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SUBMISSION BY THE ALTERNATIVE INFORMATION & DEVELOPMENT CENTRE (AIDC) ON THE 2018 MEDIUM TERM BUDGET AND POLICY STATEMENT (MTBPS). TO THE JOINT MEETING OF THE STANDING AND SELECT COMMITTEE ON FINANCE

Alternative Information & Development Centre (AIDC)
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1. INTRODUCTION

We are appreciative of the opportunity afforded us by the Finance Committee to present our input.

We would like to note that we have serious concerns with regards to the latest Medium Term Budget Policy Statement (MTBPS) tabled by the Minister of Finance, Tito Mboweni on 24 October 2018.

The MTBPS highlights the deep crisis facing the country including alarmingly high levels of unemployment, which ultimately puts South Africa at a crossroads or as we would understand at the precipice of a crisis. Included in this crisis is a stagnating economy, declining investment in the real economy as well as weak levels of aggregate demand, this must all be put in the context of a global economy which is on the brink of recession. One would think that this would necessitates urgent action in order to address the countries growing socio-economic problems. Instead, the MTBPS indicates that government is willing to proceed with business as usual, including with the perpetuation of fiscal consolidation.

1.1 UNEMPLOYMENT CRISIS MEETS ECOLOGICAL CRISIS

South Africa (SA) has one of the highest levels of unemployment in the world. SAs unemployment crisis is rooted in the structure of the SA economy. There is a mistaken view that in SA wages are too high, profits are too low and labour laws are too protective. However, in reality we witness that real wages have been stagnant since 1994 and perhaps have even fallen since 2005. A declining wage share (a fall in real wages) over time in the South African economy, gives rise to a lack of aggregate demand, particularly in relation to domestic demand. The lack of domestic demand is a structural problem that breeds high levels of unemployment. To address this SA needs to see a dramatic increase in workers' wages towards a wage-led growth path. This is because economic demand has a positive effect on jobs - increasing employment opportunities. A focus on export-led growth that has characterised the South African economy since 1994 is a counter to the development of local industries and the jobs to be expected as a consequence of a changed prioritisation

The job crisis in SA is exacerbated and perpetuated by the country's addiction to mining for both exports and for energy (reflected in the mineral energy finance complex). The mining and extractives

industry continues to shed jobs as it becomes increasingly capital intensive. Therefore, we can foresee a deepening of unemployment unless we take urgent and concomitant action. At the same time that South Africa is one of the biggest contributors to climate change in the world, dependence on mining does not only threaten many jobs it also puts us on a path towards an ecological catastrophe. If government is serious about addressing the climate change, slowing down of the economy, as well as deepening unemployment, inequality and poverty it would have to radically break from austerity and invest heavily in a new industrial development path.

Our proposal will highlight the importance of implementing an industrial policy that will address unemployment, and climate change (in-line with South Africa's commitments made at COP21) towards a wage-led low carbon economy. As well as look at progressive ways to finance this new industrial policy including through curbing illicit financial flows, base erosion and profit shifting.

2. ONE MILLION CLIMATE JOBS

Medupi was estimated to cost R30bn the cost to completion has since grown dramatically to more than R190bn, not to mention an additional R220bn for Kusile (Yelland, 2016). Stopping the building of Medupi and Kusile will dramatically reduce the level of Eskom's debt. At the same time we see the building of new coal IPPs (Thabametsi and Khanyisa) this costs the taxpayer at least R28bn more, than if South Africa were to transition to renewable energy (Energy Research Centre, 2018).

More expensive electricity is counter productive, not only for the ordinary user but also for industry. Cheaper electricity is an important catalyst for growth, reducing industry's running costs thereby allows for greater investment into production and more jobs. Renewable energy cheaper than electricity from new coal, and fast becoming cheaper than old coal.

Therefore, state-led investment in renewable energy is an innovative avenue that can be pursued. This is because of its ability to address both climate change and unemployment. A state-led renewable energy programme would be able to create 800 000 + direct jobs, whilst simultaneously mitigating the impacts of climate change (One Million Climate Jobs, 2016) .

This includes the creation of 250 000 jobs through the creation of renewable energy infrastructure towards the production of electricity. 390 000 jobs through the development of a renewable energy based public transport system. 150 000 to 200 000 jobs in construction and maintenance of renewable energy infrastructure.

This can be done over the next 3 years with a total of 252,000 jobs per annum. Including 188,000 jobs a year in the manufacture and installation of renewable energy, 44,000 jobs a year in operations, and 20,000 jobs a year in running the grid. These jobs must be public sector jobs that guarantees a living wage.

In order to ensure that we are able to create this many jobs it is critical that the renewable energy industrial programme is state driven with local manufacturing being a main objective. In relation to timeframes, developing local plants to manufacture wind turbines and solar PV cells could be built and up and running in a year. The expansion of public transport could also happen very quickly.

This will have many benefits, including increased demand for transportation, housing and other goods. All this has compounding effects, such as: creating many more jobs in other sectors and industries including jobs in the built environment, this includes: roads, buildings, water treatment plants, hospitals and schools. We need to convert old buildings so that they use less energy and build

new ones that use even less. The urgent need for water conservation requires re-plumbing toilets to use grey water. The job-creation potential here is huge. Moreover, we need ensure that our built environment can cope with the growing consequence of climate change, this too will require more jobs.

We estimate that it could cost government approximately R346 billion, per annum but it is possible for government to recover at least R252 billion per annum. R167 billion each year through electricity bills, tickets, rent, sales and the like. Next, more than a 700 000 people who did not have a job will now be making money. They will spend much more money, and some of that money will go toward paying VAT. The better paid will also be paying income tax to the government. And companies in the supply chain will also be paying corporation tax.

Moreover, we estimate that altogether the government can get back at least R85 billion in taxes.

The shortfall to fund social spending and to advance a new industrial programme centred on the path to a low-carbon economy can be raised progressively. The shortfall can be financed by:

- Increased taxation of companies. In March, 2016 non-financial private companies in South Africa were hoarding R725 billions in bank accounts. A compulsory 10% tax could raise R70 billion.

- Taxing high incomes. The top rate of tax for the rich now is only 41%. If we just roll back a third of the cuts in the personal income tax since 2000, we could raise R60 billion a year. We could raise more if we wanted to raise taxes further on incomes of over R5 million a year.

- Tax Bond Sales. There is already a tax of one quarter of one percent on sales in the stock market. If we extend that small tax to bond sales, we should raise some R20 billion a year.

- Close Tax Haven Loopholes. During the last decade, illegal capital flows from South Africa, and shifting profits to tax havens, have been very large. It is not possible to be precise about how much money we could raise, because these transactions are hidden, and only some of this money could be recovered in taxes. But these profits would be liable for the 28% tax on corporate profits.

3. CURBING ILLICIT FINANCIAL FLOWS, BASE EROSION & PROFIT SHIFTING

Another crucial point AIDC would like to highlight regarding this MTBPS is the issue tax evasion & illicit financial flows (IFFs). This multifaceted phenomenon and the incapacity of South African tax authorities to tackle it is of particular concern for us. The following paragraphs highlight in detail the scale of the problem, both in terms of public finances and tax collection, but also in terms of its massive impact on the economy.

3.1 IMPACT OF ILLICIT FINANCIAL FLOWS, BASE EROSION & PROFIT SHIFTING

The lack of investment in the real economy is one of the major impediments to the sustained creation of decent work.

According to a 2014 Global Financial Integrity report of 2012 South Africa lost almost $30 billion in illicit financial flight. A report by Ben Fine, Sam Ashman and Susan Newman (2011) estimated that for 2007 almost the equivalent of 25% of GDP was lost to illicit financial flows. All this points to the systemic involvement of SA based corporations in IFF and BEPS.

While most commentators and analysts focus on the impact of illicit financial flows, base erosion and profit shifting (BEPS) in relation to lost tax revenue (estimated to be in a range of 4 to 10% of the Corporate Income Tax), the more profound issue is not tax avoidance but wage avoidance. These practices, including aggressive tax planning, thin capitalisation and transfer pricing arrangements (with low or no commercial substance) do not only erode the tax base but also perpetuate and exacerbate wage inequality in an already highly unequal society.

Furthermore, IFF's and BEPS erodes the base for local investments in the real economy. Therefore, our concern is not just with tax avoidance but equally wage avoidance and the diminishing of resources that if halted can be diverted to be invested in the real economy. Losses to the tax authorities, nevertheless remain important in so far as curbing them would provide the state with more resources for investing in job creation.

Massive outflows of money and capital from our economy continue. It ultimately results in the slowing down of the economy and the shrinking of investment in productive industries towards industrialising (an important instrument for job creation) the economy.

Given the dynamic inter-relationship between the production process and consumption, IFFs & BEPS represents a huge blow to job creation insofar as it impacts on aggregate demand in the local economy. Better paid workers are potential consumers underpinning the local consumer market and ensuring economies of scale. Stronger domestic demand is particularly important within a constrained global market, particularly where a number of important SA products face saturated markets and conditions of overproduction. Implementing capital controls, halting IFFs and BEPS is therefore critical for expanding the South African economy and job creation.

Moreover, massive outflows of capital to offshore jurisdictions (tax havens), means that the stock of domestic savings is highly diminished, resulting in higher interest rates. This suppresses the expansion of the small-medium and micro enterprises. If the cost of credit is too high, the opportunity cost forfeited due to investing in the real economy is too high, dampening the potential for job creation.

Increasing the pool of domestic savings would put downward pressure on interest rates creating greater incentives for investing in the creation of small-medium and micro enterprises (SMMEs).This will also spur job creation.

Another positive effect of addressing capital outflows in relation to job creation is that the country will be able to increase the tax base, creating greater public resources for service delivery programs and infrastructural investment. This means direct job creation.

3.2 TAX TRANSPARENCY

There is compelling evidence that state institutions (including treasury, SARS, SARB) could do much better in curbing both tax evasion and avoidance through transfer mis-pricing and BEPS). This

would impact all the leverages for job creation mentioned before, including higher internal demand for goods and services, lower interest rate for job creating projects, and expanded public work programs.
Concretely, three main reforms have to be undertaken to massively curb illicit financial flows:

I. A complete shift from a tax secrecy culture to a tax transparency culture. We often defines it as the ABCD of transparency since the changes to implement are the following:

- Automatic Exchange of Information between tax authorities
- Beneficial Ownership, including the creation of a public registry that lists the name of the real owners of all SA assets, be it property, enterprises, trusts, or simply bank accounts.
- Country-by-Country, subsidiary-by-subsidiary reporting for all companies operating in SA
- Disclosure of all tax returns of all politicians, elected representatives and high-ranking officials within the administration

Not only would this prevent corruption and money laundering from happening, but it would also force SARS to implement existing rules effectively. The 'State Capture' episode proved that even such an essential institution wasn't exempt from governmental pressure to halt its investigations. A shift toward transparency would prevent this from easily reoccurring, that is why we don't support the current approach of the government to support the confidentiality of tax information that would stay the exclusive data of SARS.

II. Rules framing transfer pricing guidelines have to be reshaped to close the loopholes used by accountants and tax practitioners of multinational companies, who take advantage of the rules created by auditing firms to avoid paying their fair share of taxes and wages. The fact that such rules currently don't force MNC to align their accounts and tax returns to their real economic activities has to change. For this purpose, the implementation of legislation such as a general anti-avoidance rule is essential.

III. In addition, in order to address trade misinvoicing (one of the main instruments used by transnational corporations to shift profits) Customs agencies should treat trade transactions involving a tax haven with the highest level of suspicion and exercise increased scrutiny. Government should significantly boost their customs enforcement by equipping and training officers to better detect intentional misinvoicing of trade transactions, particularly through access to real-time world market pricing information at a detailed commodity level.

IV. Another short term measure is to re-impose capital control mechanisms. This could greatly ease the task of South African tax authorities by facilitating the tracking of money outflows and by allowing to them to access better the origin of financial inflows.

V. Lastly, SARS and other regulating authorities (SARB, the CIPC etc.) have to be properly resourced to make sure that they have the human and technical capacities to deal with the complexities of IFFs and BEPS. This has been highlighted multiple times by the Davis Tax Committee, an efficient and competent tax authority is one of the key instruments required to stop IFFs.

3.2 UTILISE JOBS FUND

We note that in a time where unemployment is of extreme concern, the Adjusted Estimates of National Expenditure show underspending of R17.473 million from the Jobs Fund. Whilst it is noted that the Jobs Fund is on track with achieving its targets for 2018/19, notwithstanding the underspending, there appears to be a trend of underspending from the Jobs Fund. The Jobs Fund is an important programme in terms of addressing unemployment. The underspending needs to be addressed.

4. BORROWING FROM THE GEPF AT A REGULATED INTEREST RATE

Lastly, regarding the MTBPS, it appears once again to AIDC that the issue of the management of debt is addressed in an ideological way, especially by Treasury officials, that prevents the current government to address it in a more rational way.

If AIDC doesn't dismiss the need to keep public finance in a long term path that is sustainable, it seems that currently, the Treasury has imposed over this topic a dogmatic view inspired by neoliberal school of economics. This has the effect to impose austerity budgeting in South Africa, depriving millions of South Africans from posterity and access to essential public services.

We want the Treasury and the finance minister to acknowledge that other options exist to manage our sovereign debt and the debt of SOEs differently in order to get South Africa out of its current economic crisis by allowing a stimulus budget.

We defend that an alternative management of the funds gathered within the Public Investment Corporation (PIC) could lead to an increase fiscal space by freeing up resources through the reduction of debt related payments to investors.

Currently, debt service costs – the interest on the debt and exchange rate effects – are 13% of tax revenue and rising, from R182-billion in 2018 to an estimated R220-billion in two years. In any event, the damaged SA Revenue Service is already doing this for cigarette smugglers and for corporates paying "management fees" to fictional offices in Dubai or on Cayman Islands.

One of the institutions for which the debt service costs of the public sector in fact are an income is the Public Investment Corporation (PIC). The CEO of PIC reported in March to Parliament that PIC had R2.084-trillion on its books. He was defending PIC at the Standing Committee on Finance against allegations of nepotism and corruption. These allegations will now be investigated by yet another commission.

Let this probe into PIC be a signal to completely change the borrowing regime of the South African government. Albert Einstein allegedly defined madness as repeating the same measures, but expecting different results. A definition of sanity would then read: You have to do something completely different if you want to have something you never had before.

Now, PIC has two main clients. These are the Government Employee Pension Fund (GEPF) and the Unemployment Insurance Fund (UIF). The creditors PIC, GEPF and UIF are, crucially, all government controlled.

GEPF's assets comprise 87% of this R2-trillion. Through the PIC, in March 2017, GEPF effectively lent the parastatals R163.7-billion. To the government itself, the GEPF had lent R324.7-billion. That is: the government-controlled GEPF has invested R488.4-billion in loans to government and state companies.

But 50% of GEPF's assets are held in shares. GEPF was good for R1.673-billion in March 2017; 12% of GEPF's whole financial wealth was shares in Steinhoff and in Naspers (a staggering R164-billion in Naspers, whose shares since have been falling). Steinhoff now sits in the Rogue's Gallery testifying to the Grand Corruption of the Zuma Presidency. Naspers' most important company is Tencent – a cellphone game company partnering with the Chinese government to keep political check on the citizens: face-recognition spyware and other niceties.

Another 8% of PIC belongs to the UIF. UIF payments to workers who lost their jobs have been less than the contributions it has received for over two decades. Official unemployment in South Africa stands at 28%, not counting those who gave up looking for jobs. During the rise of mass unemployment, what is supposed to be the workers' own public unemployment insurance has become an obscene bastion of financial wealth. In March 2017, UIF had hoarded R180-billion in the PIC.

The 2% UIF fee levied on the wage is paid even by the lowest paid formally employed workers (the employers deduct their half from the wage bill as labour cost). This fee is not a part of the government's budget. When UIF has paid out benefits, the surplus is handed over to PIC. For many years the annual surpluses has been R6- to R8-billion. The rules were just made more liberal. Still, however, the surplus is projected to R2-billion per year.

The increase of VAT to 15% on 1 April put an estimated R23-billion damper on consumption during this budget year. This is a factor behind the recession. If the UIF fee was scrapped for a year or two, the annual fee collection of R22- to R23-billion would add to economic demand, reversing the effect of the VAT increase on all formally employed. Indeed, if they get to hear the news, many informal workers and their families who are victims of a fraudulent UIF deduction from their salaries will also benefit.

Today it would however be necessary to defend such a stimulus measure worthy of the name from the plans of the South African Reserve Bank (SARB). SARB is expected to increase interest rates in 2018, to defend the value of the rand. The idea is that this will stop price increases on imported goods, such as oil. Anyone with a loan or a credit card from a bank or a retailer will then see a cut in buying power. Higher interest rates also increase the government's debt service costs. The government will be fighting the debt crisis and the recession and the SARB will work in the complete opposite direction. Household debt is over R1.7-trillion. A quarter percent interest rate increase will suck R5-billion into the financial system and away from consumers.
The neoliberal idea of an independent central bank must fall. The SARB must co-operate with the government. This is a more urgent issue than SARB being "private".

China uses exchange controls, instead of interest rates, to set a certain value of the Yuan – to Donald Trump's dismay. South Africa should do something similar, and it could do this if the state borrowing regime is changed along the lines here suggested.

What would such a change look like? One interesting suggestion was to convert the R84-billion in loans from the GEPF to Eskom into shares that pay no dividends. That would remove interest

payments on the R84-billion. This was disregarded for fear of private creditor institutions crying "Eskom is defaulting!"; that is: for the fear of their political power and opinions.

The non-political and rational question is whether GEPF can afford to lose its R5- R10-billion annual interest incomes from Eskom.

The GEPF is a "Defined Benefit" pension fund. The members get what they are entitled to according to the rules, not less and not more. There is no need to maximise the size of the fund. It needs to be big enough to safeguard the pension payments and meet other obligations to members. It could use the rest of the money in the fund to maximise value to society, instead of hoarding it and maximising its returns on investment. This wouldn't hurt its members.

If we accept this logic, GEPF should lend most of its funds to government. The most important reason for this is to stop budget austerity motivated by rising debt service costs.

GEPF has in fact already lent the government R324-billion, Eskom R84-billion and Transnet R25-billion (March 2017). We can only guess that the government right now pays an interest of between 6% and 9%. GEPF's holding of government and parastatal bonds should mean it earns between R20-billion and R30-billion per year in interest income from the public debt.

GEPF's annual surpluses has been about R50-billion. Even if GEPF were to give the government and parastatals an interest moratorium, it would today still harvest a surplus of between R20-billion and R30-billion per year.

The 2017 and 2018 Budget Reviews and the 2017 annual report of GEPF show that the annual rate of return on GEPF's investments has been around 4.5%, for 10 successive years. We measure this like Treasury measure it, without considering the erratic market value changes of shares and bonds. Compared to the GEPF's 4.5% income from its investments, the government is paying an average of 6.5% per year on its R2.8-trillion debt, according to the 2018 Budget Review.

Second, a change to regulated borrowing from government controlled public funds would safeguard South Africa's policy independence from the International Monetary Fund, China, or any one of the other creditors who impose conditions on loans and dictate economic policy to safeguard their investments in our debts.

The corrupted deals at Transnet and Eskom amount to tens of billions. Many have argued that the US$3.75-billion loan from the World Bank in 2005 to Eskom's financially and ecologically disastrous coal adventure at Kusile and Medupi should be regarded as odious debt. It could also very well be argued that a large chunk of the loans from Chinese institutions – to pay for trains, harbour cranes and "facilitation" – should be renegotiated. But this cannot happen if you are asking to borrow R400-billion more from China.
The direct rational for radical change in state borrowing policy remains however this:
Every 0.5 percentage point the government can save in debt service costs would save close to R14-billion per year. A reduction from the 6.5% it is currently paying, to 4.5% if it borrowed from the GEPF, would reduce the debt service cost by R55-billion rand a year.

The GEPF would not lose any income. The pensions of the GEPF pensioners would not be threatened. The only losers from PIC reallocating sizeable investments from shares into public bonds

would be the Johannesburg Stock Exchange (JSE) and the capitalists serviced by the PIC's unlisted investments, which now are coming under scrutiny.

Should one worry? Even after the fall on JSE this year, Johannesburg has one of the most overvalued stock markets in the world. The value of all shares on the JSE is about 300% of South African GDP. As for undermining the BEE investment policy of PIC and GEPF by reallocating funds from venture capital to the public service delivery sector, the project of building a black faction of the crony capitalist class has destroyed and is continuing to destroy the ANC. It is a destructive minority class project.

The winners from the policy change would be the overwhelming majority who are directly dependent on the public service delivery sector. This sector is in need of urgent expansion and insourcing to fight corruption instead of being hit by austerity, looting and cutbacks.

It is in the interest of the South African people that the government does as much of its borrowing as possible from funds that are not controlled by a tiny elite, and avoids borrowing in foreign currencies. This funds exists, it the the PIC and 95% of its assets belong to two other well-known public funds that don't need to maximise investment returns.

The investigation of corruption in the PIC should be a signal to completely change the management of public debt in South Africa. There is a solution to the debt crisis and there is no need for austerity.

5. CONCLUSION

In light in the aforementioned elements, AIDC wants to reiterate its main demands to be incorporated in the 2018 MTBPS and the AENE:

- South Africa is in a deep socio-economic crisis and the country needs radically different budget choices, both in terms of spending and in terms of revenue collection

- A massive employment scheme through a new industrial development path to implement a just transition towards a low carbon wage led economy needs to be urgently implemented, and the MTBPS must be the first step in impulsing such change

- In order to raise public resources and more broadly to strengthen the economy and increase workers' wages, the fight against illicit financial flows must become a national priority, and tax authorities and the Treasury must publicly account on their progresses consistently in the future. This MTBPS is the occasion to start such accountability process in order to ensure progresses are registered in the near future to the benefit of all South Africans.

- The South African government must reform the functioning of the GEPF and the PIC in order to reduce the overall debt repayment obligations that currently weaken our national budget unnecessarily. The current ideological management of the debt must be reformed in order to fund crucial budget expenditure programmes.