

**TAX-BASED APPROACHES TO REDUCING POVERTY AND INCOME
INEQUALITY**

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Abstract: This article explores the use of tax policy instruments to improve household incomes and alleviate poverty levels. The research emphasizes the significance of the tax system within the framework of a social welfare state and analyzes its role in income redistribution from both theoretical and empirical viewpoints. Based on an econometric analysis of World Bank survey data, the study found that expenditures related to illness and healthcare have a negative impact on the financial well-being of households. The research also proposes several policy recommendations, including introducing VAT refunds for medical expenses incurred by low-income groups, reducing social tax rates for employers hiring low-income individuals, and granting tax exemptions for financial assistance provided by charitable and sponsorship organizations.

Keywords: *poverty, tax policy, tax mechanisms, tax incentives, medical expenses, value-added tax*

INTRODUCTION

In recent years, the modernization of the tax system and the increase of household incomes in Uzbekistan have been recognized as among the most important priorities of state policy. These priorities are also reflected in the Constitution of the country and are included among the key objectives aimed at ensuring economic stability and improving public welfare. In particular, Article 63 of the Constitution states that taxes and duties shall be established on the basis of the principles of fairness, while Article 43 stipulates that the state shall undertake systematic measures to reduce poverty.

The Constitution of Uzbekistan establishes that Uzbekistan is a sovereign, democratic, legal, social, and secular state with a republican form of government¹. As stated by our President, a social state primarily means creating equal opportunities for individuals to realize their potential, creating the necessary conditions for people to live a decent life, and reducing poverty².

The “Uzbekistan–2030” Strategy sets several highly important targets, including reducing poverty in the republic by two times by 2026 compared to 2022 levels and sharply reducing it by 2030, doubling the size of the economy by 2030 and joining the group of upper-middle-income countries, as well as increasing gross domestic product to 160 billion US dollars and per capita income to 4,000 US dollars³.

LITERATURE REVIEW

Taxation is one of the important economic instruments used by the state, through which it is possible not only to generate state budget revenues, but also to regulate the economy and ensure the effective redistribution of income. The central idea of James Mirrlees’s optimal tax theory is

¹ Article 1 of the Constitution of the Republic of Uzbekistan.

² From the Address of the President of the Republic of Uzbekistan to the Oliy Majlis and the people of Uzbekistan dated December 20, 2022. <https://president.uz/oz/lists/view/5774>

³ Presidential Decree No. PF-158 of the President of the Republic of Uzbekistan dated September 11, 2023 “On the Uzbekistan–2030 Strategy”.

that the state can reduce poverty through income redistribution; however, this process should not completely weaken incentives to work⁴.

In its reports, the European Commission emphasizes that value-added tax has a regressive effect, meaning that it reduces the real purchasing power of low-income households. Therefore, the European Commission proposes the application of reduced VAT rates for certain socially significant goods⁵. Arthur Okun, a professor at Yale University in the United States, stated that the most effective social policy for reducing poverty is providing employment for low-income individuals. Therefore, the state should not force enterprises to hire the poor, but rather encourage them to do so. In his research on income policy based on tax mechanisms, Okun put forward the idea of rewarding enterprises that employ low-income individuals through the tax system. These incentives included mechanisms such as reducing the tax base, granting tax deductions, and providing tax benefits⁶.

METHODOLOGY

This study employed a number of scientific research methods to examine the possibilities of using tax mechanisms to increase household incomes. In particular, methods such as analysis and synthesis, as well as statistical and econometric analysis, were applied. In addition, theoretical approaches and practical data were studied in an interconnected manner based on the methods of induction and deduction, which enabled the formulation of general conclusions.

DISCUSSION OF ANALYSIS AND RESULTS

In the following analysis, we will explore ways to increase household incomes through the provision of tax incentives or deductions in certain areas. Medical expenses have a significant impact on the financial condition of the population. During a video conference meeting held on February 27, 2020, dedicated to measures aimed at reducing poverty through the development of entrepreneurship, the President of the Republic of Uzbekistan, Sh. Mirziyoyev, raised an important question: a family may own a car or livestock, but if one of its members suffers from a serious illness and at least 70 percent of the family's income is spent on treatment, can such a family truly be considered financially secure? Through this statement, the Head of State emphasized the negative impact of medical expenses on household incomes.

Advanced foreign experience also confirms the possibility of granting tax exemptions for medical expenses. For example, according to the practice of the United States, if a taxpayer's medical and dental expenses exceed 7.5 percent of total income, the taxpayer has the right to deduct such expenses from the tax base or receive a refund of the income tax paid on the basis of a tax declaration.

In order to assess the impact of medical expenses on household incomes, we conducted an econometric analysis. The analysis was based on data from the World Bank's "Listening to the Citizens of Uzbekistan" (L2CU) survey, which was conducted monthly in 60 rounds from September 2018 to August 2023. Relevant sections of the survey data were selected for the purposes of our analysis. Households were asked whether there was any difference between their current financial condition and their financial condition 30 days earlier, with respondents indicating whether their financial situation had improved, worsened, or remained unchanged. In

⁴ Mirrlees J.A. An Exploration in the Theory of Optimum Income Taxation. The Review of Economic Studies, Vol. 38, No. 2. (Apr., 1971), pp.

208. https://www.researchgate.net/publication/4781989_The_Theory_of_Optimal_Income_Taxation

⁵ <https://op.europa.eu/en/publication-detail/-/publication/998524d7-4fe5-11f0-a9d0-01aa75ed71a1/language-en>
https://www.europarl.europa.eu/workingpapers/econ/pdf/103_en.pdf

⁶ Okun A. M. Equality and Efficiency: The Big Tradeoff. — Washington, DC: Brookings Institution Press, 1975. — 124 p.

addition, respondents were asked questions such as whether any member of their household had been ill during the previous 30 days or whether they had visited a doctor.

Using a logistic regression model, the impact of illness during the previous 30 days (sick_past30d) and factors related to the use of healthcare services on the respondents' financial condition (finance_30d_ago) was assessed. The model was estimated based on 90,544 observations, and its overall statistical significance was confirmed.

According to the results of the analysis, the regression coefficient of the variable sick_past30d was estimated at -1.650 and was found to be highly statistically significant ($p < 0.01$). This result indicates that respondents who experienced illness during the previous 30 days had a lower probability of financial stability compared to respondents who did not experience illness. The odds ratio for this variable was calculated as $\exp(-1.650) = 0.19$, which implies that the probability of having a positive financial condition decreases by approximately 81 percent in the presence of illness. In addition, the coefficient of the variable accessing_hf_wq21d was estimated at -0.919, and this factor was also found to be statistically significant ($p < 0.01$). Since the odds ratio for this variable was $\exp(-0.918) = 0.40$, it was observed that respondents who incurred expenditures related to the use of healthcare services experienced approximately a 60 percent reduction in the probability of financial stability.

Logistic regression		Number of obs	=	90,544		
		LR chi2(2)	=	3200.03		
		Prob > chi2	=	0.0000		
Log likelihood = -22024.513		Pseudo R2	=	0.0677		
finance_30d_ago	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
sick_past30d	-1.650379	.0276068	-59.78	0.000	-1.704487	-1.596271
accessing_hf_wq21d	-.9188991	.1590877	-5.78	0.000	-1.230705	-.6070929
_cons	2.928326	.0162244	180.49	0.000	2.896527	2.960125

Figure 1. Results of the ordered logistic regression model⁷

Overall, the results of the study confirm that illness and expenditures related to healthcare services have a negative impact on the financial stability of households. This situation highlights the need to develop mechanisms aimed at reducing health-related expenses and strengthening the social protection of the population.

A 12 percent value-added tax rate currently applies to the sale of all goods and services within the territory of Uzbekistan. The Tax Code does not provide for reduced VAT rates. However, starting from May 1, 2023, a practice was introduced whereby citizens included in the "Unified Register of Social Protection" may receive a refund of the VAT paid when purchasing certain types of socially significant goods and registering the fiscal receipt through the tax authorities' "Soliq" mobile application by scanning the receipt. In other words, instead of the existing 1 percent cashback mechanism, citizens included in the social register are able to receive a refund equivalent to the 12 percent VAT amount included in the purchase price. The list of socially significant goods includes products such as mutton, poultry meat, beef, eggs, and vegetable oil. In this regard, it would also be appropriate to introduce VAT refunds on the purchase of medicines for low-income populations.

In the theoretical section, we referred to the views of scholars who consider employment of low-income populations to be one of the most effective instruments for reducing poverty. The

⁷ Calculated by the author.

reason for this is that employment provides low-income individuals with a stable source of income. However, there is an important issue in this regard: it is widely recognized that the level of the shadow economy in our republic remains high. In particular, many employers in the private sector continue practices such as paying wages in cash “in envelopes” and understating actual salary amounts. This is largely due to the fact that employers are required to pay a 12 percent social tax on employees’ wages. As a result, the tendency to avoid officially reporting employees and to pay wages in cash continues to persist. In order to prevent such practices, we support the introduction of a policy under which employers who provide jobs for low-income individuals would be granted a sharp reduction in the social tax rate, or a 0 percent rate specifically on the wages calculated for such employees.

As emphasized in the introduction, Uzbekistan is a sovereign, democratic, legal, social, and secular state with a republican form of government. The model of a social state is based on ensuring social protection of the population through cooperation between the state, society, and social institutions. Within this model, material and social assistance provided by sponsorship and charitable organizations plays an important role in supporting vulnerable groups of the population and strengthening social equality and solidarity. Therefore, in order to prevent the taxation of charitable assistance provided to low-income populations by sponsorship organizations, we consider it necessary to exempt such forms of income from taxation.

Clause 20 of Article 378 of the Tax Code contains a provision exempting from taxation material assistance and benefits provided to citizens by self-government bodies, trade unions, and charitable foundations. However, the mechanism proposed in this study provides for the exemption from taxation of funds provided by sponsorship organizations in the form of charity or donations. Under the currently existing provision, only certain forms of financial assistance received by citizens such as child benefits provided through local community bodies (“makhalla”) or assistance received from various foundations such as the “Vaqf” Foundation are exempt from taxation up to 15 million Uzbek soums.

Nevertheless, the current procedure still contains certain aspects that require further improvement. In particular, although the above-mentioned tax exemption threshold of 15 million Uzbek soums was introduced into the Tax Code on April 1, 2020, its amount has not been revised up to the present time. However, considering the annual inflation rates over the past three years, the real value of this exemption has significantly depreciated. According to data from the Central Bank, the inflation rate amounted to 11.1 percent at the end of 2020, 9.98 percent in 2021, and 12.3 percent in 2022. If the established amount is recalculated based on inflation indicators, the inflation-adjusted value of the amount set in 2020 would equal 20,582,531 Uzbek soums in 2023.

It can be observed that the fixed exemption amount established in 2020 was equal to 61.2 times the base calculation amount (245,000 Uzbek soums). By 2023, however, the value of the 15 million Uzbek soums exemption corresponded to only 45.5 times the base calculation amount (330,000 Uzbek soums). This indicates that the value of this social exemption depreciated over the years by an amount equivalent to 11.2 times the base calculation amount, or 4,614,400 Uzbek soums. Furthermore, if the amount of the exemption introduced into legislation in April 2020 is recalculated based on the 2023 base calculation amount, its value would equal 20,196,000 Uzbek soums
($61.2 \times 330,000 = 20,196,000$ Uzbek soums).

According to Presidential Decree No. PF-5723 dated May 21, 2019, the base calculation amount is used in determining the amounts of taxes, duties, fines, state fees, and other payments for public services. Therefore, the amount of tax-exempt material assistance provided to low-income individuals, as stipulated in Clause 20 of Article 378, should be established not as a fixed amount of 15 million Uzbek soums, but rather at 60 times the base calculation amount.

CONCLUSION

The results of the study demonstrated that tax mechanisms play an important role in increasing household incomes and reducing poverty. The econometric analysis revealed that illness and medical expenses negatively affect the financial stability of households. Therefore, it is considered appropriate to strengthen social protection through measures such as refunding VAT on medical expenses for low-income populations, reducing the social tax rate for employers who provide employment to low-income citizens, and exempting sponsorship and charitable assistance from taxation. In general, improving tax policy on the basis of socially oriented mechanisms serves to enhance public welfare. Based on the above, the following issues are analyzed:

1. In order to prevent medical expenses and the purchase of medicines from further reducing the incomes of low-income populations, it is necessary to refund the value-added tax paid on such goods and services in the form of cashback.
2. In order to encourage employers to hire low-income citizens, the social tax rate applied to the wages calculated for such employees should be significantly reduced or set at zero percent.
3. Income received by low-income populations in the form of sponsorship and charitable assistance should be classified as non-taxable income.
4. It is advisable to link the social deductions provided in the Tax Code, particularly tax-exempt material assistance and benefits, to the base calculation amount rather than establishing them as fixed sums.

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