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UNIVERSAL BASIC INCOME GUARANTEE FACTSHEET SERIES

# MODELLING FISCAL PATHWAYS TO A BASIC INCOME

Fiscal pathways to an expansive basic income have been modelled, and the results show that basic income is both affordable and sustainable for South Africa.

There are many possible mechanisms for financing a Basic Income Grant (BIG) in a way that is redistributive. However, some opponents of BIG suggest that raising additional resources in order to finance a BIG will have negative impacts on the economy, which undermine the economic stimulus impact of basic income. These opponents say that a BIG is not fiscally sustainable, and that it will dampen investment and growth and exacerbate unemployment. These claims are based on conservative economic modelling approaches.

These modelling approaches are fundamentally flawed. They reflect the neoclassical view of a market economy and include a series of inaccurate assumptions. In partnership with Applied Development Research Solutions (ADRS) in 2023, we conducted more integrated and holistic research on the dynamic macroeconomic impacts of different basic income financing pathways.[1]

ADRS modelled three pathways towards the progressive realisation of BIG in South Africa. The period of the modelling is from 2023 to 2030. The three scenarios range from low-ambition, to medium-ambition, to high-ambition[2] pathways; based on the rate at which the value and coverage of the grant is increased.[3] In all three scenarios the BIG constitutes a grant provided to individual adults from the age of 18 to 59, with no conditionalities.

Coverage is expanded progressively up the income deciles by way of a gradually increased means-test. The value of the grant and the means-test are set with reference to the national poverty lines. In the model the BIG scenarios are funded by different mixes of a small wealth tax, a Social Security Tax introduced towards the end of the decade,[4] and the additional government revenue recouped through higher consumption stimulated by the BIG, mainly through VAT.

## THE FOUR ELEMENTS OF A UBIG

- **UNIVERSAL** – applies to all adults.
- **BASIC** – covers basic necessities.
- **INCOME** – a regular cash benefit.
- **GUARANTEE** – provided as a right.

**Table 1: Details of Each Pathway[5]**

| | Year | Value | Means Test | Financing |
|---|---|---|---|---|
| PATHWAY 1 Low Ambition | 2023-2024 | R350 | FPL | Wealth tax at 0.5% |
| | 2025 | R350 | LBPL | |
| | 2026-2027 | FPL | UBPL | Wealth tax at 1% from 2026 onward |
| | 2028-2030 | LBPL | UBPL | |
| PATHWAY 2 Medium Ambition | 2023-2025 | FPL | LBPL | Wealth tax at 1% from 2023 onward |
| | 2026-2027 | LBPL | UBPL | |
| | 2028-2030 | UBPL | 2x UBPL | Introduction from 2028 onwards of a social security tax at 3% of wages up to taxable maximum of R2.5 million |
| PATHWAY 3 High Ambition | 2023-2025 | FPL | 2x UBPL | Wealth tax of 1% from 2023 onward |
| | 2026-2027 | LBPL | 4x UBPL | |
| | 2028-2030 | UBPL | 6x UBPL[6] | Introduction of a SST at 4% of wages up to the taxable maximum of R2.5 million |

Compared to a business-as-usual baseline, the model showed that in all three scenarios a BIG is fiscally sustainable and moreover has a significant positive impact on growth, poverty, and unemployment. The scenarios see the reduction of the poverty rate by *up to two-thirds* in the next eight years. From a baseline of 2.2% GDP growth, the BIG pathways see growth expand to between 2.8 and 3.5% by 2030.

A BIG also sees unemployment decline by a few percentage points. However, in the context of chronic high unemployment, South Africa needs a multipronged policy strategy (of which a BIG should form one component), in order to bring unemployment down significantly, as well as to achieve high growth approaching 6%.

This 'pathways' research shows clearly, based on robust and dynamic modelling, that not only is an adequate BIG possible by 2030 (and a universal basic income within reach in the 2030s), but that its introduction and progressive realisation will be good for the economy. It will help to drive inclusive growth—growth which benefits everyone and particularly the most vulnerable. It will significantly reduce the poverty rate, and help to get South Africa onto a much more sustainable fiscal and debt trajectory.

In short, it's a win-win: both a sensible policy from a macroeconomic perspective, and the most direct and effective way of protecting and advancing basic socio economic rights, and fighting hunger in South Africa.

## Financing a UBIG

An important question in the discussion of a UBIG in South Africa is how much it will cost and how the government will pay for it. When assessing the cost of any budgetary item, it is important to take into account both the gross and the net cost. The gross cost is the actual amount of money that government budgets for the programme. The net cost, however, is this gross cost minus the money that flows back to the government as a result of the programme, in this case the UBIG.

## What is the gross cost of a UBIG?

A UBIG paid to all adults between the ages of 18 and 59 at the level of the 2022 Food Poverty Line (FPL) of R624 per month would have a gross cost of R255 billion per year. However, this number assumes that everyone who qualifies will take the grant up. But research shows that a significant portion of the population won't apply for the UBIG, usually because they have alternative income sources. Based on historical uptake of other grants, we assume that only 60% of those eligible will opt to receive the grant initially, improving to 80% over time – giving a gross cost of R153 billion to R204 billion per year. But this upfront or gross cost still gives an exaggerated picture of the financing requirement for a UBIG.

**Table 4. Projections of fiscal impact of BIG pathways 2023-2030**

| Fiscal Indicators (2023-2030) | Baseline | BIG PATHWAY Low Ambition | BIG PATHWAY Medium Ambition | BIG PATHWAY High Ambition |
|---|---|---|---|---|
| Total Benefit Paid-GDP Ratio (Annual Ave) | 4.9 | 8.5 | 10.8 | 12.6 |
| Taxes on Income and Wealth-GDP Ratio (Annual Ave) | 15.7 | 16.9 | 17.3 | 17.5 |
| Government Expenditure-GDP Ratio (Annual Ave) | 31.8 | 35.6 | 38.4 | 40.7 |
| Government Revenue-GDP Ratio (Annual Ave) | 28.8 | 32.3 | 34.3 | 35.7 |
| Deficit GDP Ratio (Annual Ave) | -3.0 | -3.3 | -4.1 | -5.0 |
| Debt GDP Ratio (Annual Ave) | 74.2 | 73.8 | 75.5 | 77.3 |

Source: Dynamically Integrated Macro-Micro Simulation Model of South Africa (DIMMSIM), www.adrs-global.com.

## Benefits offsetting the cost of a UBIG

A significant amount of money is directly returned via VAT, and taxes set aside as a direct 'clawback' for the UBIG. Further, a UBIG is a form of investment or "stimulus" promoting economic activity and new government revenue.

The government makes some of the money back, because injecting large amounts of money into poor communities generates increased economic activity (the "multiplier effect"). This positive ripple effect through the economy is well supported by international evidence. If we consider these economic benefits to government, we then see that a UBIG has a much lower fiscal impact than first appears.

Research on the use of the Social Relief of Distress (SRD) grant shows that people use it to purchase food and basic necessities, spending a significant portion within their local economies. Research also shows that lower income earners spend 81% of their disposable income on items which carry VAT. So government gets back about 12% of the money it spends on grants, through VAT.

Also, people with lower incomes spend more of their income on goods produced in South Africa than people with higher incomes, and they also spend more near where they live, helping local businesses grow, thereby employing more people. The resulting business income and employment all contributes tax to the government, helping to offset the gross cost of the UBIG.

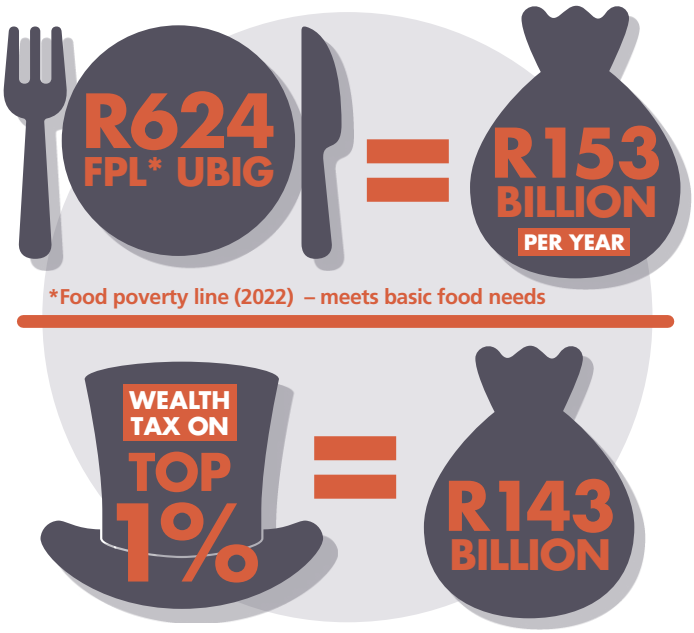
## How can we pay for the net cost of a UBIG?

Even taking into account the above benefits, the government would still need to finance the significant net cost of the UBIG.

Ideally, government would pay for most of the UBIG with tax revenue, and limit the amount of extra debt it takes on for this purpose – although it can mobilise resources cheaply through various vehicles including the Reserve Bank, and the huge public pension funds. Further, while financing could draw on a degree of reallocation of expenditure, and reduction of wasteful spending, this should not be done in a manner which undermines provision of public services — which need to be expanded, not cut.

Not all forms of taxation are the same. Some taxes eat up a large share of the income of poor people (called regressive taxation). An example of this is VAT. If a UBIG was paid for by increasing regressive taxes, this would cancel part of its poverty alleviating benefits. Studies also find that regressive taxation such as VAT have negative growth, equity, and employment effects.

On the other hand, taxes targeting the wealthiest people and companies, or that require wealthy people to pay proportionately more than poor people (called progressive taxation) can be effective at redistributing income to poor households, and are more growth and employment enhancing.




Despite claims that South African taxpayers are overburdened, there is scope to increase tax for the wealthy and high-income earners. For example, a recent study by economists found that while higher earners are paying more income tax in absolute terms, their income has increased more than their income tax payments.

There are many options for introducing progressive taxes in South Africa. One important funding mechanism is a social security tax (SST). This functions as a "clawback" mechanism to cross-subsidise the UBIG, which means that although everybody pays the tax, people pay it at different rates depending on their income. High income earners pay more in SST than they receive in UBIG benefits, and lower — or middle-income earners, while contributing something, would receive a benefit from the UBIG. The social security tax could cover around 25% of the cost of a UBIG.

Taken together, the revenue directly generated by a UBIG, combined with a progressive clawback from higher-income earners through an SST, and an anticipated lag in uptake in the short — to medium-term overall, will result in a net cost of as low as 50% of the gross cost. Studies have shown that this cost could be covered by progressive taxation, such as progressive income tax, corporate taxes, and taxes on wealth.

## What other taxes can we use?

Additional sources of revenue would still be needed to finance a UBIG beyond a social security tax. Introducing a UBIG would require a careful rebalancing of the taxation system that is phased in over time, including the removal of measures that currently disproportionately benefit the wealthy.

In South Africa, a large amount of wealth is tied up in things like assets, savings and land, which are currently undertaxed especially amongst the extremely wealthy. In addition, tax breaks and credits related to medical insurance and retirement fund contributions subsidise wealthy people with little to no policy benefit. This all has the effect of siphoning money upwards, and increasing inequality.

## Options which could target runaway inequality to fund a UBIG include...

- A wealth tax on the wealthiest 1% of the population could raise up to R143-billion.[7] This could take several years to implement.
- A higher rate of VAT on luxury goods of 25% would raise an average of R9-billion annually.
- A reduction in government subsidies on pension fund and retirement fund assets, estimated at R133-billion, much of which goes to wealthier South Africans. Similarly with medical aid subsidies.
- A Financial Transactions Tax (FTT) and Resource Rent Tax (RRT): A FTT set at 0,1% of financial transactions could achieve R41 billion annually, and a RRT could raise over R38 billion per year.
- There are various other financing options that have been proposed for consideration, including a reduction in wasteful and irregular expenditure.

The IEJ's Policy Brief on financing options for a UBIG offers 18 financing options which, if appropriately selected and sequenced, could finance a variety of UBIG models.

## What does affordability really mean?

The question of "affordability" in the context of government finances is not just technical, it is also political. It requires government to decide on priorities—is it directing resources to ensure people are able to live with dignity, or does it rather aim to rapidly reduce public spending and debt to satisfy financial markets?

While a UBIG does present a significant fiscal cost, there is also a heavy price tag that comes with not doing anything. That cost is borne by the poorest, in the form of trauma, malnutrition, and the theft of their agency and opportunities, but it is also borne by the government in the form of health costs, crime, a shrinking tax base, a stagnating economy, and inevitable social instability. We saw this in the July 2021 looting, and in the ongoing low-intensity destruction of infrastructure in communities.

Without taking bold action now, the country will find itself in a position we are even less able to afford in the long run. A UBIG is feasible and affordable without compromising South Africa's fiscal position, and without cutting spending on public services or on existing grants.

## Endnotes

1. For the full methodology and findings of the modelling exercise, and a critique of conservative economic models, see the IEJ and ADRS's working paper, Macroeconomic and Developmental Impacts of Selected Basic Income Grant Pathways for South Africa.
2. For modelling purposes, low-, medium-, and high-ambition scenarios were used. Higher-ambition BIG scenarios are however possible and preferable.
3. The high-ambition scenario comes the closest to universal coverage of a grant set at the value of the upper-bound poverty line, by 2030, covering about 45% of the working age population. This demonstrates the possibility of achieving a fully universal basic income in the 2030s.
4. In the model, this is a flat tax levied on all income, however IEJ has proposed elsewhere an SST levied progressively on the highest income earners—to make the BIG more redistributive.
5. The FPL is the Food Poverty Line (R760 in 2023), LBPL is the Lower Bound Poverty Line (R1058 in 2023), and UBPL is the Upper Bound Poverty Line (R1558 in 2023).
6. This comes to R8 500 p/m. Slightly above the income tax threshold currently around R8000 p/m or R95 750 p/a.
7. Chatterjee, A., Gethin, A., and Czajka, L. 2020. Coronavirus: why South Africa needs a wealth tax now. The Conversation, 28 April 2020 (Accessed on: 9 December 2023).

This factsheet is part of our series on the universal basic income guarantee (UBIG) in South Africa. Visit our special UBIG portal by scanning the QR code.

Factsheets in this series are:

1. Why does South Africa need a Universal Basic Income Guarantee?
2. No one left behind: Why universal basic income makes more sense than targeted grants
3. Jobs versus Grants: Are employment and basic income a policy trade off?
4. How a UBIG can support healthier kids, happier adults, and lifelong learning
5. How a UBIG can advance gender justice and social cohesion
6. Not just a handout: How a UBIG gives people the power to prosper
7. "But how will we pay for it?" Financing a UBIG
8. Modelling fiscal pathways to a basic income

Forthcoming factsheets in this series will focus on:

- UBIG, hunger, and the rising cost of living
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