

Informal Transfers and Informal Taxes in Developing Countries: How do They Affect Household Welfare Distributions and Fiscal Incidence?

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Abstract

This paper profiles and analyses informal taxes and transfer payments made by households and considers their incidence, scale and distributional effects alongside formal state taxes and transfers. Focusing on Uganda and Rwanda, it considers the effect on household welfare levels and their distribution when ‘non-consumption expenditures’ in the form of informal taxes and payments of informal transfers (such as remittances) to other households are deducted from household welfare measures. The aim of the paper is to illustrate the differences that occur in the distribution of household welfare that arise when a full set of informal payments are considered and to consider how analysis of the impact of state taxes and transfers is changed by including these alongside. The paper first considers the definition of ‘informal taxes’ and how far to include customary or religious obligations, such as Zaqat for Muslims, in definitions of taxation alongside local and national taxes. Secondly, the paper analyses the difference in inequality and poverty measures that arise from including those payments in deductions made from household consumption aggregates in addition to the deduction of informal transfer payments. Third, the paper considers fiscal incidence and progressivity of formal taxes and transfers in these amended distributions before also considering the ‘joint’ incidence of formal and informal payments and their combined effect. Finally, the paper concludes by discussing how these amended definitions and estimates of household welfare match the assumptions in national poverty measurement and in the profiling of fiscal incidence and microsimulation approaches in these and other countries.