3 Proven policies that end extreme poverty and reduce inequalities

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This chapter reviews findings from a five-year global research programme that can guide national policy makers and development co-operation agendas on how to best reduce poverty and inequality – sustainably and in tandem. Successful efforts require bigger public budgets, greater tax fairness and significantly expanded social protection, and targeted efforts to formalise workers and increase worker mobility. The chapter includes examples of Viet Nam's extension of the mandated maternity leave period, cash transfer programmes in Ecuador, South Africa and Zambia, among others; tax system strengthening in Tanzania and Uganda, and minimum wage policies and government protection for workers in vulnerable industries during structural transformation in Indonesia.

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Key messages

- Low- and middle-income countries need greater fiscal capacity to invest in policy actions that reduce gender and other inequalities, boost social mobility, and eliminate extreme poverty.
- Poverty reduction strategies are more likely to succeed in tandem with policies that support economic transformation.
- Programmes that support the expansion of social protection systems and enhance the livelihoods and working conditions of the most vulnerable informal workers are among the most effective ways to secure inclusive progress on global goals.
- Increasing data availability and local capacity to analyse the impact of tax and benefit system reforms on poverty and inequality is key to increasing domestic revenues in the Global South and encouraging prudent macroeconomic management.
- To solidify gains in reducing inequality and help people escape poverty over the long term, policy and programmatic goals should focus on continuously raising household incomes and expanding the middle class.
- Poverty and inequality are drivers and consequences of fragility and conflict. State-building efforts that recognise the economic security and sociopolitical needs of local populations are more likely to succeed in reducing both in the long term.

Despite recent setbacks, targeted aid and action at international and national levels can reduce extreme poverty and inequality

With the 2030 deadline for the Sustainable Development Goals (SDGs) looming, a barrage of global economic shocks have reversed much of the progress made since 2015. Recent projections make it clear that progress on critical poverty-related SDG targets is already derailed, threatening the lives and livelihoods of hundreds of millions of people (Yusuf et al., 2023[1]; Yusuf, Zuzy and Komarulzama, 2023[2]). Global South countries have limited fiscal space to fund the broad range of public actions known to address poverty and inequalities. More than half of low- and middle-income countries are already in or at high risk of debt distress (UNDP, 2024[3]). Without additional resources for development, the prospects for achieving the SDGs are low.

Nonetheless, the development progress of recent decades has made many low- and middle-income countries more resilient to global shocks than in the past, and this enables stronger public action to cushion shockwaves and support both economic development and the reduction of poverty and inequalities. Data availability has improved, as has the capacity to take informed decisions at the national level. Much-strengthened financial and capital markets give Global South economies easier access to finance. There is momentum, too, for important reforms to key components of global economic governance in 2024. All these positive developments offer reassurance that it is still possible to put global goals, with poverty and inequality reduction at their centre, back on track and turn the corner on climate change.

At the national level, improving the operation of labour markets can help to boost income and labour mobility, which in turn can build and expand the middle class to solidify progress on reducing poverty and inequality. Improving domestic resource mobilisation can set the stage for poverty and inequality reduction through social transfers and protection systems if states are not overly burdened by public debt. At the international level, support for initiatives that meaningfully address debt distress can increase fiscal space in low- and middle-income countries, while development co-operation should support local capacity to improve tax enforcement and compliance and encourage actions that increase national investment in sustainable development. These are the prerequisites to success that lay a working foundation for the economic, social and state transformations needed to recover lost progress and advance further.

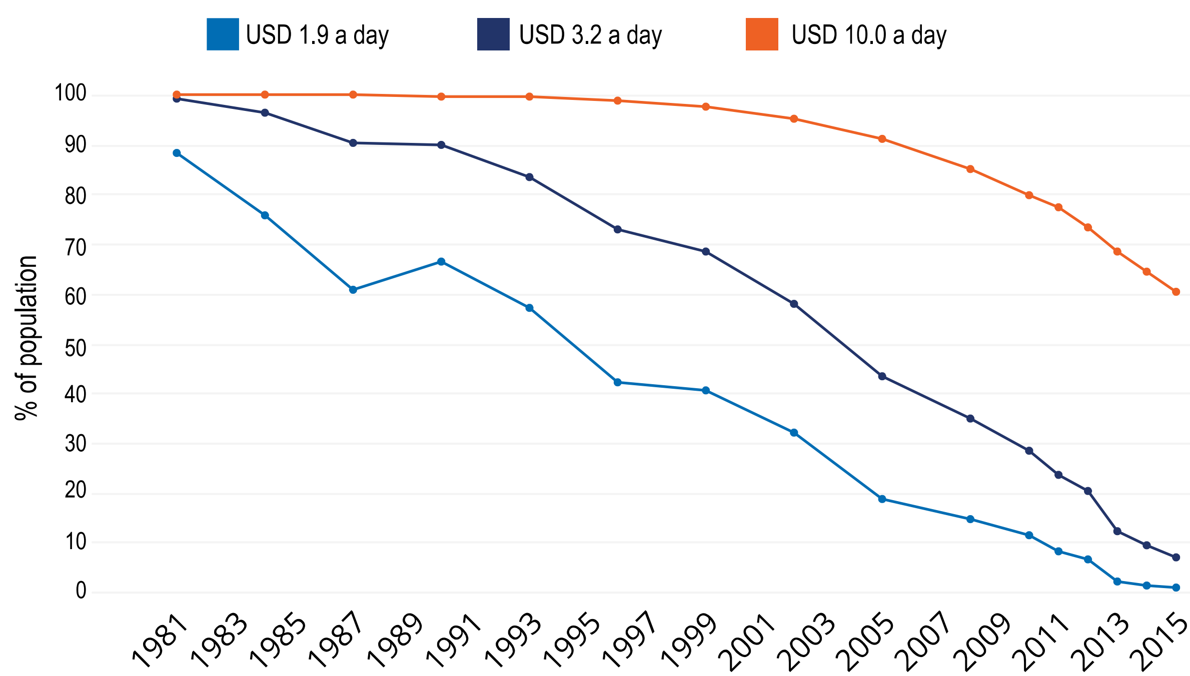
Inextricably linked, poverty and inequality must be tackled and managed together

Poverty and inequality do not always move in the same direction, but this should not be taken as evidence of a meaningful tension. Reductions in poverty today can support reductions in inequality tomorrow and vice versa. Poverty and inequality have a complex relationship depending on the country context, so it is important to look beyond headline indicators to understand what underlying data changes reflect.

For example, reductions in income inequality can coincide with zero progress on poverty when reduced inequality results from changes in the income distribution above the poverty line – for example, lower shares of economic output to the upper classes with increasing shares of output to lower middle-class families just above the poverty line. In such a case, measuring progress by poverty headcounts alone would fail to capture the worthwhile gains made for equality.

Likewise, a country may all but eliminate extreme poverty through social policies that push household consumption above the extreme poverty line. But it may also witness large increases in inequality. For example, the People's Republic of China (hereafter "China") experienced a decline in extreme poverty (per the international line of USD 1.90 a day) from 88.0% to just 0.7% of the population between 1981 and 2015 (Figure 3.1) (see also Chapter 10). At the same time, there were rapid increases in income inequality although the upward mobility of households above higher poverty lines in the future would begin to reduce inequality (Li and Xing, 2020[4]).

Figure 3.1. Poverty rates in China, 1980-2015



Notes: The figure depicts poverty rates at different poverty lines. Poverty lines are in 2011 purchasing power parities.
Source: Li and Xing (2020[4]), "Structural transformation, inequality, and inclusive growth in China", https://www.wider.unu.edu/publication/structural-transformation-inequality-and-inclusive-growth-china.

In any context, if either poverty or inequality is falling (or both), it is important to solidify short-term gains and find strategies to translate these into long-term future reductions in poverty and inequality. While several economies in recent decades experienced spikes in inequality alongside poverty reduction, permanent long-term increases in inequality are not an inevitable consequence of either poverty reduction or economic development (Alisjahbana, Sen and Sumner, 2022[5]). Strong public actions that ensure growth is inclusive can create conditions like those from the mid-1970s to the mid-1990s in Indonesia, when it became a rare example of a country with both declining inequality and poverty. This development is attributable to Indonesia’s policies on rural development, education provision and pro-poor spending that coincided with rapid economic transformation (Alisjahbana et al., 2022[6]).

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At the global level, the relationship between poverty and inequality is equally complex but for slightly different reasons. According to standard measures of global income inequality and global poverty, both have trended downward for decades (Gradín and Oppel, 2021[7]; World Bank, 2024[8]). But inequality experts now recognise that as rising incomes – that is, per capita gross domestic product (GDP) – in more populous countries surpass global mean incomes, the trend will reverse (Kanbur, Ortiz-Juarez and Sumner, 2024[9]). Assuming this progress continues, a downward trend in global poverty alongside rising global inequality could be expected.

Measures of global inequality include components on both within-country and between-country inequality. Between-country inequality is currently the dominant component driving trends (UNU-WIDER, 2023[10]). As long as between-country inequality is the bigger component, average income gains for lower income economies, such as those in sub-Saharan Africa, will need to outpace income gains for the middle-income economies, such as China and India, to prevent a reversal of the declining global inequality trend. Even if higher GDP per capita growth in the lower income economies is achieved, the within-country component of global inequality is already growing in importance and could become the dominant component in the future (Figure 3.2). Therefore, the long-term upward trajectory of the within-country component also urgently needs to be arrested to prevent increases to already high global inequality.

These trends and dynamics (Figure 3.2) demonstrate that poverty reduction at the global level is not by itself enough to achieve global goals. Progress in global poverty reduction must be both significant and long-lasting, and the growth of both between-country and within-country inequalities must be prevented. At the level of individual nations, what is important is to solidify gains in poverty reduction, manage for an initial rise in inequality with support for moving the remaining low-income households out of poverty, and prevent the sudden reversal and loss to progress associated with periodic crises.

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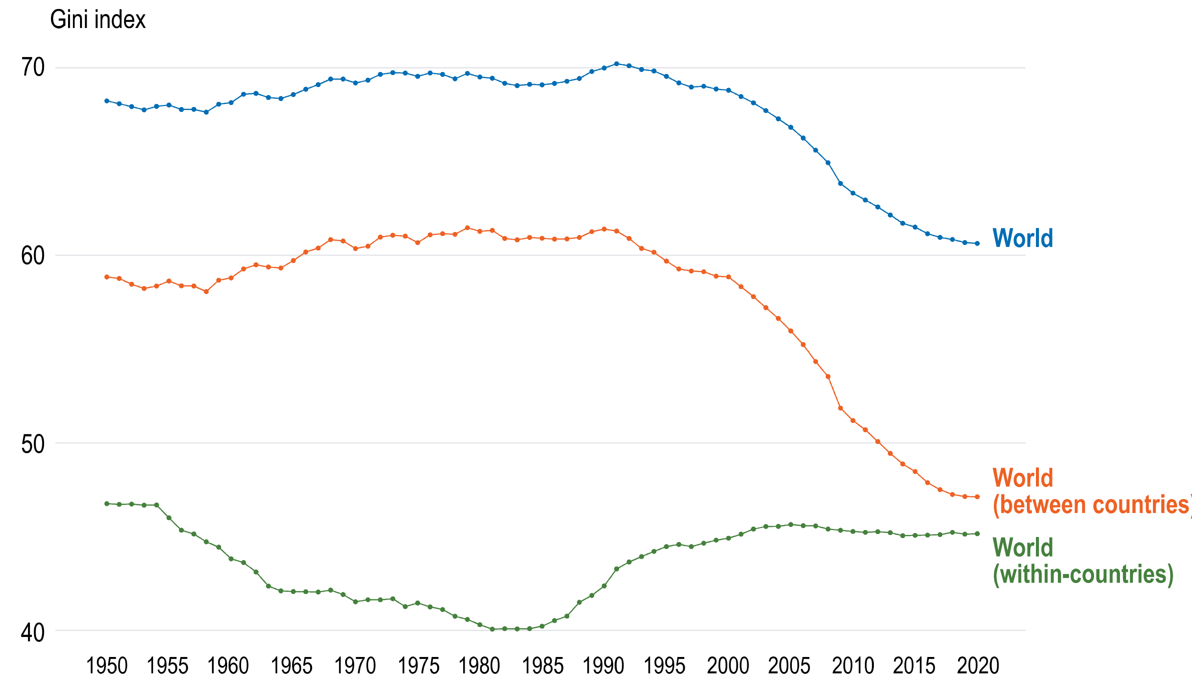
Figure 3.2. The trend in global inequality (global Gini) and global Gini decomposed,1950 - 2020



Source: UNU-WIDER (2020[11]), *WIID Explorer: Gini Index* (database), https://www4.wider.unu.edu/?ind=1&type=ChoroplethSeq&year=70&byCountry=false&slider=buttons.

Strategies to generate and solidify gains in poverty and inequalities reduction must be tailored to context

Some constraints to reduce poverty and inequality effectively and sustainably are context-specific. The public actions that are known to reduce both poverty and inequality in high-income countries may not work as well in low- and middle-income country contexts. There are several critical differences between lower and higher income contexts to consider that primarily relate to the labour market inefficiencies of Global South countries and the overall capacity of the state to make critical public investments, raise revenues and redistribute. UNU-WIDER research finds that key targets for inequalities reduction in low- and middle-income countries are to: reduce labour market economic inequality, achievable through more inclusive labour markets and economic development; and reduce post-market inequality, which can be achieved through social transfers and the provision of critical public goods such as health, education, and transport and transit infrastructure. It is also vital to understand how to address context-specific constraints to effectively reduce poverty and inequality. For example, poverty and inequality are drivers as well as consequences of fragility and conflict. To break the cycle in fragile and conflict-affected situations, establishing a just and sustainable peace is a prerequisite (Box 3.1).

Box 3.1. Poverty and inequality must be addressed deliberately and systemically in fragile and post-conflict contexts

Conflict and fragility are key drivers of poverty and inequality. While global poverty has been on a downward trajectory for most of the past 34 years, poverty has increased in conflict-affected countries, and gaps between peaceful and conflict-affected countries are predicted to widen further (World Bank, 2022[12]). Per capita income levels in more than half of all fragile and conflict-affected countries are lower than in 2019 (World Bank, 2024[13]). Conflict, in particular, can restructure the social, political and economic order, setting the stage for cycles of exclusion and violence in the absence of appropriate intervention.

Recognise the complexity of conflict dynamics

Conflict brings about enormous suffering and loss. It also leads to profound forms of institutional change with unexpected results. For instance, in some cases, exposure to certain forms of wartime governance has been shown to increase grassroots participation and organisational capacity (Steele and Weintraub, 2022[14]) and create greater economic resilience to post-conflict shocks (Ibáñez et al., 2023[15]). This does not mean that exposure to conflict improves lives. It means that conflict dynamics are complex and may result in positive outcomes for some. These positive effects are typically associated with infrastructure improvements and the provision of public goods from both state and non-state armed groups, including improved local-level dispute adjudication systems (Bakke and Rickard, 2023[16]; Kloppe-Santamaría, 2019[17]).

Post-conflict state building should lay foundations for a strong social contract and economic security

State-building efforts that put the needs of local populations at the centre are more likely to succeed. To re-establish the state as a legitimate actor, it is important for state and development co-operation actors to focus on building state capacity to provide for basic rights and economic needs, which in turn increases the state's ability to effectively control territory. Provision of political representation (especially if the conflict has run along identity lines) not only reduces group-based inequalities but also significantly prevents violent conflict (Bhalotra, Clots-Figueras and Iyer, 2023[18]). Simultaneously, support for grassroots democracy can help raise the concerns of poor and marginalised groups, consolidate democratic practices, and re-establish trust in the state (Cremaschi and Masullo J., 2023[19]).

Inclusive post-conflict economic transformation is crucial

Local communities require viable economic alternatives to sustain their livelihoods, broad socio-economic inclusion and protection from powerful criminal organisations. State efforts to replace lucrative wartime economies, which often rely on illicit markets, and cash transfers schemes (Sviatschi, 2022[20]) can increase economic security. A move away from coercive policies that reduce trust in the state and towards more co-operative approaches can also strengthen state legitimacy and the social contract (Ortiz-Ayala, 2021[21]).

The formation of a legitimate state during the transition to peacetime is the foundation needed to begin reducing poverty and inequality in fragile and conflict-affected contexts. The international community can best support such efforts by integrating a deeper understanding of the economic networks and power structures established during conflict (Justino, 2022[22]).

Sources: World Bank (2022[12]), *Global Economic Prospects, June 2022*, https://www.worldbank.org/en/publication/global-economic-prospects; World Bank (2024[13]), *Global Economic Prospects, January 2024*, https://www.worldbank.org/en/publication/global-economic-prospects; Steele and Weintraub (2022[14]), "Rebel governance and political participation", https://doi.org/10.35188/UNU-WIDER/2022/232-4; Ibáñez et al. (2023[15]), "The long-term economic legacies of rebel rule in civil war: Micro evidence from Colombia", https://doi.org/10.1177/00220027231170569; Bakke and Rickard (2023[16]), "'Ten pound touts'": Post-conflict trust and the legacy of counterinsurgency in Northern Ireland", https://doi.org/10.35188/UNU-WIDER; Kloppe- Santamaría (2019[17]), "Lynching and the politics of state formation in post-revolutionary Puebla (1930s-50s)", https://doi.org/10.1017/S0022216X18001104; Bhalotra, Clots-Figueras and Iyer (2023[18]), "Ethnic conflict: the role of ethnic representation", https://doi.org/10.35188/UNU-WIDER/2023/392-5; Cremaschi and Masullo (2023[19]), "The political legacies of wartime resistance: How local communities in Italy keep anti-fascist sentiments alive", https://doi.org/10.35188/UNU-WIDER/2023/352-9; Sviatschi (2022[20]), "Making a NARCO: Childhood exposure to illegal labor markets and criminal life paths", https://doi.org/10.3982/ECTA17082; Ortiz-Ayala (2021[21]), "'They see us like the enemy'": Soldiers' narratives of forced eradication of illegal crops in Colombia", https://doi.org/10.1080/14678802.2021.1986305; Justino (2022[22]), "Wartime governance and state-building trajectories in post-conflict societies", https://doi.org/10.35188/UNU-WIDER/2022/179-2.

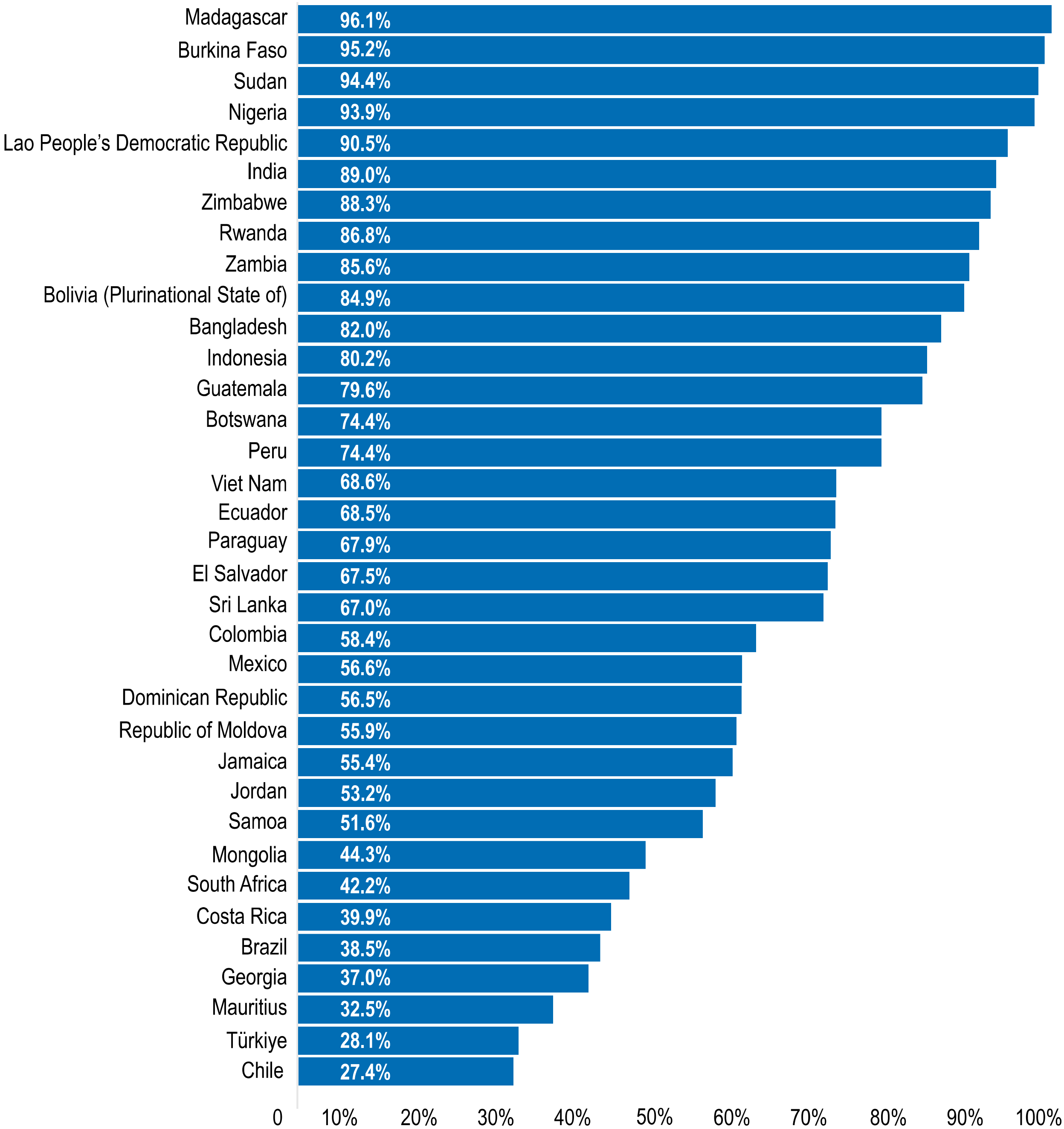
Equality cannot be achieved without more inclusive labour markets

Achieving more equal and sustainable economies requires high-functioning and inclusive labour markets that provide workers with secure, safe and fairly remunerated jobs.

High rates of worker informality limit prospects, but policies and programmes that improve outcomes for informal workers can reduce inequality

Labour markets in Global South countries are characterised by high levels of informal work (Fields et al., 2023[23]) (Figure 3.3). In lower income countries especially, most jobs are self-employment or unpaid family work in agriculture or services. These jobs are often poorly paid, transitory and insecure and lack formal legal protections for workers' rights (ILO, 2019[24]). Informality also undermines the bargaining power of some workers more than others, which is a barrier to reducing wage inequality between different groups of workers (see also Chapter 8).

Figure 3.3. Share of informal employment in total employment (selected countries, 2022)



Source: ILO (2024[25]), 2024, *Indicators and Data Tools – SDG Labour Market Indicators* (database), https://ilostat.ilo.org/data/#.

High levels of informality also mean that large numbers of people do not have adequate access to social protection (ILO, 2021[26]), which itself is an inequality that can compromise efforts to reduce other inequalities. In high-income countries, for instance, higher participation rates in contributory insurance schemes, such as unemployment insurance, make for stronger automatic stabilisation during economic downturns than in lower income countries where social protection is characterised by relatively larger shares covered by non-contributory schemes, such as cash transfers. For this reason, high rates of informality can diminish the ability of social protection to act as a bulwark in an economic crisis.

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A primary way to address labour market inequality is to improve earnings and working conditions for vulnerable informal workers in the Global South. While there are large potential gains to increasing formalisation of labour markets, a high rate of formalisation is a long-term prospect that would require the kind of historically exceptional progress in economic transformation that few countries have achieved. To reduce inequality, steps to encourage formalisation should, therefore, be balanced with those that address poor working conditions, low earnings and the lack of social protection for today's informal workers (UNU-WIDER, 2023[27]).

Actions that can increase worker mobility out of dead-end jobs – that is, increasing the rate at which workers move from lower paying and less secure positions to higher paying positions with greater protections – also can help create a path out of poverty. A recent examination of worker transitions in several countries using panel data from each country found that in almost all countries analysed, jobs fall into the ranked categories of high-wage formal work at the top of the job ladder followed by formal work, upper-tier informal work and, at the bottom rung, lower tier informal work (Fields et al., 2023[23]). Data on how often workers transition between these categories demonstrate that lower tier informal work is a dead end (Fields et al., 2023[23]). Once workers enter this sector, particularly across the Global South, there is little hope they will ever move up the job ladder (OECD, 2024[28]). For instance, the highest persistence rates, the proportion of workers observed who remain in the same employment status over time, in lower tier informal self-employment are in China (86%), Indonesia (81%), Niger (79%), Uganda (73%), Ghana (67%), the United Republic of Tanzania (65%) and Nigeria (61%). The lowest are in Costa Rica (34%) and Nicaragua (34%). In lower tier informal wage employment, the highest persistence rates are observed in Mexico (49-57%) and Paraguay (53%) and the lowest in Costa Rica (28%) (Fields et al., 2023[23]).

To reduce inequality, steps to encourage formalisation should, therefore, be balanced with those that address poor working conditions, low earnings and the lack of social protection for today's informal workers.

Upper tier informal employment, especially upper tier informal wage employment, is the least persistent work status and therefore a potential stepping stone towards formal wage employment. Policy makers hoping to increase rates of formalisation can target workers in this category. But workers in lower tier informal employment need targeted support to improve their current working conditions, provide social protection and increase their incomes.

Across Global South countries, policy makers need good ways to identify and subsequently support the types of informal firms that encourage upward mobility for workers and to discourage the types of firms that prevent upward mobility. A number of policy questions need more research attention: What kinds of interventions prevent downward slides for formally employed workers? What kinds of interventions increase upper tier informal employment while decreasing lower tier informal employment? And what else can policy makers do to enhance the livelihoods of those lower tier informal workers who are caught in dead-end jobs?

Gender disparities are a barrier to transforming labour markets.

Data on workers' demographic characteristics and their positions in the labour market highlight constraints on upward mobility and point to some areas for policy makers to target. Fields et al. (2023[23]), found that education is positively associated with employment stability in higher wage work status groups and reduces the risk a worker will slide down the job ladder. In addition, men have more chances than women to climb up the ladder. While married men in particular are more likely to climb the job ladder, married women are less likely to be able to do so. Male workers also are more likely to move into wage employment while female workers are more likely to stay in self-employment. These findings supplement a large body of research that suggests that gender disparities are a barrier to transforming labour markets.

Labour market segmentation is a barrier to inclusive growth and requires active labour market interventions

Formal labour markets in lower income country contexts also differ from those in high-income countries. They are much more likely to suffer from segmentation of the labour market by low and high value added, for instance, or by other factors such as rural and peri-urban and urban employment. There may also be important differences between workers within the same industries and within the same professions depending on whether they produce for domestic, global or regional value chains as well as on the size of the firms they work for and the location of their work. Such differences are not observed at the same scale in high-income economies.

New research on South Africa's earnings inequality, for example, finds that dual labour markets greatly increase firm-level wage premiums – so much so that the differences in pay between workers doing the same jobs but for different companies explain one-fifth of pay inequalities of South Africa's formally employed workers (Foster, 2023[29]).

Overly segmented labour markets imply that the benefits of economic growth spells are unlikely to lift multiple groups of workers at once, even when economic gains are shared with labour. While this makes it more difficult to reduce inequality, there are also many policy options for making growth more inclusive. More active labour market interventions alongside active industrial policy are thus needed to ensure that future spillovers from concentrated gains to earnings for some workers – and which put upward pressure on inequality – can complement efforts to reduce inequalities in the long term.

Technology and globalisation are not yet driving wage polarisation in emerging economies

An examination of labour markets and sectoral composition in 11 emerging market economies and the global economy, covering nations in 3 major world regions, documents large transformations of these economies' workforces in the 2000s and 2010s. Large numbers of workers moved away from employment in agriculture and towards employment in manufacturing or away from agriculture and into low-productivity services (Gradín et al., 2023[30]). The studies reclassify formal jobs using an indicator for routine task intensity, an alternative to the skilled-unskilled dichotomy, to examine labour market composition, the drivers of earnings inequality, and the role of technology and globalisation in national earnings inequality trends.

Partly due to the smaller sectoral shares in global manufacturing and high value-added economic activity found in the emerging market economies, the adoption and advancement of technology in production are not big drivers of earnings inequality. A major finding of the cross-country work is that the documented wage polarisation that technology and globalisation have induced in high-income economies does not yet threaten lower income ones. However, the impacts of technology adoption and globalisation on informal sector labour markets and workers are an area that needs deeper exploration.

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In many countries, a change in the earnings premiums for more skilled or more highly educated professions drives changes in earnings inequality, as many labour market economists would expect. But the interaction between labour market composition and workers' characteristics is only sometimes a critical driver of the trend in market inequality. In several of the cases examined, active labour market policy reforms such as minimum wage laws, wage subsidies and effective labour market institutions actually promoted greater wage equality by offsetting the upward pressure on earnings inequality attributable to wage premium growth for a minority of highly skilled or highly educated workers (Gradín et al., 2023[30]).

Though structural changes in the economy could exacerbate poverty and inequalities, strong public policy to support competitive labour markets and wage growth can offset this outcome

Conventionally, economic development transforms the labour market and leads to a rise in formal, non-agricultural and urban shares of employment and in workers' incomes. The economic process responsible for this type of transition, called structural transformation, creates more demand for higher productivity labour and is often driven by strong growth in the economy's manufacturing, value-added tradables and technology sectors. More recently, employment growth in knowledge sectors and tradable services such as software engineering, communications and medicine has been a source of decent work.

Evidence on contemporary structural transformation shows different varieties of structural transformation, including economic development that follows unconventional pathways.

Today, many lower income economies are transitioning directly from mostly agriculture to non-business services, a sector with less potential for wage and productivity gains and one that is more difficult to formalise.

If unchecked, this growth pattern could pre-empt reductions to poverty and inequality, which suggests that public policy can play a role in supporting employment creation in the growth industries and higher productivity sectors that are complementary to strong wage growth for workers. Such support should not be limited to industrial policy and incentives for investment. Rather, it should coincide with active labour market policies and other incentives that support competitive labour markets and the growth of wages alongside any sales, revenue or productivity growth for corporations – that is, policies that ensure greater inclusivity of economic growth. As some sectors will experience wage growth more quickly than others, countries may experience upward pressure on inequalities – "the developer's dilemma" – but a comprehensive examination of development experiences shows there are several policy options to improve inclusivity (Alisjahbana et al., 2022[6]).

Historical experience also suggests that public investments in rural and agricultural development can minimise urban-rural income divergence, unionisation and agrarian reforms can protect lower income workers, and education policy can help minimise worker income divergence in the future. Access to other public services including healthcare, housing and social security also protects against increasing labour market inequality (Alisjahbana et al., 2022[6]).

State capacity to fund public investments and social transfers is critical to reducing poverty and inequalities

Weaker social protection systems restrict the scope for progress on poverty and inequality goals

Direct government transfers offer greater potential to reduce poverty and inequality in lower income countries as the entirety of the bottom 40% of the distribution is often unemployed, underemployed or informally employed. Expanding social transfers to this bottom 40% and beyond (in terms of either recipients or benefit amounts) can make a huge difference without even addressing the market inequality in earnings and employment. Because people in this proportion of the population officially have zero earnings, even small increases to household consumption at the bottom of the distribution, coming directly from government transfers, can reduce poverty and inequality substantially.

South Africa during the shock of the COVID-19 pandemic offers an example of this potential impact. During April-June 2020, the government responded with emergency social assistance, expanding eligibility for some social transfers to previously excluded groups. Due to these policy decisions, South Africa enjoyed a sudden, unprecedented reduction in poverty of 3-6 percentage points, and significant mitigation of upward pressure on inequality at the height of the crisis, when the economy was under duress and active employment down 40% (Schotte and Zizzamia, 2021[31]; Bassier, Budlender and Zizzamia, 2021[32]).

SOUTHMOD, a collection of tax benefit microsimulation models, provides additional evidence of both the efficiency and redistributive potential of tax and social protection policy reforms. The pandemic demonstrated that African tax and social protection systems are generally ill-equipped to protect households from income losses. Of the seven African countries studied (not including South Africa), only the additional policy measures of Mozambique and Zambia somewhat cushioned the COVID-19 shock for poorer households (Lastunen et al., 2023[33]).

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The case of Zambia illustrates a common scenario across Global South countries: the need to continue to expand social protection systems – in terms of coverage and the amount of support beneficiaries receive – and how tax benefit microsimulation models can provide powerful evidence for policy makers. In 2019, Zambia undertook a large expansion of its benefit system, mainly by adding a set of social cash transfers known as Cash Plus. An impact assessment found that the system reduces poverty by 4-6 percentage points. The social protection system as a whole provides support to 76% of the extremely poor, and the new cash transfers reach only 36% of that population. While the elderly, disabled and female-headed households are well-targeted, members of the extremely poor population outside of these groups, especially in urban areas, are least supported (Table 3.1). Overall, Zambia's benefits system does not have the potential to meet ambitious national poverty goals without further expanding support to uncovered groups (Gasior et al., 2021[34]).

Table 3.1. The impact of social protection measures on poverty and inequality in Zambia

POPULATION GROUP	COVERAGE RATE (%)	POVERTY AND INEQUALITY AFTER BENEFITS (%)			POVERTY AND INEQUALITY REDUCTION (pp)		
		Poverty headcount	Poverty gap	Gini	Poverty headcount	Poverty gap	Gini
Ages 0-17	76.7	44.5	19.1	51.9	-4	-4.4	-2.8
Ages 18-24	73.8	33.4	13.6	50.8	-3.8	-3.3	-2.1
Ages 25-64	73.7	34.7	14.1	56.7	-3.9	-3.6	-2.1
Ages 65+	98.4	44.3	18	52.2	-10.9	-9.7	-6.2
Person with disability	99.4	48.1	19.4	50.5	-10.9	-12.3	-8.1
Rural	79.7	58.4	25.1	42.4	-6.4	-6.5	-4
Urban	55.7	13.8	5	48.4	-1.1	-0.8	-0.6
Female-headed	92.1	41.4	18.4	53.5	-5	-6.1	-3.8
Male-headed	72.2	39.4	16.3	54.1	-4	-3.7	-2.3
Entire population	76.3	39.7	16.7	54	-4.2	-4.2	-2.6

Notes: The table shows simulation results for all social protection measures in Zambia. The measure of the reduction in poverty and inequality is relative to a counterfactual with no benefits, expressed in percentage points. Coverage rate is defined as the proportion of the extreme poor population who receive a benefit. The results are derived from MicroZAMOD, a tax benefit microsimulation model. Microsimulation models such as MicroZAMOD assess the next-day impact of tax benefit policies on poverty and inequality compared with a scenario without those policies in place.
Source: Adapted from Gasior et al. (2021[34]), "Towards greater poverty reduction in Zambia: Simulating potential Cash Plus reforms using MicroZAMOD", https://doi.org/10.35188/UNU-WIDER/2021/104-4.

In Latin America, tax benefit systems are slightly better equipped to cushion income losses. During the COVID-19 crisis, sizeable discretionary emergency cash transfers supported the least well off. But overall, Latin American tax benefit systems did not play a large countercyclical role. Tax systems provided automatic stabilisation only to a limited extent because lower tax and social security contributions only applied to the small share of formal sector workers at the top of the income distribution, while benefit eligibility and amounts were not responsive to sudden income losses in the rest of the income distribution (Rodríguez et al., 2022[35]).

In Ecuador, for example, national poverty rates increased from 25.7% to 58.2% during the first six months of the pandemic, extreme poverty rose from 9.2% to 38.6%, and inequality rose from 46 to 59 on the Gini Index. The addition of a new social transfer, the Family Protection Grant, to the social protection system supported mainly the bottom 20% and, while sizeable, was not entirely sufficient to counter the impact of the shock (Jara, Montesdeoca and Tasseva, 2021[36]).

Global South countries need international support to increase their fiscal space and improve domestic revenues

There is a clear role for international support and multilateral co-operation in expanding funding for social protection systems in Global South countries. First, international aid financing can provide direct support to governments to expand social protection systems. Second, multilateral and bilateral co-operation can promote greater tax fairness and support improvements to domestic resource mobilisation, creating more funds for programmes that reduce poverty and inequality.

The International Labour Organization (ILO, 2021[26]) has estimated that more than half the global population has no access to social protection against poverty vulnerability. Yet, as an analysis for the Swedish Expert Group for Aid Studies found, the share of aid targeting social protection is declining from already low levels of about 2%, despite a positive and statistically significant relationship between social protection aid and the percentage of a population covered by benefit systems (Niño-Zarazúa et al., 2022[37]).

Greater tax fairness is key to generating needed public revenues, and international co-operation can play an important role through efforts to prevent tax evasion, tax avoidance and profit shifting by the most profitable businesses and the richest individuals. Globally, corporations shifted less than 2% of annual profits to tax havens in the 1970s, but the share had increased to 37% by 2019, accounting for a global loss of revenue equivalent to EUR 250 billion, or one-tenth of annual total global corporate tax revenue (Figure 3.4 and Figure 3.5) (Wier and Zucman, 2022[38]). Thanks to newly granted access to South Africa tax data[1] (Box 3.2), researchers have been able to estimate the annual losses attributable to corporate profit shifting at approximately ZAR 7 billion (South Africa rand), the equivalent of EUR 400 million, each year (Wier and Reynolds, 2018[39]; Wier, 2019[40]).

Box 3.2. Increasing data availability and local capacity to analyse the impact of tax and benefit system reforms on poverty and inequality

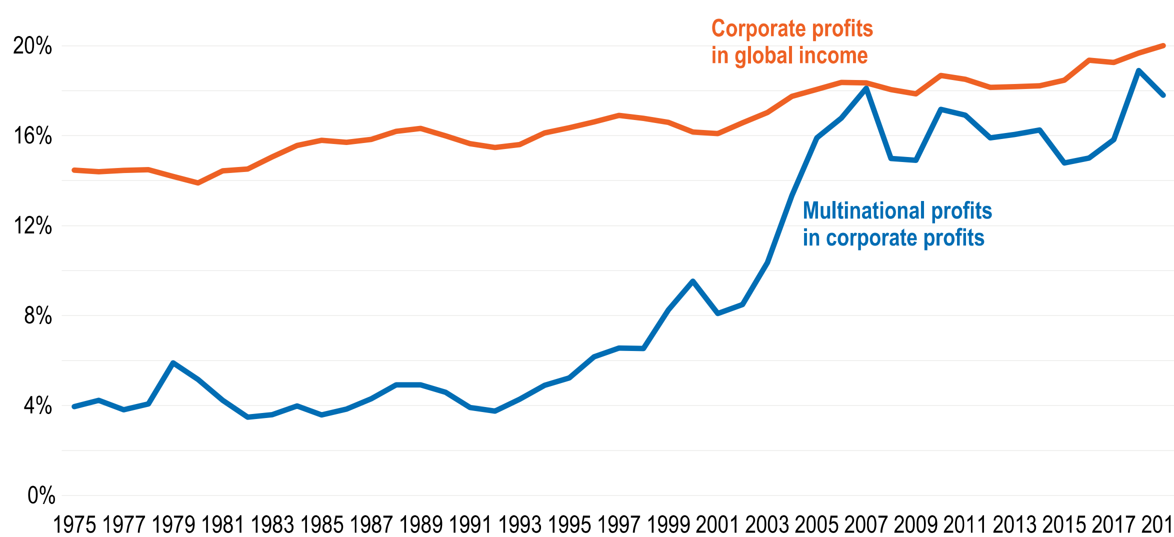
International partners can support domestic resource mobilisation over the long term by building local capacity to conduct analysis of the most effective ways to improve tax systems, support economic development, and reduce inequality and poverty.

For example, UNU-WIDER supported efforts by the South Africa Revenue Service and National Treasury to build a secure data lab and provide access to the national tax data for local and international researchers and policy makers.

The lab, housed at the National Treasury, is a hub that now provides a new interface between these actors. For example, researchers who use the data for their academic work hear directly from policy makers about what kinds of analysis would be most useful. And analysts and officials in government agencies now have access to datasets and expert advice for conducting their own analyses. Other sub-Saharan African governments have expressed interest in this approach, and there is strong demand to develop new local capacity. UNU-WIDER has since supported the development of a secure research lab at the Uganda Revenue Authority and is now working with Zambia on similar efforts.

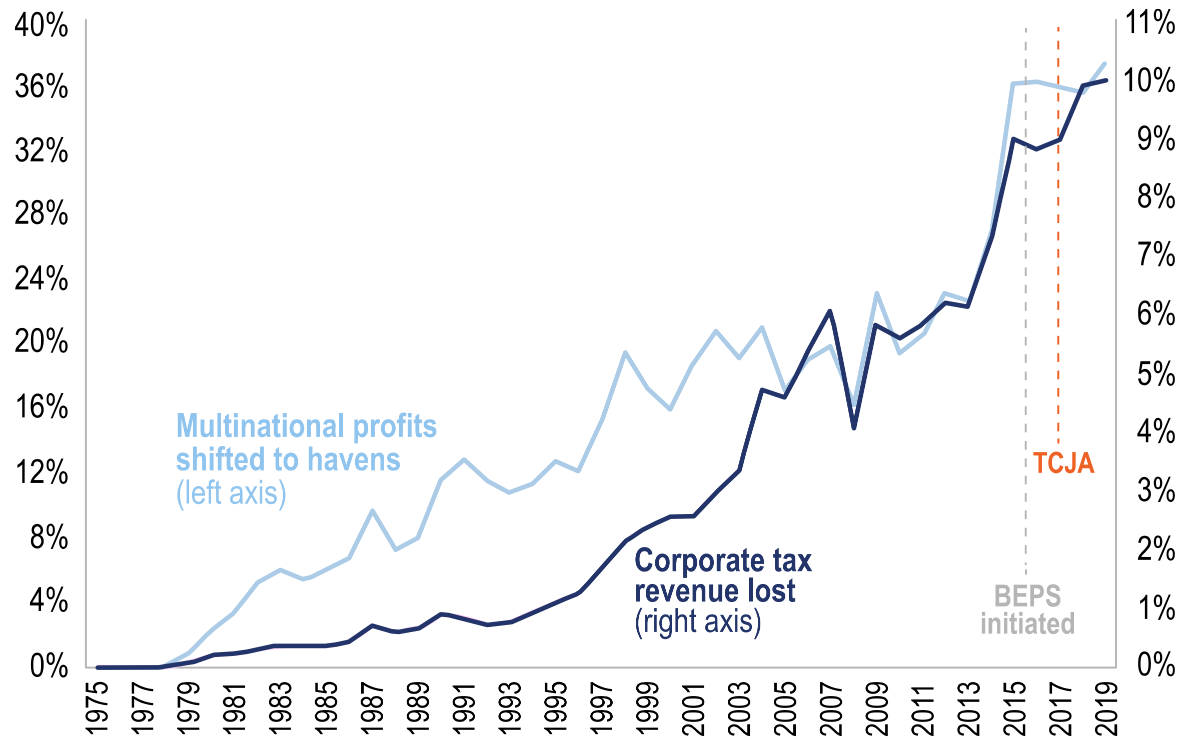
Administrative tax datasets are a natural complement to the SOUTHMOD project, which entails a set of 13 freely available tax benefit microsimulation models for Global South economies. Analysts and policy makers can use these models to simulate the next-day effects of tax and benefit system reforms on poverty and inequality at the level of households and individuals. The models are critical tools for understanding the potential effect of policies and reforms on different population groups. The SOUTHMOD project updates the models with the latest survey data and policy regimes, trains local officials and analysts to use the models, and carries out original country-specific and cross-country comparative research on tax and benefit systems. Like the original research conducted with newly accessible administrative data, research and analysis using the SOUTHMOD models are largely demand-driven, responding directly to the needs of national policy makers.

Figure 3.4. Profits of multinational corporations make up a growing share of total global income



Source: Wier and Zucman (2022[38]), "Global profit shifting, 1975-2019", https://doi.org/10.35188/UNU-WIDER/2022/254-6.

Figure 3.5. The share of multinational profits shifted to tax havens grew to 37% by 2019



Notes: The share of multinational profits shifted to tax havens is shown on the left axis. Revenue losses as a share of global corporate income tax revenues are shown on the right axis. BEPS = Inclusive Framework on Base Erosion and Profit Shifting; TCJA = United States Tax Cuts and Jobs Act, which changed the US international tax regime on corporate profits and dividends.
Source: Wier and Zucman (2022[38]), "Global profit shifting, 1975-2019", https://doi.org/10.35188/UNU-WIDER/2022/254-6.

Opportunities to increase domestic revenues through improved tax administration are effective and relatively inexpensive to identify and put into action

Alongside increased capacity and fiscal space, more effective tax systems can increase domestic resource mobilisation at relatively low cost in many countries. Access to administrative tax data can prove invaluable to pinpoint opportunities for future reforms or assess the impact of past ones, as demonstrated in several UNU-WIDER studies. For example, in Uganda, where the tax-to-GDP ratio is 11.4% (UNU-WIDER, 2023[41]), researchers estimated that multinational corporations pay an effective tax rate of 20 percentage points less than large domestic corporations (Koivisto et al., 2021[42]). Another study found that corporate tax incentives for both domestic and multinational corporations cost the Ugandan government the equivalent of one-fifth of the annual corporate income tax take (Musoke, Palanská and Schimanski, 2023[43]), while other research showed that fewer than 15% of local firms in the Uganda capital of Kampala are fully tax-compliant and file for both local trade licences and the national corporate income tax (Vincent, Dietrich and McNabb, 2023[44]; UNU-WIDER, 2023[45]). When researchers combined tax compliance estimates with Google Street View images, they found that firm compliance is linked to the quality of public infrastructure in the firm's neighbourhood, suggesting compliance is higher where public investments are more visible (Vincent, Dietrich and McNabb, 2023[44]; UNU-WIDER, 2023[45]).

A Ugandan government taxpayer registration campaign led to a 70% increase in the number of small businesses filing presumptive taxes. The roll-out of a simpler e-filing system on top of the registration campaign was even more effective, almost doubling the number of presumptive taxpayers (Jouste, Nalukwago and Waiswa, 2021[46]). Both reforms jointly led to an approximately twofold increase in presumptive tax revenues, although it should be noted that small business tax revenues constitute only 0.04% of total Ugandan tax revenues (Jouste, Nalukwago and Waiswa, 2021[46]).

In Tanzania, as part of a collaboration between the Tanzania Revenue Authority and the Finnish Tax Administration, a new data-driven approach to tax examinations in the Dar es Salaam tax offices increased adjusted taxable income by 15% in the first year (Ebrahim et al., 2021[47]). Likewise, results from Zambia suggest that the adoption of a new value added tax (VAT) withholding system in 2018 increased VAT revenues by 13% (Adu-Ababio et al., 2023[48]). These findings clearly demonstrate that there are opportunities for lower income countries to increase domestic tax revenues by harvesting low-hanging fruit in improved tax administration.

Savoia, Sen and Tagem (2022[49]), in a broad study of the development of fiscally capable states, found that among various political factors, constraints on the executive branch in particular were critical to shifting the composition of state revenues away from taxes levied on a narrow base and towards broadly levied taxes such as income taxes. The reason is that institutionalised checks and balances reduce leaders' discretion over public finance decisions, improve public accountability and increase legitimacy – all of which tend to make citizens and businesses more willing to pay tax.

Building a bigger middle class and promoting gender equality will solidify progress on reducing poverty and inequality

Investing in upward social mobility

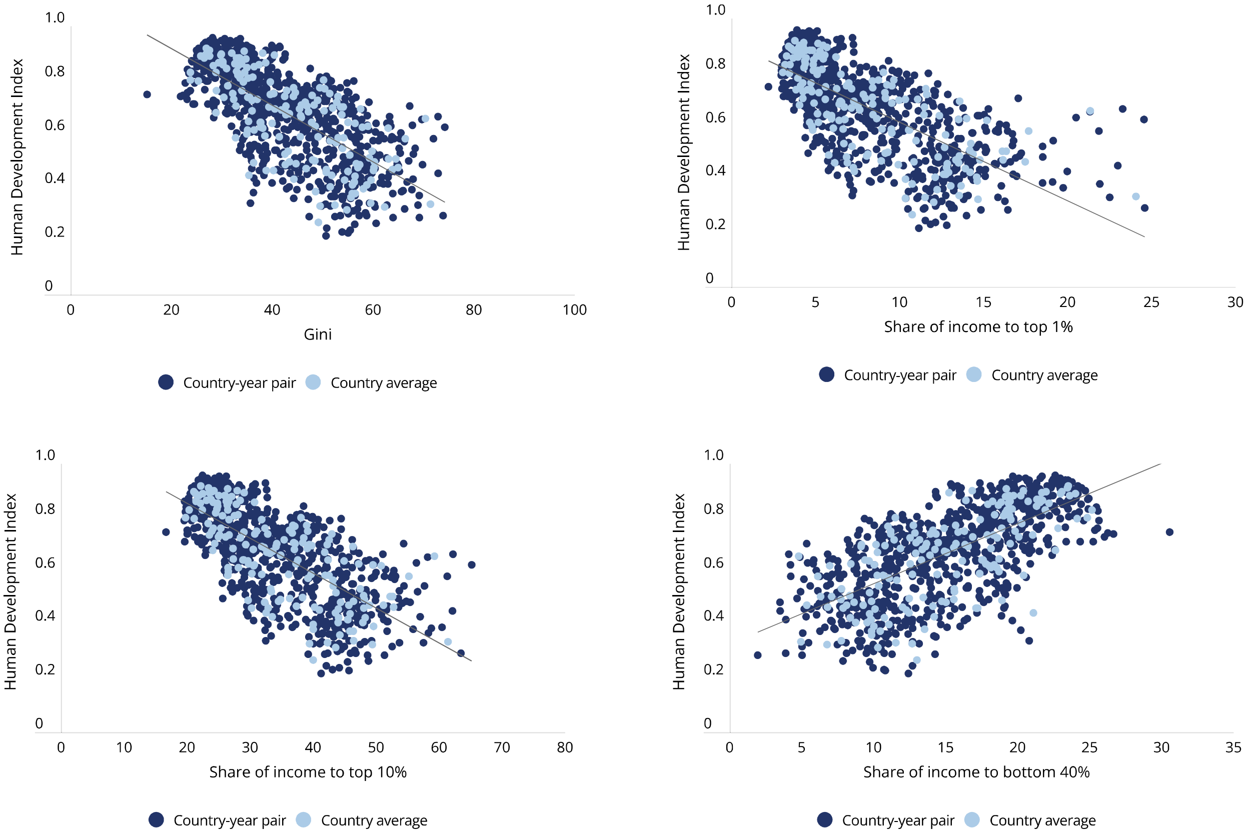
While there are major gaps in data and knowledge regarding social mobility in Global South countries (Iversen, Krishna and Sen, 2021[50]), it is widely recognised that poverty reductions are often temporary. Most households that move above the poverty line, for instance, remain vulnerable to downward slides back into poverty. Progress in reducing inequality is similarly at risk of backsliding. Without improved rates of upward social mobility, reductions in inequality that are driven by income gains at the bottom of the distribution will also be vulnerable.

> It is widely recognised that poverty reductions are often temporary.

To solidify gains in reducing inequality and to help people durably escape poverty, policy and programmatic goals should focus on continuously raising household incomes and on expanding the middle class. However, poverty rates and inequality levels are snapshot indicators that do not capture the core aspects of resilience and vulnerability that ultimately determine the permanence of inequality and poverty reductions. To protect gains, efforts should target, measure, monitor and report on indicators beyond poverty rates and inequality levels, especially those related to overall well-being, the strength of the economy and other indicators of human development.

According to cross-country analysis using panel data on more than 145 countries from the UNU-WIDER *World Income Inequality Database* (UNU-WIDER, 2023[10]), there is a strong correlation between high levels of inequality and lower Human Development Index (HDI) scores, which measure society-wide levels of education, public health and life expectancy, and economic performance (Castells-Quintana, Gradín and Royuela, 2022[51]). As illustrated in Figure 3.6, the strength of the correlation varies by inequality indicator, but is strongest when inequality is measured by the share of income going to the top 10% or the bottom 40%. This implies that it is not only high inequality, but the associated lack of a middle class, which reduces a country's HDI score.

Figure 3.6. High levels of income inequality correlate with low Human Development Index scores



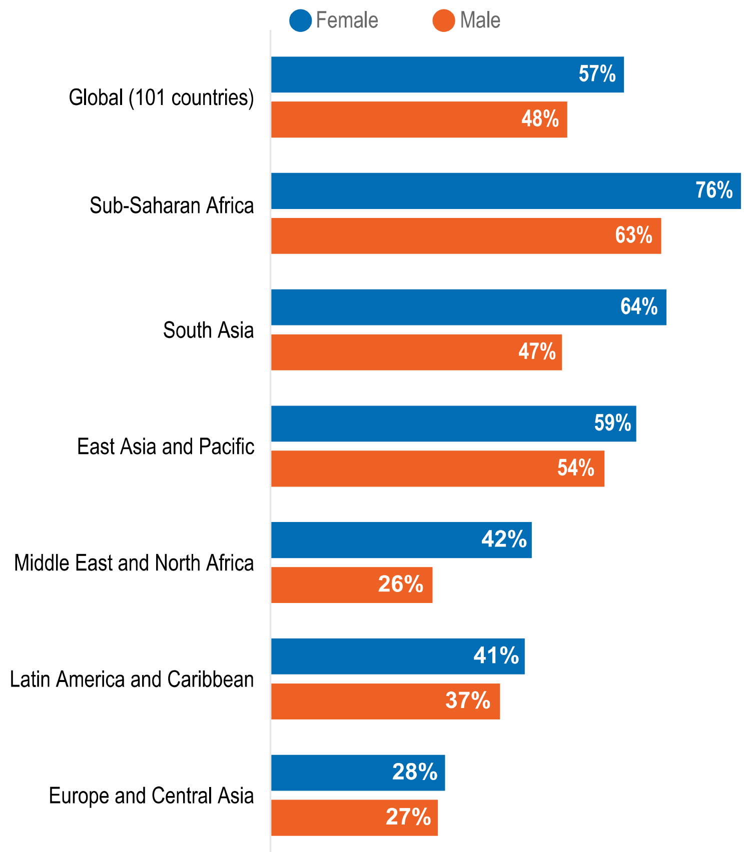
Notes: Each data point represents a country in one particular year (a country-year pair) or a country's average over several years for each of the four indicators analysed in each of the panels. The trend shows high levels of income inequality correlating with low Human Development Index scores.
Source: Castells-Quintana, Gradín and Royuela (2022[51]), "Inequality and human development: The role of different parts of the income distribution", https://doi.org/10.35188/UNU-WIDER/2022/230-0.

The growth of a middle class is supported by investments in critical public goods such as access to public health and sanitation; clean water; education and infrastructure; and additional investments in early childhood education, maternal healthcare and family support, which can all underpin increased upward social mobility.

Evidence-based policies to promote gender equality

While investments in public goods provide a helpful foundation, they are unlikely to redress long-term systemic inequalities between groups such as gender-based inequality. Since the early 1990s, for instance, gender gaps in education have narrowed across Global South countries, and yet these gains have not translated into a narrowing of gender gaps in labour markets. Women continue to be employed at significantly lower rates than men and are often concentrated in lower paying jobs with more limited protections. According to data from 101 countries and conditional on individual and household characteristics, women were 7 percentage points more likely than men to be in vulnerable employment (Lo Bue et al., 2021[52]). One estimate is that 57% of female workers globally are in vulnerable employment, characterised by poor working conditions, insecurity of tenure and inadequate earnings, compared with 48% of male workers. In South Asia and sub-Saharan Africa, fully 64% and 76%, respectively, of female workers are in vulnerable employment, compared with 47% and 63%, respectively, of male workers in those regions (Figure 3.7).

Figure 3.7. Share of male and female workers in vulnerable employment, by region



Notes: The figure shows the percentage share of the male and female labour force in vulnerable employment. The data used for each country in the regional groupings are the most recent in the 1992-2017 range. The figure uses the World Bank regional classifications and shows unweighted averages of selected countries grouped by region.
Source: Lo Bue et al. (2021[52]), "Gender and vulnerable employment in the developing world: Evidence from global microdata", https://doi.org/10.35188/UNU-WIDER/2021/094-8.

National-level policy makers have mainly tried to address supply-side constraints such as lower educational attainment for women to advance gender equality. But overcoming these constraints has rarely led to better labour market outcomes for women. The female labour force participation rate in India, to cite just one example, is among the lowest in the world despite strong economic growth, high levels of female education and declining rates of fertility (Deshpande et al., 2024[53]; UNU-WIDER, 2024[54]).

Standard packages of policy efforts to improve women's ability to enter the labour market and compete with men for decent jobs through the provision of universal public goods are not wholly sufficient. These efforts focus more on individual-level factors that constrain women from engaging in paid work (supply-side constraints) but overlook factors that influence the extent to which employers and economies offer women opportunities for decent work (demand-side constraints). Public actions that ease supply-side constraints must be paired with efforts to increase demand for women in paid work, particularly from those in the bottom 40% who are often also marginalised for reasons of race, ethnicity, religion or other factors.

Socio-cultural norms about women's roles exert a significant influence on outcomes. For policy makers who want to change these norms, an important question is which norms matter? For example, research in India (West Bengal) finds that neither veiling nor religion substantially reduces women's labour force participation, but that the primary responsibility for domestic chores is the most significant association (Deshpande and Kabeer, 2024[55]). By contrast, a family history of working women increases the probability that a woman in India is in paid employment by 18-21 percentage points (Deshpande and Kabeer, 2024[55]). Norms around gender roles and their relationship to household responsibilities and care labour are one of the most impactful constraints on progress for gender equality.

An analysis of which macroeconomic variables correlate to better outcomes for women in 15 countries in Latin America, the region that scores the best on several indicators related to women's work, found that "the most significant and robust positive correlate of women's relative access to good jobs is public social spending as a share of GDP" (Arora, Braunstein and Seguino, 2023[56]). Social spending can ease both supply-side constraints and create jobs for women.

> Mandating employers to provide more supportive family leave frameworks did not reduce job opportunities for women. Rather, it attracted more applicants from qualified women who would have otherwise remained in informal livelihoods.

Policy action to address the over-representation of women in self-employment also shows promise. High levels of self-employment among women indicate working cultures that do not support women's – and especially mothers' – stronger preference for flexibility in working life. The motherhood penalty is a major driver of gender gaps, especially in pay and lifetime earnings. In Viet Nam, government policy action to extend the maternity leave period led to increased rates of formalisation by pulling women from agricultural household work to private formal employment, with a resulting increase in women's formal sector employment (Vu and Glewwe, 2022[57]).

Applying the insights from policies that work to reduce poverty and inequality in Global South countries

Developing impactful and inclusive policies and programmes to reduce both poverty and inequality is a constantly evolving challenge. While recent global shocks reversed hard-won gains since 2015, many low- and middle-income countries across Africa, Latin America and Asia found ways to cushion their most vulnerable populations. This experience and other policies and programmes offer important insights into what works to reduce poverty and inequality. National governments, international partners and development co-operation all have important and interlocking roles to play.

First, the primary constraints facing Global South countries are on fiscal space. Critical reforms to the international financial architecture and international support can reduce the risks of global economic shocks and the costs of debt distress. Multilateral initiatives and international co-operation can reduce revenue losses by improving tax enforcement and compliance and supporting the development of local state capacities.

Second, national governments need to address two common weaknesses: relatively high rates of informality and relatively weak tax and transfer systems. Economic development and structural transformation that support strong job creation and wage and productivity growth – coupled with strong labour market policies to protect weak workers (such as minimum wages) and redistributive measures to support inclusive growth (such as transfers to rural areas) – can increase formalisation and tackle both poverty and inequality. Targeted efforts to formalise upper tier waged informal workers are a good strategy for formalising work, as are actions that can increase worker mobility out of dead-end jobs. Social support and legal protection of workers' rights can usefully support the large number of workers trapped in lower tier informal employment.

Finally, development co-operation can play a bigger role in supporting programmes and policies that have been shown to contribute to poverty and inequality reduction. Globally, only 2% of official development assistance explicitly supports the expansion of social protection systems, for instance. Increasing this support can also improve the countercyclical role of social protection in the Global South, which is critical to sheltering progress from periodic crises, especially in the most fragile states. Support for long-term transformations of economies, states and societies can also solidify the gains that these large-scale public actions support.

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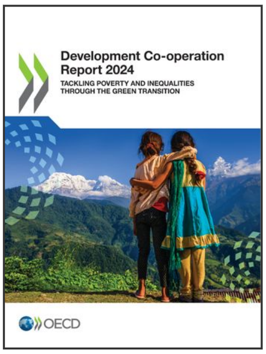
Note

[1] This finding, based on South African tax data, was made possible by South Africa’s pioneering granting of secure access to administrative tax records to researchers and analysts for economic study. Uganda was the second African country to provide secure access to its administrative tax records in partnership with UNU-WIDER. Overall, UNU WIDER has worked with revenue authorities and other government agencies to make tax administrative data available for research and policy analysis. Access to these data has enabled many studies that point to policy options for increasing fiscal space in Global South countries to finance public investments and increase social protection.



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