2 (PIT financed) outperforms CGE Sim 1 (VAT financed)
- The CGE Sim4 outcomes are strongly redistributive, but not significantly different to CGE Sim2
- The SRD Grant also has important inter-provincial redistributive effects, with a material narrowing of the inter-provincial Gini Coefficient differentials around a lower national result of 0.61 (CGE Sim2)

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# Economic outcomes

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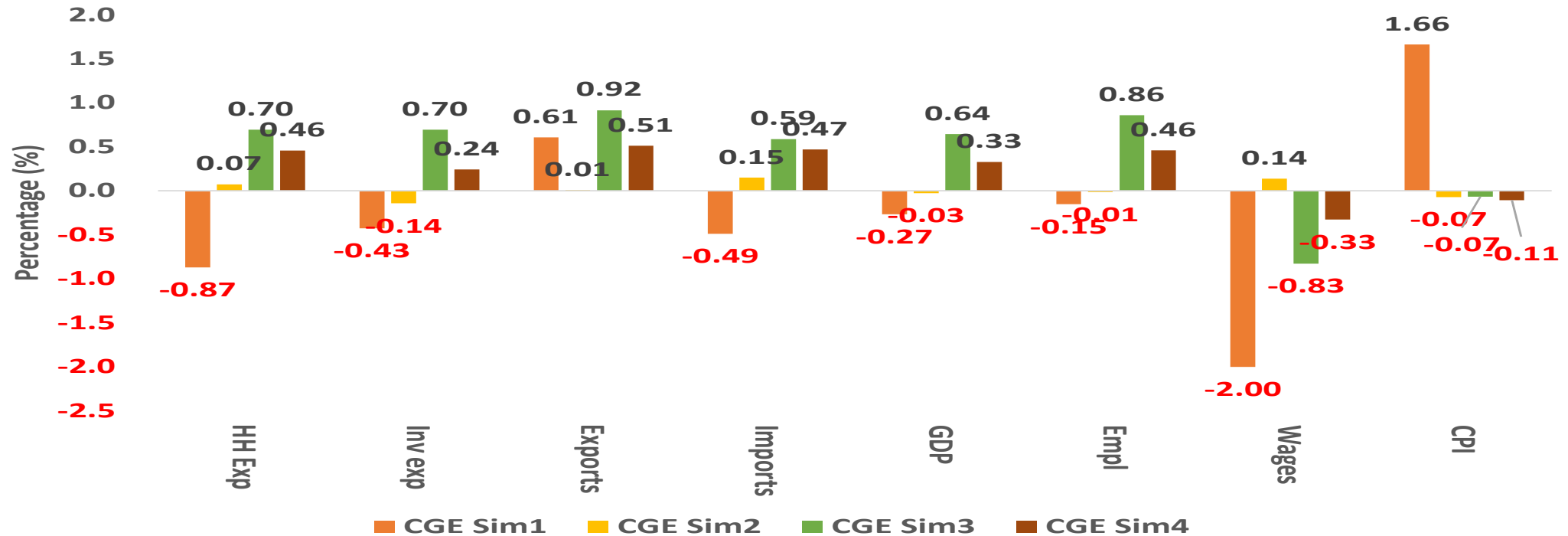


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# National Output: Variations from the Baseline for the Year 2035



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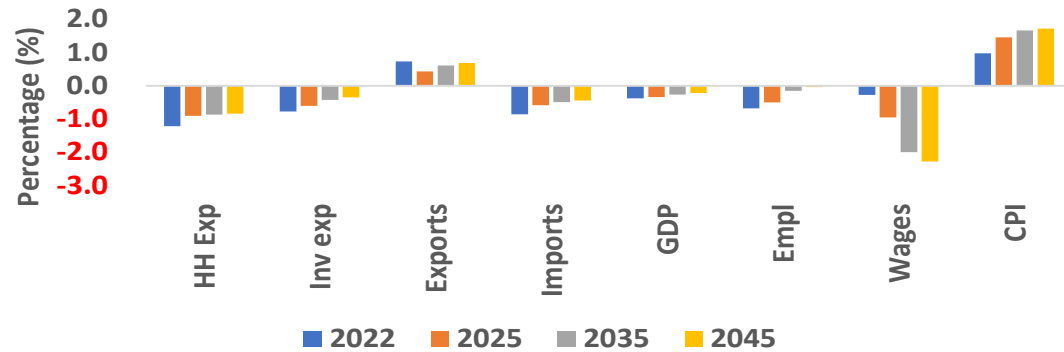
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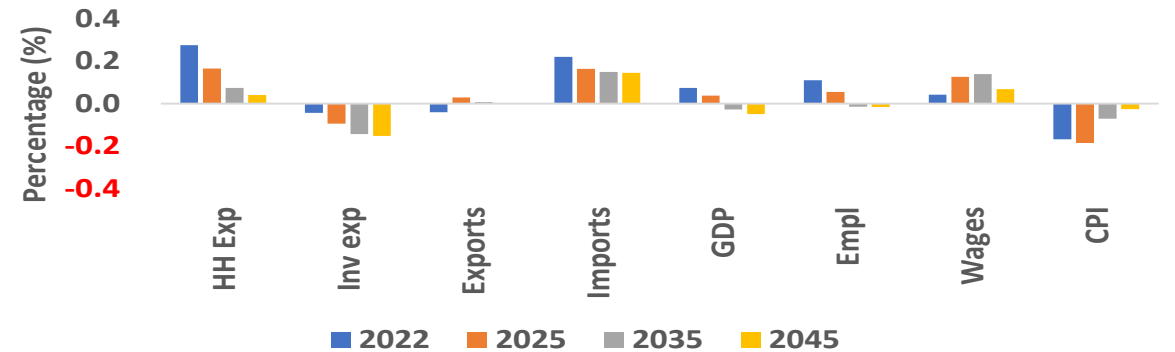


# National Output Outcomes 2022 to 2045

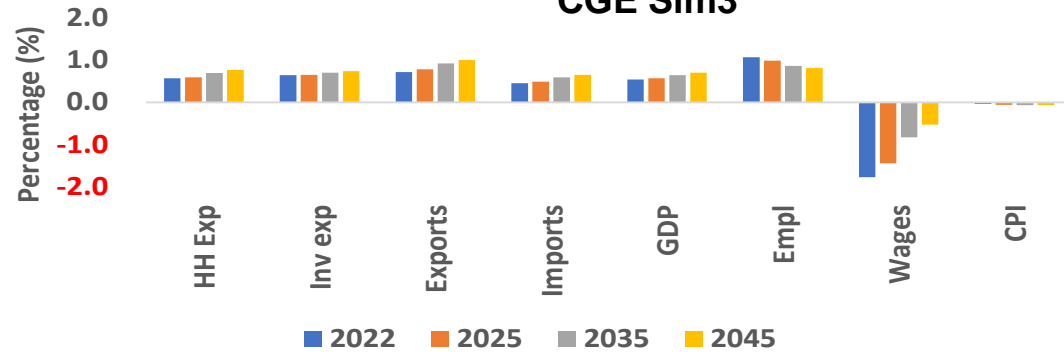
### CGE Sim1



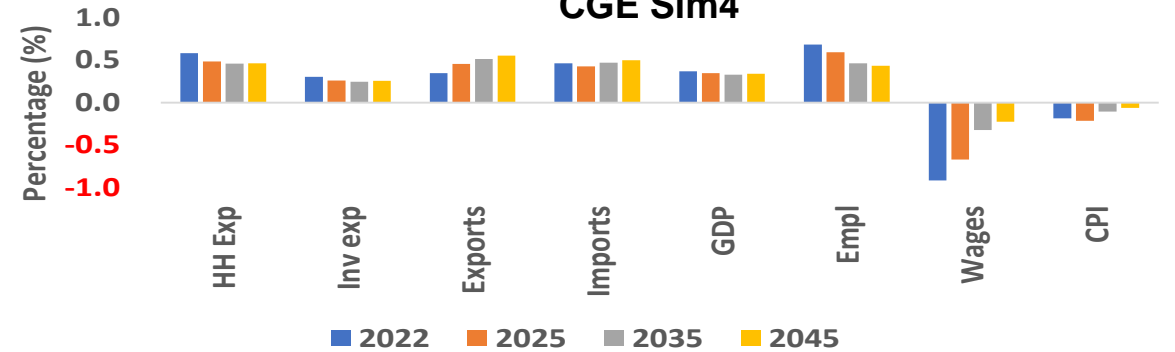
### CGE Sim2



### CGE Sim3



### CGE Sim4



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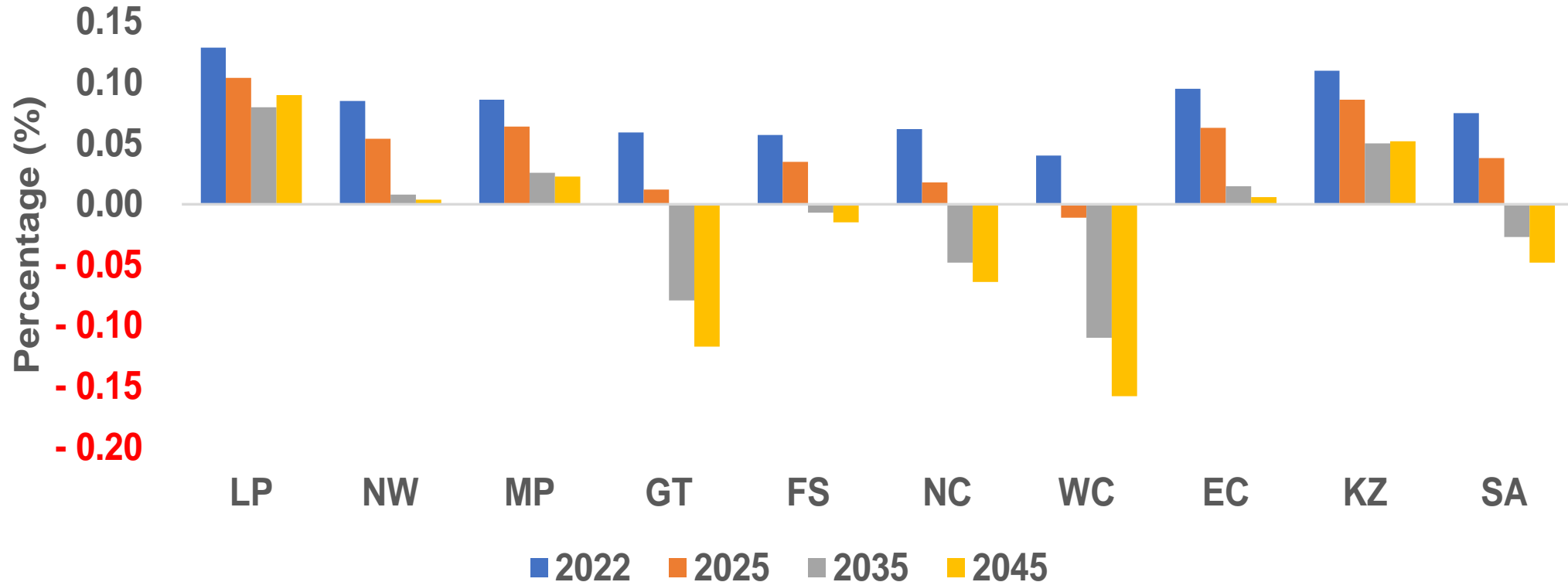


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# CSG Sim2: Provincial Variations from the Baseline for GDP from 2022 to 2045



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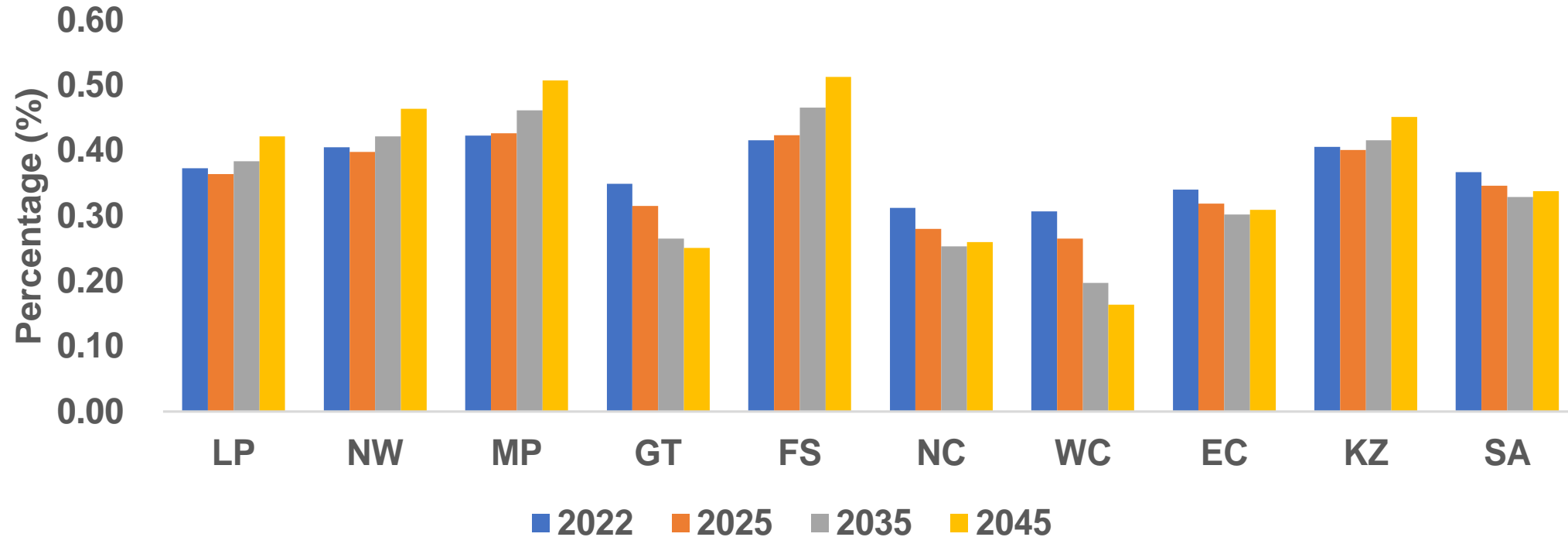


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# CSG Sim4: Provincial Variations from the Baseline for GDP from 2022 to 2045



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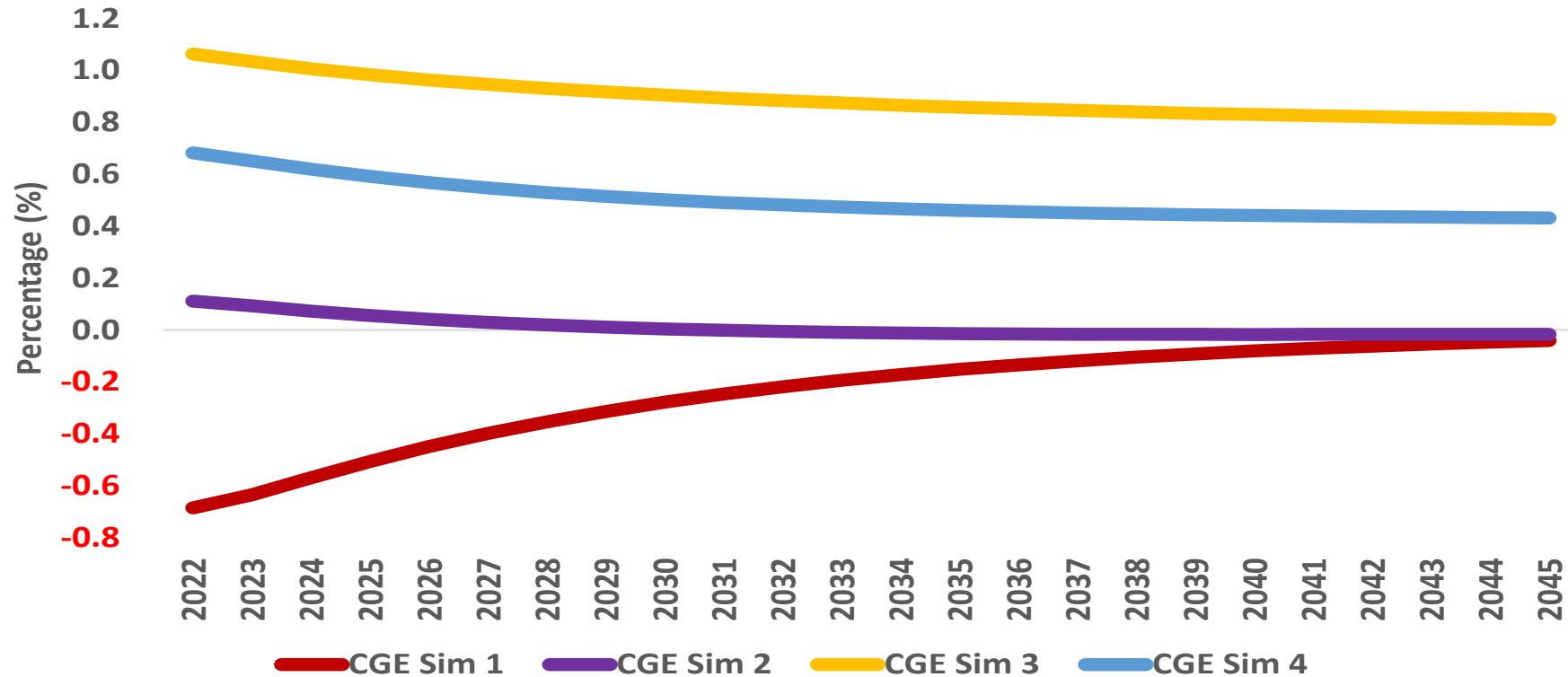
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# National Variations from the Baseline for Employment from 2022 to 2045



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# Findings

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# Inclusive growth

- The SRD Grant offers significant redistributive opportunities, diminished only by the choice of financing option
- Where PIT rather than VAT is used, economic output deviates positively from the **Baseline** while also achieving material positive distributional outcomes
- Inclusive growth options appear strong when the SRD Grant is combined with a wage subsidy that targets the lowest occupational groups
- However, in practice the achievement of a well-targeted wage subsidy scheme may provide difficult

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# Financing

- The negative outcomes for economic output resulting from the use of VAT to finance the SRD Grant suggest that it should not be considered to address any financing gaps in the programme in future until further work is carried out to evaluate any complex interactions with the economy
- Given South Africa's extreme income inequality, revenue raising options for new redistributive programmes, such as the SRD Grant, should make use of progressive taxation options

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# Viability of the SRD grant

- The modelling results show that, depending upon how it is financed, the SRD Grant can be introduced in a manner that is fiscally and economically sustainable while at the same having a material impact on poverty and income inequality if implemented at the level of 13.1 million beneficiaries
- The modelling work produced in this report analysed the SRD Grant on a zero-based budgeting basis, effectively assuming that the outlay must be financed from new sources of revenue

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# Employment strategies

- A wage subsidy targeted at the four lowest income occupational categories shows promise for improving economic output but is less effective in addressing poverty and inequality in comparison to the SRD Grant
- When the interventions are combined, however, there are potential gains for economic output, poverty and inequality
- Replicating the modelled wage subsidy with an equivalent programme in practice, however, may prove difficult
- While more work is needed to better identify an effective government subsidised employment intervention, such approaches are not substitutes for income-protection
- They are instead complementary, as they have distinct, although related, social objectives

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