

Ex-ante analysis of the impact of proposed taxation changes on vulnerable children and families

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Abstract

To overcome the effects of the global economic crisis, the Serbian Government considered a variety of fiscal reform measures, including an increase in the Value Added Tax (VAT). An ex-ante analysis of the announced taxation reform was conducted by UNICEF in 2010, which highlighted the effects of the proposed changes on the most vulnerable groups, particularly families with children. The evidence enabled UNICEF to open a public debate that explored the possible costs and benefits of the proposed reform and called for submission of more evidence on the potential impact before proceeding with the reform process. The Serbian experience is a successful example of being able to raise children's issues with the Ministry of Finance and International Financial Institutions [IFIs] in middle income countries. Moving beyond an exclusive focus on social expenditure and towards revenue generation as a key element of social policy represents an important step ahead.

Innovation

Engaging in analysis and discussions related to changes in fiscal and macroeconomic policies and highlighting linkages between them and the wellbeing of children has not been a part of UNICEF's traditional role in promoting children's rights. Moving beyond an exclusive focus on social expenditure and towards revenue generation as a key element of social policy and as a primary redistribution mechanism represents an important step ahead.

The Serbian experience is a successful example of innovative engagement in middle income countries which present new and different sets of challenges for fulfilling children's rights. It shows the potential of engaging directly with the Ministry of Finance and IFIs – around issues that are not the expected domains of UNICEF's expertise – fiscal policies – but where nonetheless UNICEF is able to add significant value to the policy process.

Key elements of success: The Serbian experience reaffirms the power of

sound evidence and research, even if all stakeholders do not necessarily agree with its specific content. This, in turn, highlights the significant gains that UNICEF can obtain by positioning itself as an authoritative knowledge organization. Fostering public discussion on an issue of vital importance for the nation can contribute to promoting a more consultative and evidence-based approach to policy changes that affect children.

In addition, timely, firm decision-making and quick execution within the office were critical to the success of this initiative. In the context of crisis and emerging priorities, it is critical to be able to foresee a window of opportunity for evidence-based advocacy in an area traditionally beyond UNICEF's comfort zone but with huge potential in terms of impact for children.

Potential application

Ex-ante analyses of the impact of policies on children from a perspective of equity and poverty could be replicated in any other country programme and applied to any other sector and policy. Demonstration of UNICEF's ability to engage with the Ministry of Finance and the IFIs on politically sensitive issues such as taxation expands the potential for its further engagement with these key actors on other areas of critical importance for children. Eventually, fiscal policies can be a very powerful and efficient redistributive instrument, if well managed. The case of Serbia highlights the potential in this area, especially in the context of middle income countries with huge inequalities.

The successful replication of this experience requires regular monitoring of policy developments outside of traditional UNICEF sectors in order to recognize and seize opportunities to bring in the perspectives of children. Further, more efforts should be invested into capacity building of staff in the area of public finance management and availability of technical assistance that could support country offices in follow-up technical discussions.

It is important to recognize that measuring the impact of such initiatives may be difficult, as will clearly attributing the results to UNICEF. In addition, where there is a general lack of transparency around policy-making, it may be possible, in some cases, to miss the window of opportunity for similar analyses to be conducted before major policy decisions are made. In this regard, it is essential for UNICEF to quickly mobilize high quality technical assistance to carry out such projects.

Background

In late 2010, as part of several measures to mitigate the negative effects of the global economic crisis, the Ministry of Finance, together with its team of experts, announced its intention to conduct a structural reform of the tax system in Serbia. The main purpose of the proposed reform was to reduce the burden of non-wage labour costs by abolishing social contributions that

are used to finance state health care and unemployment benefits. In turn, these revenue losses would be offset through the adjustment of indirect taxation, namely by increase in VAT by almost four per cent.

From the outset it was clear that the reduction of wage taxes and contributions would benefit employed persons (and their families) to a certain extent (depending on tax incidence). Due to low employment rates among the poor and vulnerable groups there was a high probability that these groups would not benefit considerably from wage tax reduction. On the other hand, it was apparent that the increase in the VAT would lead to a reduction in the consumption of the entire Serbian population. In the medium term, it was possible to argue that these measures would increase employment. At the same time it was not realistic to expect an increase in employment of certain groups such as Roma, farmers, persons with disability, people living on pensions among others. Further, the proposed tax reform was not widely discussed nor was any research on its potential social impacts commissioned by the Government. At a time when poverty rates were increasing at an alarming rate due to the crisis, UNICEF's concern was that families with children, who have consistently higher rates and depth of poverty than the majority of the population, would be the first to be hit by any negative effects of the potential reform.

Strategy & implementation

UNICEF Serbia commissioned the Centre for Liberal-Democratic Studies, a local think-tank to conduct an ex-ante impact study of the proposed taxation reform in 2010. The study seeks to (1) assess how the poor segments of the population, especially families with children and members of other vulnerable groups, would fare should these tax changes be put into effect; (2) propose compensatory measures that would alleviate any adverse effect of the proposed tax changes on these groups; and (3) generate public discussion that would oblige decision-makers to view the reform with an equity lens, taking into account the perspectives of vulnerable groups before initiating the reform process.

A tax benefit micro-simulation model based on the Household Budget Survey in Serbia was used to compute the effects of the proposed changes in tax policy on individual population groups. This model made it possible to analyze the effects of the relevant policies on the consumption of the population as a basic indicator for the standard of living and well-being of the population.

The findings of the study were used to generate a public debate, especially among the eminent experts in this field, including representatives of the Ministry of Finance who were the authors of the reform proposal, experts from research institutions and think-tanks, including the International Monetary Fund (IMF) and the World Bank. Participants were invited to

engage in a discussion on the recommendations of the report and to share their thinking on the proposed tax reform. The robust discussion led to the creation of a proposal on which aspects of the impact of the tax reform should be further explored. After the meeting, discussion and vigorous debate continued via an e-mail group that included the Minister of Finance at that time, IMF and World Bank representatives. The participants split into two groups as supporters or in opposition to the suggested reform and have continued development of arguments and evidence to document why certain positions are preferable. The discussion was not shared with the media owing to its technical and political nature. The issue became a much discussed topic among experts and while there was not necessarily agreement on the type of reform needed, all the key experts informally expressed unanimous appreciation for having an ex-ante analysis available.

Progress & results

The analysis revealed a number of potential negative effects for the living standards of the most vulnerable groups and predicted an increase in poverty for all age groups. The poverty of children aged 15 years and under in Serbia, whose poverty rates by age are the highest, would increase by 10 per cent. Overall, it was estimated that during 2010 the combined effects of the crisis and tax reform could bring about an increase in the share of poor people to over nine per cent. At the same time, there was no certainty that in the longer run the reform would bring about positive economic outcomes.

As of May 2011, more than eight months after the debate on the effects of the taxation reform, the proposed changes have not been carried out in the Serbian tax system. While the analysis and advocacy cannot be attributed as the main factors that prevented the implementation of the reform nor can it guarantee that any such reform will not take place in the future, the analysis was able to engage all relevant and affected stakeholders, including key institutional players, to have an in-depth discussion and take into account all aspects of the potential impact of the announced reform. UNICEF was able to capitalize on its convening power and its strong reputation in voicing the rights of children to bring together partners, conduct advocacy and make the policy process more participatory and consensual around the situation of the most vulnerable population.

Next steps

This experience has clearly demonstrated the value of ex-ante analysis of new policy proposals and will be applied more systematically in UNICEF Serbia's work. It has also introduced the practice of evidence based policy making within the government. UNICEF will continue to advocate for this approach with its government partners. The office will continue to pay careful attention to recognizing new policy development processes and assessing their impact on the most vulnerable children and families.

