SUBMISSION ON FISCAL FRAMEWORK AND REVENUE PROPOSALS

28 October 2022

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3rd Floor 90 Plein Street
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Dear Members of the Standing Finance Committee, Select Finance Committees, and Committee Secretaries,

The Institute for Economic Justice (IEJ) wishes to make a written submission on the Budget Review and the Revised Revenue Framework and Revenue Proposals tabled by the Minister of Finance on 26 October 2022.

We wish to thank the Committee for the opportunity to make our written submission.

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1. Introduction

The IEJ recommends that the Committee calls on the Minister of Finance to put the needs of all South Africans at the centre of the Budget and budget processes. This entails a radical shift in the fiscal framework, from focusing on short-term goals such as the primary budget surplus to targeting unemployment, poverty, and inequality. The urgency of resolving this triple burden is more pronounced in the context of a rising cost of living crisis that disproportionately falls on the majority, low-income households, and the unemployed.

This submission provides analysis and evidence of how the current fiscal framework is unsustainable and at odds with the State's obligation to progressively realise human rights. The current path of austerity has had an impact on the delivery of public services, leading to a regression in the protection of human rights, and disinvestment in public services.

The submission discusses proposals for progressive taxation to raise the maximum available resources to invest in public services, comprehensive social protection, and public employment. Mobilising resources for the realisation of human rights involves raising, allocating, and spending money in a manner that prioritises people's rights. The State has a Constitutional obligation to progressively realise socio-economic rights. As such, it has a duty to prioritise those who are most vulnerable, excluded, or discriminated against. It is this approach that should guide priorities in the Budget.

2. The need to rethink the fiscal framework

The fiscal strategy put forward by National Treasury has largely remained unchanged, despite the unprecedented socio-economic crisis compounded by the COVID-19 pandemic. This strategy has been narrowly focused on debt stabilisation by cutting non-interest expenditure, lowering the tax burden, and aiming for a primary budget surplus. Accordingly, the MTBPS states a primary budget surplus will be reached by 2023/24, a year earlier than was forecast in the 2021 MTBPS. This goal, however, is divorced from the reality many face in South Africa. On the contrary, the fiscal framework continues to increase inequality, poverty, and unemployment.

The Parliamentary Budget Office states that South Africa has experienced a lost decade (2012-2021) due to the government's fiscal policy. During this period, levels of investment have decreased from 18% to around 13% in 2021, unemployment has increased, and economic growth has fallen. This is unsurprising, given the evidence of the impact of budget cuts during recessionary times. Although the government has maintained its stance that containing expenditure levels will crowd in investment, the levels of Gross Fixed Capital Formation (GFCF) have been falling across all sectors of the economy since 2015. The 2022 MTBPS notes that investment levels remain R62 billion below pre-pandemic levels, while levels of investments in the public and private sectors are below National Development Plan (NDP) targets.

In this context, the IEJ calls for the state to use counter-cyclical spending to boost aggregate demand and supply capacity in the economy. The state needs to play an important role in reviving the economy by leading in investment. Part of this involves abandoning debt stabilisation and a primary budget surplus as the overwhelming priority. Instead, expenditure targeted at sectors like manufacturing and construction, as well as towards public services, and social and economic infrastructure must be increased to support the development of human capital alongside economic growth.

Proposals

- Abandon a narrow fiscal policy framework aimed at debt stabilisation through austerity.

- Adopt an integrated pro-macroeconomic framework: fiscal policy must target an increase in both aggregate demand and aggregate supply with the aim of ensuring structural transformation over the medium term.
- Undertake cost-efficient pro-employment budgeting: including estimating how changes in budgetary allocations and levels will impact employment and making these public.
- Ensure fiscal and sectoral policies are aligned, including through strong resourcing of industrial policies, for example, the current master plans.
- Regularly evaluate fiscal spending and its impact on growth and employment, aiming for high employment and growth multipliers per rand of spend.

3. Debt

In calling for increased public investment, the IEJ is not implying that debt should be left unchecked. Rather, increased public investment, as discussed above and below, should be seen as one of the ways to resolve debt in a manner that does not undermine the quality of public services or increase inequality. Investing in social protection, public services, and economic infrastructure are ways in which the economy can be stimulated, supporting consumption, the creation of enterprises, and unlocking economic growth. The growth of the economy will lead to a lower debt-to-GDP ratio. Other options include using domestic resource mobilisation, the use of state funds such as the Government Employees Pension Fund (GEPF), and monetary policy interventions to lower borrowing costs. There is no threshold or number in which debt is acceptable, nor is there any evidence to suggest that at a certain debt level, the economy stops growing.

Proposals

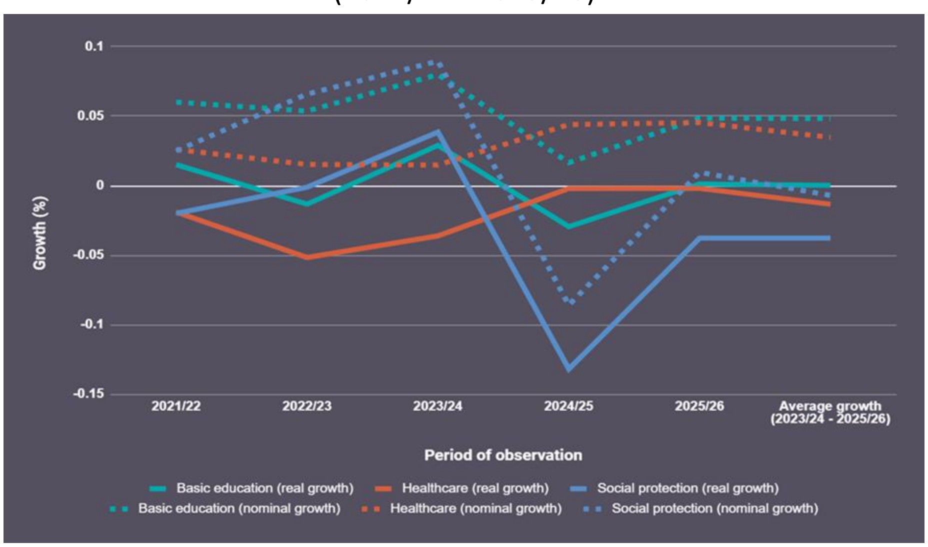
- The IEJ calls on the Committee to ask the Treasury to provide evidence on how it has decided that a primary budget surplus will resolve debt, and how this will in turn not lead to a regression in constitutionally-mandated rights.
- Increase investment through spending, such as social protection, public services, and economic infrastructure, to stimulate the economy.
- Managing capital flows: Capital outflows have an impact on currency devaluations and therefore make debt service costs more difficult to repay. These need to be curbed to reduce the cost of borrowing.
- Use state funds such as the Government Employees Pension Fund to lower borrowing costs through prescribed assets, set interest rates for local private institutional investors, and encourage reserve bank intervention in bond markets.

4. Austerity at the expense of Public Services

Budget cuts continue to dominate expenditure trends. Figure 1 below summarises the nominal and real growth in government spending on basic education, healthcare, and social protection to show the impact of austerity on key public services. Government spending on public services and social protection has been growing slightly in nominal terms. However, when the impact of rising inflation is taken into account: it becomes clear that, in real terms, expenditure has not kept up with the need on the ground. These changes are discussed in more detail in the following subsections to illustrate the extent and impacts of the cuts.

Budget cuts are ultimately self-defeating as they impact the long-term development of human capital which is key to inclusive economic growth. Moreover, they have disproportionately affected women, who use more public services, are more likely to be employed in public service provision, and undertake the majority of care for children and other family members who need these services. Women have to fill the gap and mask the impact of budget cuts through their unpaid care work. These cuts will also increase the burden of unpaid care work for Black women and girls, therefore reducing their time for school attendance, women's time for paid employment, and other activities and this will further contribute to gender inequalities.

Figure 1*:* Nominal vs real growth in basic education, healthcare, and social protection (2021/22 - 2025/26)



Source: own calculations from the MTBPS 2022

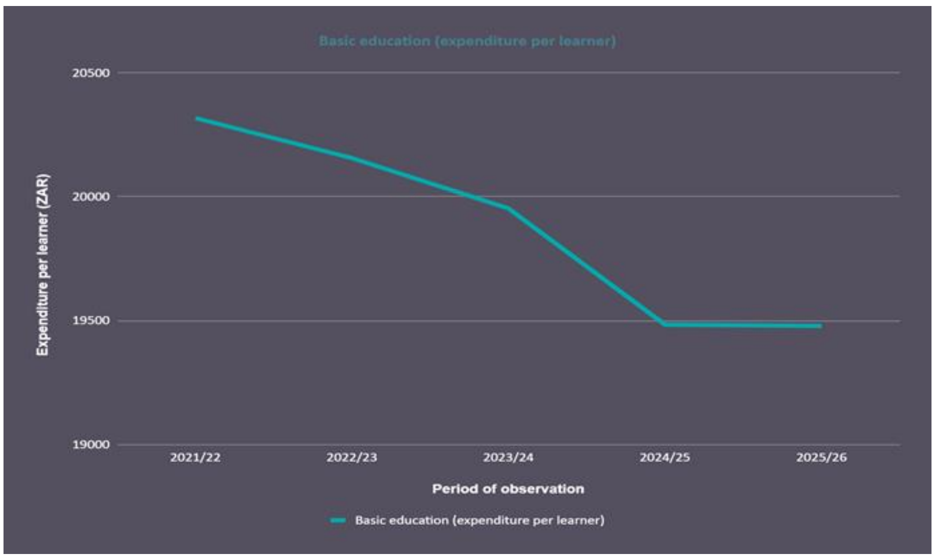
5. Education

Section 29(1) of the Constitution of the Republic of South Africa guarantees everyone a right to:

(a) basic education, including adult basic education; and (b) to further education, which the state, through reasonable measures, must make progressively available and accessible.

However, we have seen that the realisation of this right to basic education will *regress* under austerity. Figure 2 below shows the basic education expenditure per learner over the medium term.

Figure 2: Basic education: Expenditure per learner



Source: own calculations from the MTBPS 2022

Over the years, government spending on basic education has fallen. In real terms, the average annual growth remains almost stagnant, at 0.3% over the medium-term. When the growth in learners is taken into account, expenditure falls each year from R20 156 per learner in 2021/22 to R19 478 in 2025/26. Class sizes have also increased from 30.7 learners in 2018/19 to 31.4 learners in 2021/22. This is on top of 73 000 vacant posts reported in public education. A fall in budget per learner, continued overcrowding in classes, lack of textbooks, and fewer teachers mean the quality of basic education will deteriorate over the medium term, especially for schools in township and rural areas. The decline in real expenditure on education is concerning. Vacant teacher jobs and overcrowded classrooms combined with the commodification of education through private schools mean that the existing gap in the quality of education will continue to grow.

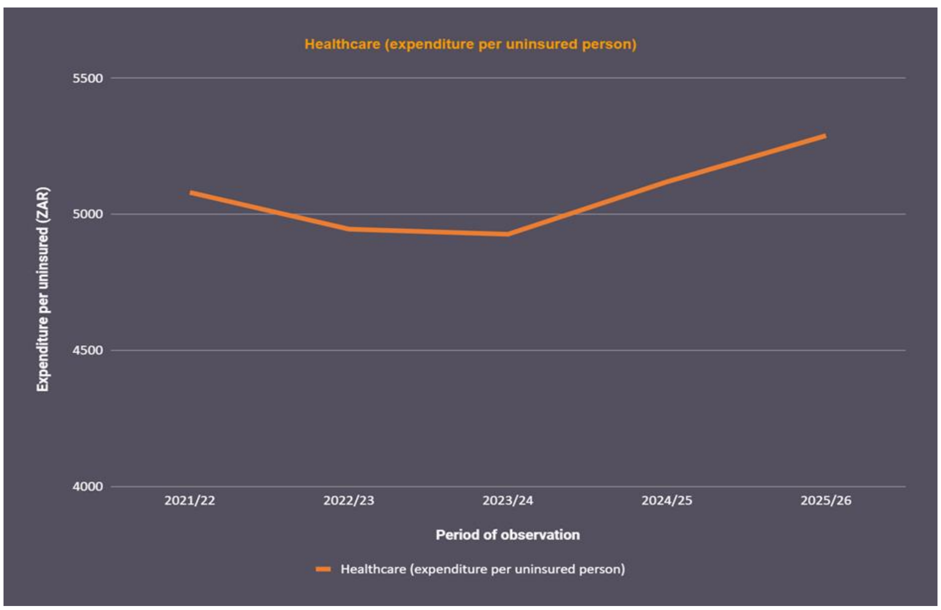
6. Healthcare

Governments have an obligation to the progressive realisation of a right to health, irrespective of fiscal constraints. Section 27 of the Constitution of the Republic of South Africa states that:

> Everyone has the right to have access to healthcare services as a basic human right, including reproductive healthcare. This right must be enjoyed without discrimination based on age, race, gender, and other social categories. Healthcare services should be accessible to everyone and be affordable for all.

Large numbers of South Africans, however, continue to suffer prematurely from poor health services. Access to quality healthcare services not only guarantees well-being but also provides the economy with a healthy workforce. Figure 3 below shows the healthcare expenditure per uninsured person between 2021/22 and 2025/26.

Figure 3: Healthcare: expenditure per uninsured person



Source: own calculations from the MTBPS 2022

Real healthcare expenditure declines from R246.3bn to R242.2bn in 2022/23, and by an average of -2% over the medium term. These cuts also come on the back of 39 000 vacant posts in public health. The extent of cuts in health care is shocking, coming as it does, in the wake of a global pandemic, and huge stress on our public health services and healthcare workers. Rising unemployment means that more and more people cannot afford private health services, therefore pushing up the number of uninsured people.

When expenditure accounts for both Consumer Price Index (CPI) inflation (which is lower than current healthcare inflation) and for growth in the uninsured population who rely on public healthcare services, the implication is that real expenditure per capita drops from R5 080 in 2021/22 to R4 926 in 2023/24, with expenditure at current levels only restored in 2024/25.

7. Social Security

The Covid-19 pandemic and lockdown regulations led to job losses and loss of income for many families, which amplified existing poverty and inequalities that threatened societal stability and required the government to mobilise resources for social relief. Despite our ongoing social crisis, there is no clarity on the medium-term replacement of the Social Relief of Distress (SRD) grant beyond the one year extension until March 2024. Additionally, increases to other social grants in 2023/24 will all be slightly below inflation.

The IEJ welcomes the extension of the SRD grant. However, it is disappointing that the SRD has not been adjusted for CPI inflation and that there is still no clear pathway on how permanent social support will be introduced following its termination. It is not sustainable to continuously extend the SRD grant at the current level. Instead, the SRD should be transitioned into permanent basic income support. This would be financed through progressive taxation as detailed below. The MTBPS has acknowledged that much of household consumption was sustained by the SRD grant. Therefore, not expanding it despite this evidence is a deliberate political choice that reneges on the state's Constitutional obligations by not allocating resourcing where there is a clear need.

8. Revenue Proposals for the 2023 Budget

The evidence highlighted above necessitates the need for a more equitable tax structure. The MTBPS states that tax revenue is projected to be R83 billion higher in 2022/23 compared to the 2022 Budget. This revenue overrun has been dedicated to supporting fiscal consolidation, as opposed to supporting households through the expansion and improvement of the SRD grant and the protection of public services. The overrun was driven by Corporate Income Tax (CIT) mainly from the commodity boom. More revenue could have been raised if the CIT was not cut by 1% from 28% to 27% in the 2022 Budget. CIT has been decreasing from 50% in 1990 to 27% in 2022. This has impacted the amount of revenue that tax generates/raises as a proportion of the GDP expenditure on public services. A windfall resource rent tax should also be in place. Progressive taxation should be seen as one of the ways to redistribute income, given the high levels of inequality in South Africa. The current tax regime reinforces inequality by giving tax breaks to the wealthy. It is not clear what evidence was used to make the decision to cut CIT as research evidence shows that where cuts have been implemented, they have not led to any economic growth, but rather increased inequality.

The IEJ calls for progressive taxation to be adopted. This could include:

- **Reverse the CIT decrease**: The CIT should be reversed back to 28% to enable the state to collect more revenue and alleviate inequality.
- **A wealth tax**: Implement a wealth tax for the top 1%. This will raise about R143 billion to finance development needs.
- **A VAT on luxury goods**: Additional revenue can be mobilised through a VAT on luxury goods of 25%. This would raise an average of R9 billion annually.
- **A social security tax**: A social security tax can be instituted to raise finances for the Universal Basic Income Guarantee. This can be taxed on personal income, with those earning more being net contributors while low-income earners are net beneficiaries. It is progressively levied on those earning income above R80 000 a year – at 2 to 3% of taxable personal income.
- **Resource rent tax**: Implementing a resource rent tax will allow for an expansion of the tax base which will raise an additional and permanent tax revenue stream.
- **End to tax rebates for corporates and the wealthy**: There are tax rebates extended to the wealthy through medical tax credits and pension fund contribution deductions. The IEJ has shown that eliminating medical tax credits for those earning above R500 000 could raise R5.7 billion. In addition, an end to retirement fund contribution deductions for those earning above R1m could raise R28 billion.

Conclusion

This submission has discussed the need to urgently rethink the current fiscal framework from narrow debt stabilisation to targeting unemployment, poverty, and inequality. This shift will ensure that fiscal policy is used to stimulate aggregate demand and supply. In addition, public investment should be seen as one of the ways to drive inclusive growth by protecting the quality of public services and resourcing industrial finance. These development goals rest on the promotion of an equitable tax structure through progressive taxation. The state should ultimately be guided by the Constitution in its budget priorities and not short-term goals that lead to a regression in socio-economic rights realisation.