INSTITUTE FOR ECONOMIC JUSTICE'S PRE-BUDGET SUBMISSION

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1 BACKGROUND

The Institute for Economic Justice (IEJ) appreciates the opportunity to provide input prior to the Medium Term Budget Policy Statement. We note in National Treasury's Invitation to participate in pre-budget consultation the questions on which National Treasury seeks input pertain to improvements to deal with the "challenge of long-term fiscal sustainability" and financing of "key priorities". While National Treasury should be commended for public consultation, the call for participation takes as given a fiscal strategy that: includes stabilising the debt-to-GDP ratio via cutting non-interest expenditure growth; precludes long-term spending measures to support the economy; and proposes cuts to the public sector wage bill.

Meaningful consultation on South Africa's budget can only occur if these premises are themselves debated. Instead, National Treasury continues its decades-old approach of attempting to place the macroeconomic framework as 'off limits'. The IEJ submission, while responding to the questions posed, tackles the problematic assumptions underpinning National Treasury's pre-determined policy stance.

2 INTRODUCTION

The fundamental improvement that needs to be made in the MTBPS to deal with the challenge of long-term fiscal sustainability is rethinking National Treasury's extreme approach to fiscal consolidation. The National Treasury's underlying logic of fiscal consolidation (austerity) is economically flawed and will have ramifications for the South African economy. Most importantly, their impact will be felt by the most vulnerable groups in South Africa. The assumption that cutting government spending has relatively little adverse effect on aggregate demand has been discredited.[1] In fact,

[1] UNCTAD. (2019). Trade and development report 2019: financing a global green new deal. Retrieved from: https://unctad.org/en/PublicationChapters/tdr2019ch3_en.pdf

the effect of government spending cuts on output has proved to be larger than anticipated during recessionary times.

The existing Budget already makes deep and dangerous spending cuts. The 2021 Budget proposed R1.74 trillion in consolidated non-interest expenditure in 2021/22, R1.73 in 2022/23, and R1.75 trillion in 2023/24. Considering expected inflation, as Treasury notes "consolidated non-interest spending will contract at an annual real average rate of 5.2 per cent".[2] This entails a fall in spending per person and leads to real reductions in health, learning and culture, and general public services.

Austerity policies dismantled the mechanisms that "reduce inequality and enable equitable growth".[3] When people needed the welfare and social protection systems the most, they crumble, as a result of fiscal cutbacks.[4] This hurts women and the vulnerable hardest as the "existing structural inequalities, including gender and ethnic inequalities, mean that poor women from marginalised groups have been disproportionately affected".[5] Giving the pressing social needs, enormously exacerbated by COVID-19, this is deeply irresponsible and will not lead to fiscal sustainability.

[2] National Treasury. 2021. Budget Review. Available at http://www.treasury.gov.za/documents/National%20Budget/2021/review/FullBR.pdf

[3] Oxfam International, 2013. A Cautionary Tale. https://www.oxfam.org/en/research/cautionary-tale

[4] Gomes, V. A. B 2015. Office of the United Nations High Commissioner for Human Rights, 2013. Report on austerity measures and economic and social rights;. The Female Face of Austerity.

[5] Gomes, V. A. B 2015. Office of the United Nations High Commissioner for Human Rights, 2013. Report on austerity measures and economic and social rights;. The Female Face of Austerity.

3 TACKLING SOUTH AFRICA'S DEBT

A contextual understanding of public debt is required. This shows that South African debt, although already on an upward trajectory, has increased further due to COVID-19.[6] However, relative to its peers, the country's debt is not an anomaly. According to the IMF, South Africa's general government gross debt will reach 89% by 2024. Although this is higher than the 71% average for emerging market and middle-income economies, it is not an anomaly. By 2024, projections show Brazil's debt at 100%, Egypt at 87%, and India at 86%. Of course, there are other countries with lower projections.[7]

The National Treasury's approach to prioritising debt reduction through expenditure cuts is out of sync with lessons from economic history and current policy thinking. National Treasury's plan is to achieve a primary fiscal surplus by 2024/25 which will be followed by a 'stabilisation' of debt in the following year at 88.9% of GDP. In a recent post, the International Monetary Fund warns that "countries should not run larger budget surpluses to bring down the debt, but should instead allow growth to bring down debt-to-GDP ratios organically".[13] Further, stating that "[i]t is indeed self-defeating to target a higher budgetary balance when the pandemic is not behind us".[8] Deficit and debt stablisation isn't best achieved through cutting non-interest expenditure.

While reducing the share of the budget spent on debt servicing costs is a valid objective, other avenues are available. The government could reduce gross debt through making better use of quasi-state funds, such as those in the Government

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6 IEJ, Section 27 and Centre for Socio Economic Rights. 2021. The impact of public debt on Human Rights during COVID-19. COVID-19 Economics and Human Rights #FACTSHEET4. Available at https://www.iej.org.za/wp-content/uploads/2021/06/IEJfactsheet-4-Debt-sustainability-2.pdf

7 IMF. 2021. Fiscal Monitor. A Fair shot. Available at https://www.imf.org/-/media/Files/Publications/fiscal-monitor/2021/April/English/text.ashx

8 Chamon M & Ostry J. 2021. A future with high public debt: Low for long is not low forever. IMF Blog. Available at https://blogs.imf.org/2021/04/20/a-future-with-high-public-debt-low-for-long-is-not-low-forever/

Employees Pension Fund. It could reduce borrowing costs through prescribed assets and interest rates for local private institutional investors, managing capital flows, and reserve bank invention in bond markets. It could also shift certain expenses to public development finance institutions - such as, the Development Bank of Southern Africa - by capitalising those, including through the Reserve Bank.

Ultimately, the only way to ensure debt reduction is through raising economic growth, and a well-targeted government-led stimulus plan is essential to that. Fiscal consolidation of the sort proposed in the Budget is economic suicide, as the international experience, most famously of Greece, has conclusively shown.[9]

4 THE SHORT-TERM 'GAINS' HAVE HIGH LONG-TERM COSTS

Across a number of countries austerity has led to rising unemployment, falling incomes, and increased inequality. In addition, austerity has resoundingly failed to solve the problem it purportedly sought to address: rising debt levels. The reality for most countries has been that "the interaction between the austerity measures and structural reforms generated a downward spiral of shrinking GDP and continued increases in sovereign debt".[10]

The Parliamentary Budget Office also acknowledges that developing and growing the South African economy means "the government's fiscal policy framework and long-term planning have to start increasing expenditure to ensure the socio-economic rights in the Constitution" and therefore proposes R32 billion in additional spending for COVID-19 relief.

[9] Sibeko, B. (2019). The cost of austerity: Lessons for South Africa. Institute for Economic Justice Working Paper Series, No 2.

[10] Engler, P. & Klein, M. 2017. "Austerity Measures Amplified Crisis in Spain, Portugal, and Italy," DIW Economic Bulletin, DIW Berlin, German Institute for Economic Research, vol. 7(8), pages 89-93. <https://ideas.repec.org/a/diw/diwdeb/2017-8-1.html>

Budget cuts will undermine human capital investment thus reducing the country's long-term growth potential. The 2021 Budget Review notes that "low compensation growth of 0.8 over the MTEF period, will reduce the number of available teachers. This, coupled with a rising number of learners, implies larger class sizes, especially in no-fee schools, which is expected to negatively affect learning outcomes."[11] In this sense the budget will exacerbate inequality in access to basic education, violating the rights of many children. In Kwa-Zulu Natal the MEC of Education, stated that the budget has been cut by R6.3 billion and this will have a severe impact on the department's ability to fill 2 000 existing teacher vacancies and that they will have to retrench 4 000 teachers.[12] Similarly, the Cabinet has approved reductions up to R25 billion in the medium-term in higher education.[13] This will have an impact on the intake of new first-year enrolments and thereby affect the accessibility of higher education through cuts to the National Financial Aid Student Scheme (R6.5 billion) and university subsidies (R5 billion). Fiscal consolidation not only has a direct impact on the quality of public healthcare and education but also leads to the loss of public-sector jobs and will contribute to unemployment. The short term 'savings' will have long-term costs in human capital development, socio-economic rights realisation, and the provisioning of other basic services such as health, as shown in Greece where cases of HIV infection leapt by 52% between January and May 2011 when the government cut its budget for a needle-exchange programme targeting drug addicts.[14]

Reductions in physical capital investment stifles growth potential. We question how it is possible to facilitate an infrastructure-led recovery in tandem with an ongoing underspend in infrastructure. In 2020, Government reported that the total underspend in infrastructure between 2016 and 2020 was over R140 billion. In addition, despite the

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[11] National Treasury. 2021. Budget Review. Available at http://www.treasury.gov.za/documents/National%20Budget/2021/review/FullBR.pdf

[12] ENCA. 2021. Interview with MEC of Education in KZN."KZN looks to the National Treasury, education budget slashed by billions". Available at https://www.enca.com/news/kzn-education-budget-slashed-r63bn

[13] National Treasury. 2021. Estimates of National Expenditure. Available at http://www.treasury.gov.za/documents/National%20Budget/2021/ene/FullENE.pdf

[14] Branas CC, Kastanaki AE, Michalodimitrakis M, et al The impact of economic austerity and prosperity events on suicide in Greece: a 30-year interrupted time-series analysis. BMJ *Open* 2015. doi: 10.1136/bmjopen-2014-005619

former Finance Ministers' narrative of a R791 billion Infrastructure Fund, only R18 billion (in total) has been allocated in the budget to this Fund in the medium-term (2021 - 2024).

UNCTAD warns of 'lost decade' if countries adopt austerity.[15]

5 THERE IS MORE FISCAL SPACE THAN ORIGINALLY THOUGHT

Increased tax revenue and international financing has provided additional fiscal space. In February 2021, the former Minister of Finance announced that SARS revenue collections are expected to be R99.6 billion more than the forecasts from the 2020 Medium Term Budget Policy Statement (MTBPS).[16] In addition, the IMF recently injected emergency funding, effective August 2021, of R65 billion through its Special Drawing Rights (SDR).[17] These injections should be used to expand the country's response to COVID-19 and support rescue and recovery measures.

Further tax increases, including through capitalising on the current commodities boom should be implemented to raise additional revenue. As part of the principle to maximise available resources, progressive tax increases should be implemented to raise revenue. The introduction of a social security tax (SST), luxury VAT, a wealth tax, and removal of corporate tax breaks are some of the taxes that should be considered as they target the wealthiest individuals.[18] The introduction of a SST, for instance, could add an additional revenue of R67.29 in 2022/23, R69.10 in 2023/24 and R70.97 in 2024/25 if it is progressively levied upon all income earners – ranging between 1.5 to 3% of

[15] UNCTAD. 2020. COVID-19: UNCTAD warns of 'lost decade' if countries adopt austerity https://unctad.org/news/covid-19-unctad-warns-lost-decade-if-countries-adopt-austerity

[16] Theunissen, G. 2021. Collected income: Treasury's R99 billion windfall. Business Live. Available at https://www.businesslive.co.za/fm/special-reports/2021-02-25-collected-income-treasurys-r996bn-windfall/

[17] Dludla, S. 2021. IMF provides R65bn emergency funding for SA to tackle Covid-19. IoL News. Available at https://www.iol.co.za/business-report/economy/imf-provides-r65bn-emergency-funding-for-sa-to-tackle-covid-19-b97a7f2f-2c44-4f77-9c8d-42f41c9572c9

[18] IEJ. 2021. Financing options for a Universal Basic Income Guarantee. Policy Brief. Avaulable at https://www.iej.org.za/wp-content/uploads/2021/08/IEJ-policy-brief-UBIG-july2021_3.pdf

taxable personal income. On the other hand, "a wealth tax of 1% for the top 1% and a wealth tax rate of 3% for the top 0.1% is proposed. This will generate R59 billion in revenue". [19]

Fiscal space is not a given – governments can either create or diminish fiscal space through their policies and actions.[20] By modifying sources and levels of funding, governments are able to generate new internal or external resources on a sustainable basis. By using existing or new resources efficiently the state can generate different outcomes.[21] As UNCTAD notes:[22]

> [F]iscal space cannot be identified as a predetermined level of resources in any economy. Rather, it is dependent on past and current fiscal policy choices, such as the extent of the government's spending, its savings and the level of its debt relative to GDP.

6 SOUTH AFRICA'S FISCAL OBLIGATIONS

The National Treasury's fiscal strategy cannot be delinked from its Constitutional and international obligations as set out in international treaties such as the International Covenant on Economic, Cultural, and Social Rights (ICECSR). According to the Constitution, the state has an obligation to progressively realise socio-economic rights within its available resources. In addition, Article 2 of the ICECSR states that each party to the Covenant should undertake measures to progressively realise socio-economic rights, including through legislative measures.[23]

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[19] IEJ. 2021. Financing options for a Universal Basic Income Guarantee. Policy Brief. Avaulable at https://www.iej.org.za/wp-content/uploads/2021/08/IEJ-policy-brief-UBIG-july2021_3.pdf

[20] Van der Linde, G. 2018. An Incomplete Transition Overcoming the Legacy of Exclusion in South Africa. Retrieved from: http://www.treasury.gov.za/publications/other/AfricanFiscalForum/english%20version/Session3/3a/Notes%20-%20World%20bank%20-%20Gert%20vd%20Linde.pdf

[21] Duran-Valverde, F. & Pacheco, J. 2012. Fiscal space and the extension of social protection: Lessons learnt from developing countries https://www.social-protection.org/gimi/gess/RessourcePDF.action?ressource.ressourceId=34168

[22] UNCTAD. (2019). Trade and development report 2019: financing a global green new deal. Retrieved from: https://unctad.org/en/PublicationChapters/tdr2019ch3_en.pdf

[23] International Covenant on Economic, Cultural and Social Rights. Available at https://www.ohchr.org/en/professionalinterest/pages/cescr.aspx

The duty of the state to promote, protect and fulfil socio-economic rights is underpinned by three principles in addition to progressive realisation. The following principles must guide fiscal policy:

1. The principle of non-retrogression. Under this principle, the state must ensure that none of its policies or measures diminish the realization of socio-economic rights unless there is an emergency.[24] In the context of the latter, the emergency must be proven and measures are justified through substantive and procedural criteria.
2. The principle of maximum available resources. This principle requires states to also show that they used all resources available in taking into account the economic conditions.
3. The concept of the minimum core sets a threshold for the minimum levels of each of the rights. Accordingly, the obligation states that "a state party in which any significant number of individuals is deprived of essential foodstuffs, of essential primary health care, of basic shelter and housing, or of the most basic forms of education is, prima facie, violating the Covenant".[25]

In addition, the *Guiding principles on human rights impact assessments of economic reforms* note that all measures that would result in backward steps in terms of the achievement of rights are permissible only if states can prove that such retrogressive measures are: temporary, legitimate, reasonable, necessary, proportionate, non-discriminatory, protective of a minimum core, based on transparency and participation, and subject to meaningful review. The National Treasury has not demonstrated this and there is *prima facie* evidence that proposed fiscal consolidation will violate these, for example, by impacting women disproportionately. Principle 12 stipulates that:

> Independent debt sustainability analysis should incorporate human rights impact assessments. Findings of human rights impact assessments should be used to inform debt strategies, debt relief programmes and restructuring negotiations, potentially

[24] Liebenberg, S. 2021. Austerity in the midst of a pandemic: pursuing accountability through the socio-economic rights of non-retrogression. South African Journal on Human Rights. Available at https://doi.org/10.1080/02587203.2021.1972331

[25] SPII. 2016. Budget analysis for advancing socio-economic rights. Available at http://spii.org.za/wp-content/uploads/2018/05/2016-SPII-SAHRC-Guide-to-Budget-Analysis-for-Socio-Economic-Rights.pdf

triggering the latter where actual or potential adverse impacts are identified. Debt audits can contribute valuable information in conducting such assessments.

The National Treasury has not done this and should all fiscal consolidation measures until this is undertaken.

7 ALTERNATIVES TO AUSTERITY

Investment in South Africa's people and economy is essential. The problems confronting South Africa are high unemployment, inequality, and poverty, lack of access to basic services, and low economic growth. A rethinking of policy approaches reveals that the government should invest in its people. This should be done through increasing expenditure towards basic public services and key sectors of the economy for job creation. The following alternatives need to be considered:

1. **A real stimulus package is required to stimulate demand; expand supply capacity, including in network industries; and support the economic recovery of hard-hit sectors in the economy**. The care sector, construction, and manufacturing can be targeted to ease the burden of unpaid care work and support infrastructure for public goods. The IEJ has shown that a stimulus of 10% of the GDP (R492.2 billion) will generate an income of R826.9 billion and create 3.3 million jobs.[26] Duma Gqubule argues a R50 billion increase in public investment would generate a GDP increase of R135 billion.[27]
2. **Additional sources of finance and tax revenue should be pursued**. These include the introduction of a Social Security Tax (SST) – ranging between 1.5 to 3% of taxable personal income – which has the potential to raise R67.29 billion in 2022/23, a Resource Rent Tax (RRT) which could raise R38.80 billion assuming a tax rate of 25% on the value of total resource rent, the removal of ineffective tax incentives, amongst others as highlighted above. Further details are contained in [IEJ's Financing Options for a Universal Basic Income Guarantee in South Africa](#).

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[26] Sibeko, B and Isaacs, G. 2020. A fiscal stimulus for South Africa. Briefing Paper. Available at https://www.iej.org.za/wp-content/uploads/2020/08/A-fiscal-stimulus-for-South-Africa-Final-IEJ.pdf

[27] Gqubule, D. 2021. South Africa needs growth, not austerity. New Frame. Available at https://www.newframe.com/south-africa-needs-gdp-growth-not-austerity/

3. **A Universal Basic Income Guarantee (UBIG) is one social expenditure priority that must be implemented**. The UBIG will close the gap that the labour market has not filled[28] in the context of rising vulnerability to poverty. After the introduction of the caregiver's and SRD grant, in June, poverty was below levels seen in March by a measure of all food poverty lines, showing the importance of social security in alleviating poverty. [29]
4. **Promote a more equitable tax structure in the medium term by implementing a wealth tax.** Calculations by the IEJ have shown that "a 1% wealth tax for the top 1% of earners could raise R63 billion" whilst "a 3% wealth tax on the richest 0.1% raises R103 billion". Additional tax measure proposals have been made by the IEJ.
5. **Conduct a human rights impact assessment, that are gendered,** on the budget using the United Nations Human Rights Council's Guiding principles on human rights impact assessments of economic reforms. Assessing the potential impacts of retrogression are critical as outlined above. Such assessments should be conducted in collaboration with civil society in a meaningful way.
6. Increase and improve processes for meaningful participation and transparency. National Treasury needs to strive to achieve a fiscal sustainability through sustained engagement and collaboration with social partners
7. **Acceptance that South Africa will have, for the medium term, significantly higher levels of debt.** This would entail setting the debt target higher, and announcing this. This will stop the regular increases of projected debt levels which undermine market confidence.
8. **Commitment by the National Treasury to counter cyclical borrowing to spend.** Measures that need to be put in place to contain borrowing costs must also be put in place.

[28] IEJ. 2021. Introducing a Universal Basic Guarantee for South Africa: Towards income security for all. IEJ Policy Brief. Available at https://www.iej.org.za/wp-content/uploads/2021/03/IEJ-policy-brief-UBIG_2.pdf
[29] Wright G et al. 2021. A measure of relief: how the Covid-19 grants have dented poverty and inequality. Available at http://www.econ3x3.org/article/measure-relief-how-covid-19-grants-have-dented-poverty-and-inequality