T20 POLICY BRIEF

Task Force 01

FIGHTING INEQUALITIES, POVERTY, AND HUNGER

Taxing Informal Workers Fairly to Reduce Inequality and Support Inclusion

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Abstract

Given that almost two-thirds of the world's working population work in the informal economy, reforming fiscal policies to tax them more fairly is perhaps the single most impactful way to reduce inequalities and improve the livelihoods of the working poor. Rethinking policy approaches to the taxation of the informal economy in both G20 and lower-income partner countries can be a central pillar of the G20 agenda on reforming fiscal policies to reduce inequalities and eradicate poverty.

The main challenges in this area include:

1. Regressive and unfair tax regimes in countries with high levels of informal employment;
2. A large social protection finance gap in countries with large informal economies; and
3. High levels of poverty and income inequality.

The G20 can play a crucial role in raising awareness of and supporting fiscal policies that decrease inequality and support inclusion and social cohesion. The G20 can support fairer taxation of the informal sector by taking the following actions:

1. Support fairer taxation of the informal sector within member countries and in countries with high informal employment;
2. Extend social protection to informal workers and close the social protection finance gap without increasing taxes for low-income informal workers;
3. Promote progressive taxation beyond the informal economy to reduce income inequalities, poverty, and
4. Facilitate knowledge generation, information sharing and South-South exchanges between revenue authorities.

Diagnosis of the issue

In the face of high debt servicing costs and the need for significant development investments, lower income countries across the world are facing huge pressures to increase domestic revenues. How they respond to these pressures has significant implications for inequality, poverty, and social cohesion. An increasingly common way that governments are seeking to fill revenue gaps is through the taxation of informal workers and businesses.[1] In recent years, governments have undertaken efforts to register informal businesses or to tax them through a variety of methods, including mass tax registration drives, new presumptive taxes, and taxes on digital financial services.[2]

But increasing evidence suggests that many common ways of taxing the informal economy have negative impacts on equality, while eroding livelihoods. At the same time,

[1] Max Gallien, Mick Moore, and Vanessa van den Boogaard, "Taxing the Informal Economy Is Not a Silver Bullet for Financing Development – or the Covid-19 Recovery," ICTD Summary Brief (Brighton: Institute of Development Studies, 2021); Max Gallien et al., "Why Mass Tax Registration Campaigns Do Not Work," Policy Brief (Institute of Development Studies, 2023), https://doi.org/10.19088/ICTD.2023.032.

[2] Nana Akua Anyidoho et al., "Mobile Money Taxation and Informal Workers: Evidence from Ghana's E-levy," *Development Policy Review*, May 18, 2023, e12704, https://doi.org/10.1111/dpr.12704; Mariona Mas-Montserrat et al., "The Design of Presumptive Tax Regimes," OECD Taxation Working Papers, vol. 59, OECD Taxation Working Papers, February 14, 2023, https://doi.org/10.1787/141239bb-en.

they often raise little revenue in practice.[3] Given that almost two-thirds of the world's working population works in the informal economy, reforming fiscal policies to tax them more fairly is perhaps the single most impactful way to reduce inequalities and improve the livelihoods of the working poor. This policy area also has substantial effects on gender inequality; in many countries, women are over-represented in informal economies and rely on them as a key livelihood strategy. Rethinking policy approaches to the taxation of the informal economy in both G20 and lower-income partner countries can be a central pillar of the G20 agenda on reforming fiscal policies to reduce inequalities and eradicate poverty.

Common policy approaches to taxing the informal economy often overlook three key dynamics that lead to inequitable and ineffective outcomes. First, informal work is highly heterogeneous. While there are high-income earners, many informal workers are among the working poor. For these workers, even relatively low taxes and fees can represent a substantial burden. Common strategies to tax the informal sector often take the shape of "flat taxes" or simplified daily fees that end up disproportionately affecting low-income

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[3] Gallien et al., "Why Mass Tax Registration Campaigns Do Not Work"; Max Gallien and Vanessa van den Boogaard, "Formalization and Its Discontents: Conceptual Fallacies and Ways Forward," *Development and Change*, April 24, 2023, dech.12768, https://doi.org/10.1111/dech.12768; Nana Akua Anyidoho et al., "The Price of Simplicity: Skewed and Regressive Taxation in Accra's Informal Sector," ICTD Working Paper (Brighton, UK: Institute of Development Studies, 2024).

earners while leaving relatively high-income groups, including professionals, out of the tax net or with comparatively little taxes to pay.[4]

Second, while policymakers at the national and international level often assume that informal workers do not pay taxes and that taxation can help formalise their activities, neither is true. Many informal workers often already pay a range of fees and levies at the local level and to non-state actors, meaning that new efforts to tax the informal economy often inadvertently add extra layers to existing fiscal burdens. At the same time, the expected benefits of taxation and formalization are often not forthcoming at the firm level or are concentrated among larger and higher-income firms.[5]

Third, informal workers are commonly excluded from key aspects of state service provision and social protection. Focusing on taxing them before considering how to better include them within social protection schemes undermines equity and creates a perception of taxes as extractive rather than embedded in a fiscal exchange.

[4] Daisy Ogembo, "Taxation of Self-Employed Professionals in Africa: Three Lessons from a Kenyan Case Study," African Tax Administration Paper (Brighton: International Centre for Tax and Development, 2020); Max Gallien, Giovanni Occhiali, and Vanessa van den Boogaard, "Catch Them If You Can: The Politics and Practice of a Taxpayer Registration Exercise," ICTD Working Paper (International Centre for Tax and Development, 2023).

[5] Anuradha Joshi, Wilson Prichard, and Christopher Heady, "Taxing the Informal Economy: Challenges, Possibilites and Remaining Questions," ICTD Working Paper 4 (Brighton: Institute of Development Studies, 2012); Gallien and van den Boogaard, "Formalization and Its Discontents."

As a consequence of these dynamics, current approaches to taxing informal workers often reinforce inequalities and entrench pernicious cycles of social and economic exclusion. More fundamentally, when policy attention and limited implementation and reform capacity is focused on taxing the working poor rather than on high-net worth individuals or corporate tax evasion, both informal workers and state coffers lose out.

Given the number of people employed informally and the fact that these individuals have the lowest incomes, poorly adjusted tax regimes can represent a substantial burden to many of the world's workers. This is, therefore, one of the most effective policy areas to implement the G20's priority to reform fiscal policies to reduce inequalities and eradicate poverty.

Recommendations

The G20 can play a crucial role in raising awareness of and supporting fiscal policies that decrease inequality and support inclusion and social cohesion. The G20 can support fairer taxation of the informal sector by taking the following actions:

1. Support fairer taxation of the informal sector within member countries and in countries with high informal employment.

Research on presumptive taxation and the taxation of the informal economy has identified some clear actions that revenue authorities can take to ensure fairer taxation of informal sectors.[6] This includes ensuring that minimum tax thresholds remain well above the poverty line, especially in contexts of high inflation. It is also best practice to review the use of fixed-rate simplified payments to ensure that the rates and categories of presumptive tax regimes are updated regularly and designed to be both progressive and reflective of actual earning distributions within informal sectors.

In many cases, following these recommendations is complicated by a lack of data availability. To address this, a policy intervention that has substantial potential but is as of now underused is to combine a regular review of the set of tax policies that affect informal workers with survey data on earnings and tax burdens to ensure that these have not become regressive or have layered multiple burdens upon low-income operators. The G20 could both raise awareness of such policies in lower-income partner countries and support the availability and implementation of the required diagnostic tools.

[6] Mas-Montserrat et al., "The Design of Presumptive Tax Regimes."

2. Extend social protection to informal workers.

The social protection financing gap for developing countries was about US$ 1.2 trillion in 2020 and existing research suggests that the gap is higher in contexts with high levels of informal employment.[7] The G20 should support the recommendations of the Global Partnership for Universal Social Protection (USP 2030) and, in particular, endorse a framework for social protection financing which recognises the unique challenges experienced by countries with large informal economies.[8] Some of the key strategies are likely to comprise:

- Including informal workers into universal social protection programmes in return for their tax contributions;

[7] Cyrus Afshar, "Social Protection for Informal Workers: Trends and Changes," Social Protection Briefing Note (WIEGO, 2023), https://www.wiego.org/sites/default/files/publications/file/wiego-social-protection-briefing-note-no.7.pdf.

[8] "The Global Partnership for Universal Social Protection and the Global Accelerator Discuss Joint Action towards the SDGs | UN Global Accelerator," Global Accelerator Sustainable Development Goals, October 2, 2023, https://unglobalaccelerator.org/global-partnership-universal-social-protection-and-global-accelerator-discuss-joint-action-towards.

- Adopting the ILO's recommendations for redesigning social insurance programmes so that they are affordable and accessible for informal workers;[9] and
- Endorsing alternative social protection funding schemes such as implementing Extended Producer Responsibility (EPR) models, as well as taxing value chains to fund welfare boards. Both of these funding models have been shown to be effective ways of financing social protection for informal workers.

In short, there are several ways to bridge the social protection financing gap to cover informal workers in contexts with high levels of informality. The G20 is well positioned to support the policy recommendations and funding frameworks which have been designed and endorsed by the ILO, WIEGO, and global initiatives such as USP 2030.

3. *Promote progressive taxation beyond the informal economy*.

While there are substantial steps that can be taken to make tax instruments that apply to the informal economy more progressive and less burdensome to the poorest workers, further progress requires re-evaluating the role of lower-income workers in the wider tax system. Here, the recent focus on taxation of the informal economy can be a distraction from other revenue generation strategies that will both promote equality and be more effective in addressing the fiscal pressures governments are facing. The G20 can help shift the conversation away from expanding tax nets toward informal economies in

[9] ILO, "Extending Social Security to Workers in the Informal Economy: Lessons from International Experience" (ILO, 2019), https://www.ilo.org/wcmsp5/groups/public/---ed_protect/---soc_sec/documents/publication/wcms_749431.pdf.

general and instead make it less porous for higher-income operators in the formal and informal economies. The G20 can support international standard development and data sharing around taxing high-net-worth individuals, taxing self-employed individuals in the professional sector, or addressing corporate tax evasion. This can be done through providing technical and capacity building to lower-income partner countries with regards to both developing and implementing policies for progressive taxation.

4. Facilitate knowledge generation, information sharing, and South-South exchanges.

Perhaps the most important bottleneck in taxing informal economies more fairly is the lack of data and information sharing on the issue. Especially income differentials within informal economies and, consequently, real tax rates paid by lower income operators are often merely estimated and not updated in line with inflation. At the same time, best practices between revenue authorities and other relevant stakeholders are not commonly exchanged. The G20 can support its lower-income country partners in developing the tools to gather this information regularly and provide better evidence based on the effects of tax policymaking and administration in relation to informal economies. This can include partnerships with research organisations and South-South exchanges between stakeholders, as well as conversations that are more focused on the experiences of particular sub-sectors of informal economies and, in particular, the experiences of women.

Scenario of outcomes

The pressure on lower-income countries to increase domestic revenue substantially and quickly has created a global environment that works against the fair taxation of informal workers. Against this backdrop, and with common misconceptions around informal economies as 'missing gold mines' for tax revenue, the global trend has gone toward interventions that worsen pre-existing inequities without raising much revenue. This coincides with a context in which the financial situation of many of the world's poorest informal workers has been eroded by successive economic crises and the COVID-19 pandemic. Critically, small tax payments made by the lowest income operators within informal economies can have substantial negative equity impacts, while contributing little to national budgets, especially given their high collection costs. Thus, current tax policies aimed at informal economies risk being a source of deepening inequality and exclusion.

On the other hand, when targeted at higher-income earners in particular, tax policies can support revenue gains. But the real potential lies beyond revenue: taxing informal economies more fairly can reduce the fiscal burdens on the working poor, freeing up resources to support precarious livelihoods. It can facilitate more equitable and less coercive relationships between state structures and informal economies, thereby contributing to stronger trust and a better flow of information at this critical intersection.

Relatedly, supporting the implementation of social protection floors and closing the social protection financing gap in G20 countries can be an important complement to tax policies. Joining existing initiatives which promote universal social protection without increasing the tax burden on informal workers will lead to important progress towards the SDGs and particularly towards gender equality (SDG 5).

The G20 can play a crucial role in rethinking taxation policies for the informal sector to ensure that informal workers are treated more fairly in the tax system, which will ultimately contribute to more inclusive and sustainable economic development. It can achieve this most effectively in collaboration with lower-income partners through facilitating research exchanges and supporting the diagnostic toolkits and data gathering efforts needed to better adjust current policies. The G20 can also be a convenor of forums—from high-level dialogues to working groups—that will help shift attitudes and trends on taxing informal economies away from a simplistic revenue focus and towards greater appreciation of their equity impacts.

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