SUBMISSION

Revised Fiscal Framework and Revenue Proposals

6 November 2023

Attention:

- **Standing Committee on Finance:**
  Chairperson: Mr MJ Maswanganyi (ANC)
  Members: Ms PN Abraham (ANC), Ms W Alexander (DA), Mr EM Buthelezi (IFP), Mr JN De Villiers (DA), Dr DT George (DA), Mr NL Kwankwa (UDM), Mr RA Lees (DA), Ms MD Mabiletsa (ANC), Mr M Manyi (EFF), Mr PG Masualle (ANC), Ms MR Mohlala (EFF), Ms Z Nkomo (ANC), Mr AN Sarupen (DA), Mr F Shivambu (EFF), Mr GJ Skosana (ANC), Mr SN Swart (ACDP), and Mr W Wessels (FF+).
  Secretaries: Mr Allen Wicomb and Ms Teboho Sepanya.
- **Select Committee on Finance:**
  Chairperson: Mr YI Carrim (ANC).
  Members: Mr S Aucamp (DA), Ms LC Bebee (ANC), Mr SF Du Toit (FF+), Mr J Londt (DA), Ms DG Mahlangu (ANC), Ms ML Mamaregane (ANC), Mr Z Mkiva (ANC), Mr S Mohai (ANC), Ms MO Mokause (EFF), Mr MS Moletsane (EFF), Ms LN Moss (ANC), Mr ME Nchabeleng (ANC), Ms ZV Ncitha (ANC), Mr EJ Njadu (ANC), Ms NE Nkosi (ANC), and Mr D Ryder (DA).
  Secretary: Mr Nkululeko Mangweni.

Dear Members of the Standing Committee on Finance, Select Committee on Finance, and Committee Secretaries,

On behalf of the Institute for Economic Justice (IEJ) thank you for the opportunity to make both the following written submission, and the opportunity to participate in the public hearings on 8 November 2023, in response to the Budget Review and the Medium Term Expenditure Framework (MTEF) tabled by the Minister of Finance on 1 November 2023.

Given the centrality afforded to public participation in our constitutional democracy, we trust that you will give our submissions and its considered and substantiated proposals, meaningful consideration.

Should you have any questions regarding this submission, please feel free to contact Zimbali Mncube, the IEJ's Tax and Budget Policy Researcher at zimbali.mncube@iej.org.za.

1. Background

The Institute for Economic Justice (IEJ) views the Medium-Term Budget Policy Statement (MTBPS) with both relief and alarm. We welcome National Treasury's marked departure from the drumbeat of a looming 'fiscal crisis' that has been repeated *ad nauseam* over the past two months. This 'fiscal crisis' was almost completely absent from the Minister's speech and associated MTBPS analysis. Rather, the Minister identified a lack of growth as central to our economic and fiscal challenges. Despite this, the budget does not put forward a credible growth strategy, passing on this responsibility to the private sector.

We are alarmed that National Treasury has doubled down on the existing path of austerity that has, and will continue to fail to grow the economy and improve the well-being of everyone in South Africa. The IEJ believes that the budget must take growth, employment, poverty, and inequality as seriously as debt stabilisation. This entails ensuring that resources are mobilised through: new forms of tax; new channels of concessional development finance; untapped pools of public funds; and credit allocation policies to lower the cost of available debt.

2. The need to reimagine the country's Fiscal Strategy

There has been a notable shift by the National Treasury in terms of the key challenge facing the South African government. The notion that there is a 'growth crisis' rather than a 'fiscal crisis' is welcome. The IEJ has consistently argued that claims of an imminent risk of fiscal collapse were exaggerated to justify indiscriminate budget cuts.

2.1. Sustainable economic expansion to achieve a sustainable fiscal path can help improve revenue collection and address the debt-to-GDP ratio without compromising key public services as the current fiscal strategy continues to do.

2.2. The current fiscal framework has narrowly focused on stability and boosting business confidence and that accordingly, eradication of poverty and job creation, are seen as a consequence of growth.

This strategy has proved ineffective for two reasons:

- First, historically, sustained growth has typically required the government to play a far more direct role than that suggested by the MTBPS. These have included the supply of cheaper credit or subsidies to strategic industries, and sometimes the development of new industries.
- Secondly, in an economy dominated by capital-intensive industries such as South Africa, higher economic growth need not lead to proportionally higher employment. So, it is important to be cautious about seeing growth as a solution to poverty and unemployment.

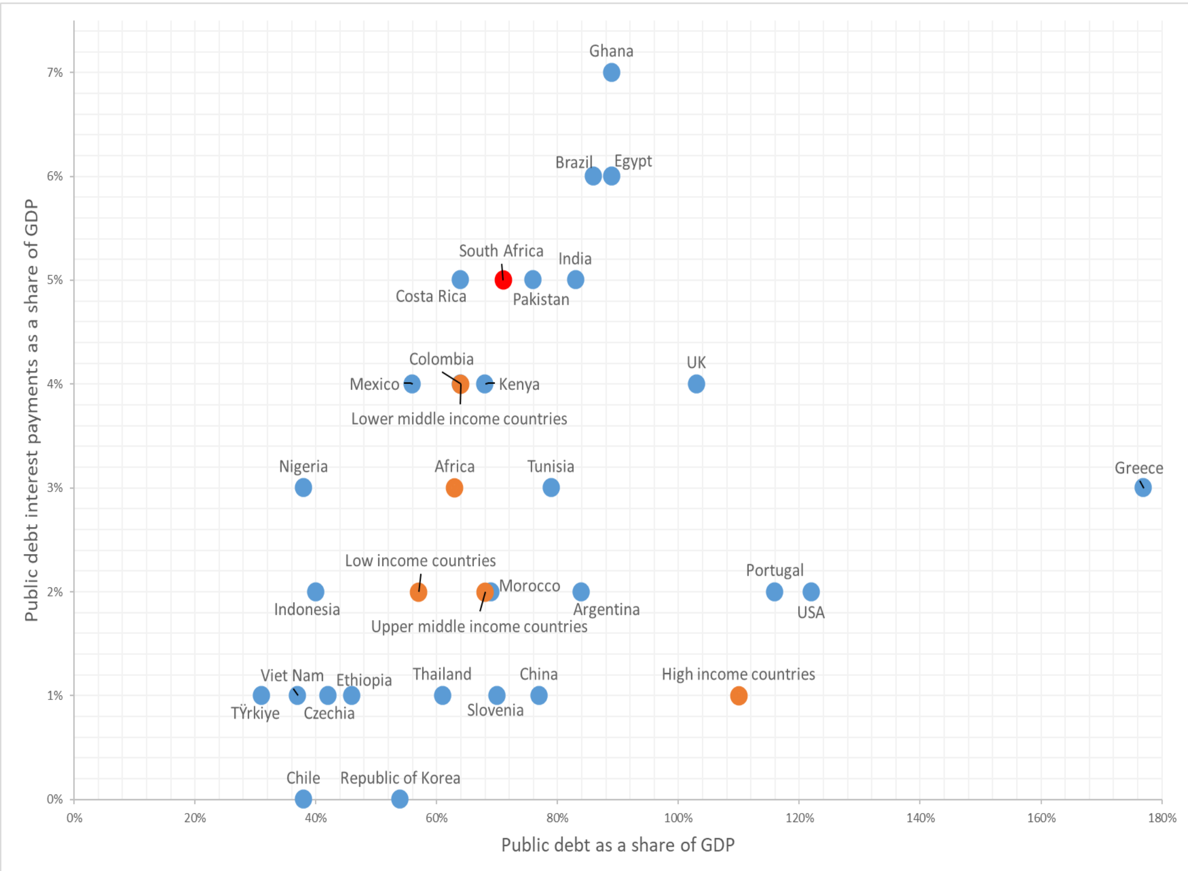
2.3. The MTBPS is unfortunately silent on the dire socio-economic crises we face. This in a context where there are currently 11.9 million unemployed people by the expanded definition and 62.6% of South Africans live in poverty. In addition, around a fifth of households lack access to adequate food and regularly send out a household member to beg for food. This is worse for rural and female-headed households. These are the crises that the budget should be overtly geared towards solving.

2.4. **The IEJ recommends** that the National Treasury adopt a development-focused budget that prioritises public investment in physical infrastructure, shifting our economy towards greener energy, greater financial support for the care of children and the elderly, expanding employment in social services like health and education, greater and more targeted spending towards industrialization and exports, all of which have been shown to have a positive impact on employment outcomes and GDP growth.

3. South Africa's debt comparatively

3.1. Our cost of debt, not our debt levels, should be the centre of debate on debt. South Africa's debt level – public debt share of GDP – which stood at 71.4% at the end of 2022/23, is similar to the average for countries at a comparable level of economic development, at 69%.[1] Even when considering the higher projected debt-to-GDP ratio in the 2023 MTBPS, South Africa is still in line compared to peer countries. However, compared to that group of countries, see Figure 1, our yearly debt service costs are relatively high. Thus, the real burden of debt is not its size, but its cost.

Figure 1: Public debt and interest payments as a share of GDP for select countries[2]



3.2. The projected revenue shortfall of R44 billion is actually below that estimated by the IEJ and most analysts, indicating a somewhat 'less-bad' picture than expected. This

[1] Based on 2022 data from IMFs Fiscal Monitor.
[2] United Nations Conference on Trade and Development (UNCTAD). 2023. A World of Debt. (Accessed on: 28 September 2023).

revenue shortfall is also within the range of previous shortfalls that the country faced between 2017 and 2020, of between R30 billion and R70 billion.

3.3. Deficit spending can allow the economy to approach its full potential. The policy of fiscal consolidation amid low growth has meant that increases in one expenditure item implies a cut to another. For example, for 2024/25, National Treasury proposes an extension of the SRD grant and the Presidential Employment Stimulus. However, these largely come at the expense of other programmes within departments. These trade-offs stunt development as in this instance, efforts at poverty alleviation might come at the expense of quality public services. Additional borrowing, especially if channelled into growth-inducing items such as ‘industrialisation and exports’, offers a way to reduce these trade-offs.

3.4. Additional borrowing can only be helpful if we are able to lower the market cost of borrowing. Due to the perceived risks to South Africa’s economic and fiscal outlook, the demand for South African bonds in the domestic market has declined. This has contributed[3] to higher interest rates on government bonds, especially bonds of longer term maturity.

3.5. **The IEJ recommends** two main ways to address this in the short term. First, the government should increasingly borrow more using relatively cheaper short and medium term debt. In the current year, short term debt is only 11.32% of domestic financing.[4] Secondly, the government should temporarily pause switching maturing debt for expensive longer term debt (the switch auction programme), which is set to continue in the current year.[5]

3.6. Further measures to alleviate our high borrowing costs include: Direct purchase of government debt by the Reserve Bank, and requiring institutional investors (such as insurance companies) to hold a greater share of their funds in government debt. In either case, lending could be done at below-market rates.

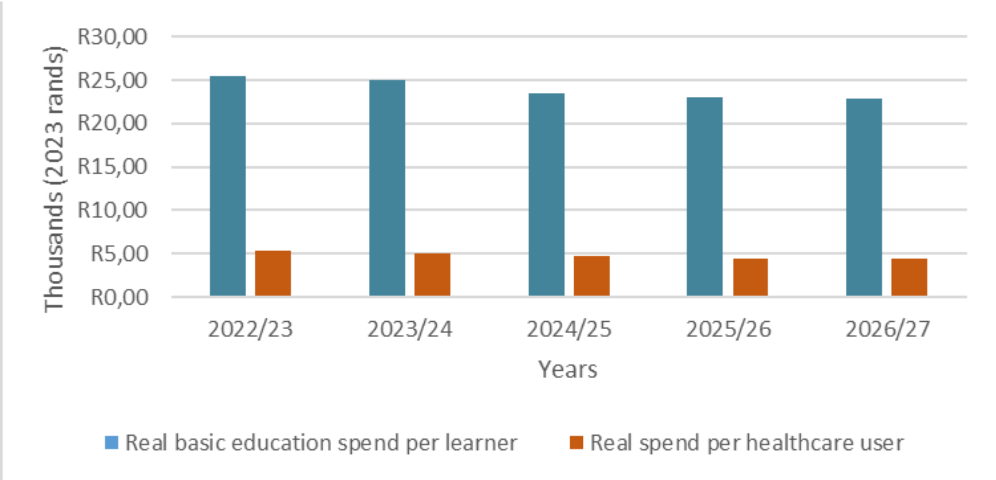
4. The cost of continued austerity

4.1. The MTBPS has made cuts to key social services and economic expenditure over the medium-term. In the medium term (over the next three years), the government aims to decrease real spending on basic education and healthcare by R16 and 14 billion respectively.

4.2. As illustrated in Figure 2 below, this means spending per enrolled learner will fall, in real terms, from R25 387 in 2022/23 to R23 363 in 2026/27. It also means that while each public healthcare recipient was receiving an average of R5 326 in 2022/23, by 2026/27 this will fall to R4 525 in real terms.

[3] Other factors which have led to an increase in the interest rate (yield) on government bonds include the increase in interest rates in advanced economies and high inflation in the last two years (see page 28 of 2023 Medium Term Budget Policy Statement).
[4] National Treasury, 2023, Medium Term Budget Policy Statement, p. 29
[5] Ibid, p. 28

Figure 2: Real spending per learner in basic education and per healthcare user in healthcare



4.3. On-going cuts will put further stress on already struggling public services. There are currently around 224 people for every nurse and 29.8 learners for every educator in the public sector, ratios much higher than recommended.

4.4. Much of the burden for coping with the additional pressure due to spending cuts falls on women. Given women constituted over 60% of public service employees, the freezing of posts or 'managing headcount' undermines women's employment and well-being. Further, as access to healthcare and other services decreases, women have to fill the gaps, such as taking care of sick relatives, who should be in hospital or under professional care.

4.5. Despite noting that growth is the challenge facing the South African economy, the budget proposes cuts to key economic expenditure over the medium-term as shown in Table 1 below.

Table 1: Percentage cuts to key Economic Expenditure

Key economic spending	**Real Change Over the Medium-Term (%)**
Job creation	-1%
Industrialisation and trade	-13%
Innovation, science, and technology	-20%
Agriculture and rural development	-11%

4.6. These budget cuts will also result in a shrinking economy. As evidence has shown, fiscal contraction larger than 1.5% of GDP generates a negative effect of more than 3% on GDP even after 15 years. The drop in GDP reaches 5.5% for cuts larger than 3%.

4.7. In the lead up to the MTBPS, the IEJ released a joint statement with 12 civil society partners and labour. In this statement we called for a halt to budget cuts. We continue to reiterate that this Committee should reject a budget not premised on sound evidence. As such, making budget allocations must be in line with population growth and the Consumer Price Index (CPI).

4.8. **The IEJ recommends** fully absorbing the public sector wage bill into additional spending (not just partially) in order to not suck up funds that should be spent elsewhere.

4.9. **The IEJ recommends** expanding spending and targeting it where immediate economic and social gains can be made. This includes for instance extending the SRD or expanding and extending the Presidential Employment Stimulus.

4.10. There cannot be trade-offs. The IEJ believes that there should not be trade-offs between government programmes.

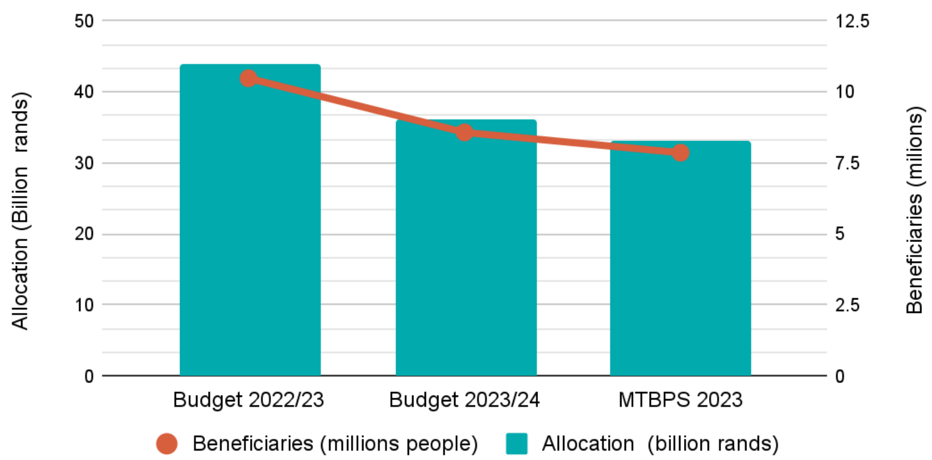
4.11. **The IEJ recommends** a thorough review of fiscal spending, especially its impact on growth and employment.

4.12. While the IEJ welcomes the move towards state configuration, the IEJ urges the committee to ask the National Treasury to conduct such a configuration in a transparent, consultative, and evidence-based manner.

5. The Social Relief of Distress Grant

5.1. The SRD grant's budget has steadily decreased—from R44 billion in 2022/23 to R36 billion in 2023/24 and now to R33 billion in the MTBPS. This has had an impact on the number of beneficiaries that can be paid within the budget allocation as shown in Figure 3.

Figure 3: SRD allocations overtime and the number of beneficiaries that can be accommodate within that allocation



5.2. These allocations are arbitrary, without any evidence-based assessment of how many people in South Africa qualify for the grant. The Department of Social Development's (DSD) own figures show that 18.3 million people in South Africa live below the Food Poverty Line (FPL), and that 13.4 million have no income.

5.3. This irrational budget cap forced DSD to create regulations that set an alarmingly low income threshold means test of R350 for the grant alongside a complex and exclusionary application process. As a consequence, Treasury's arbitrary budget cap resulted in 27 million fewer SRD payments having been made between April and June compared to payments made prior to the new regulations.

5.4. The continuation of such a budget cap is likely to continue placing undue pressure on DSD and SASSA to implement an application and approval process which, by necessity, is designed to limit the number of recipients, irrespective of need.

5.5. Despite claims by National Treasury that DSD has underspent, and that the challenges are not a budget problem, the IEJ believes that the decreasing allocation overtime to SRD stems directly from the austerity agenda that governs the fiscal strategy.

5.6. **The IEJ recommends** that the SRD be increased to the FPL and insert the budget for the ongoing provision into the MTEF, while working with stakeholders for pathways towards a UBIG and pursuing additional sources of finance and tax revenue for UBIG.

5.7. **The IEJ recommends** that current challenges with the SRD are addressed immediately. These include, but are not limited to unlawful questions in the online application form, the exclusionary online-only application process, flawed bank and database verification processes, a reduction in the grant's value over time, an irrational and retrogressive income threshold and widespread and systemic non-payment of approved beneficiaries.

6. The failure to maximise available resources

6.1. South Africa's fiscal strategy must be guided by human rights obligations set out in the South African Constitution. Sections 26 and 27 of the Constitution state that "state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of each of these rights."

6.2. In addition, according to the International Covenant on Economic, Cultural, and Social Rights (ICESCR) the state has an obligation to progressively realise socio-economic rights within its available resources. As a party to the ICESCR, South Africa also has an obligation to mobilise the maximum available resources for the realisation of social and economic rights. This involves raising, allocating, and spending money in a way that prioritises people's rights.

6.3. The MTBPS states that the Minister of Finance will implement measures to raise additional revenue of R15 billion in the next budget. The IEJ recommends that the committee ask the National Treasury to immediately disclose where the R15 billion is coming and to state whether it will be enough to inject required expenditure.

6.4. There are various additional revenue measures that need to be implemented.

6.5. **The IEJ recommends** the following measures to raise maximum available resources:

6.5.1. **Reducing the leakages in our economy**. A reduction or elimination in tax breaks for individuals earning beyond R750 000 per year can bring in just over R80 billion annually.

6.5.2. **Implementing measures to address Illicit Financial Flows (IFF).** Meanwhile, a recent estimate by UNCTAD put net illicit financial outflows from South Africa at US$18.4 billion in 2017. Thus, there needs to be continued support towards efforts that help reduce IFF outflows – including the capacity of SARS and specialised law enforcement including through additional funding – needs to be increased

6.5.3. **Instituting a net wealth tax of the high-net worth individuals** which could generate between R70 to R160 billion. Furthermore, this can be done by expanding the financial transaction tax (FTT) by including financial instruments such as equities, which could raise R41 billion.

6.5.4. **Drawing down on a portion of the R459 billion surplus on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA).** Unlike other major banks around the world, the SARB does not transfer these funds to the government. This is despite Section 28 of the Reserve Bank Act specifying that balances (profits or losses) on this account are owed to the government. A portion of these funds should be used to partially finance the current budget deficit. Another portion should be ring-fenced and allocated towards developmental projects and pressing social needs.

6.6. **The IEJ recommends** that the Committee place on record its objection to an increase in VAT as one of the avenues to raise revenue. An increase in VAT would make the tax mix more regressive, increase inequality, and have a disproportionately negative impact on the poor, particularly women and children. It would place significant pressure on key consumer goods in the context of recent relatively high levels of inflation, particularly for food. Moreover, the previous VAT increase in 2018 generated far less revenue than expected by the Treasury.

7. Outsourcing growth to the private sector

7.1. The growth path presented in the MTBPS over the medium term hinges on mobilising private finance. As outlined by National Treasury in the recent MTBPS, private sector finance will be central to both the provision of infrastructure and to investment spending in the economy.

7.2. The IEJ cautions against a private finance-led growth paradigm. The responsibility to grow the economy is essentially being placed on the shoulders of private finance through proposed Public-Private Partnerships infrastructure projects, while the National Treasury fails to leverage fiscal policy to industrialise and diversify.

7.3. Since private finance generally invests in ventures that are likely to yield profits in a short period of time, it might be inadequate to the needs of the country. Infrastructure and economic output in general remains concentrated in a few, dominant sectors.

7.4. Private finance is likely to invest in those established areas as they provide reliable demand. However, if the economy is to be made more inclusive and dynamic, it is necessary for the government, as a provider of patient capital, to play a more central role.

7.5. In addition, this approach risks increasing the cost of, and reducing access to, public services, and saddles the state with massive financial, legal, and social risks, while allowing the private sector to extract rents from the privatisation of public infrastructure.

7.6. The line of thinking has also informed the debt relief extended to Eskom and the conditionalities attached to it. The relief extended to Eskom hinges on facilitating private sector participation in the Energy sector.

7.7. The roll out of IPPs, instead of direct investment by Eskom in renewables, will make it more difficult for Eskom to use industrial policy levers such as public procurement to industrialise the local renewable energy value chain and to generate decent work in the process.

7.8. **The IEJ recommends** that National Treasury should swap 75% of Eskom's legacy debt into a separate state-owned financial entity that is managed by National Treasury. This will circumvent the conundrum of many debt holders having veto rights over restructuring plans.

7.9. **The IEJ recommends** that Developmental Finance Institutions such as the IDC and DBSA to support developmental priorities. This should include the SARB lending to the DBSA and IDC to support development priorities of small businesses in particular.

7.10. **The IEJ recommends** that National Treasury renegotiates for haircuts and debt restructuring with Eskom creditors and any other appropriate creditors.

7.11. The IEJ also recommends that the National Treasury uses JET-P financing and the fiscus to decisively restructure Eskom's financial liabilities in order for it to play a developmental role in the economy.

8. The unaccountable nature of National Treasury and the Minister of Finance

8.1. The IEJ and other progressive social forces, has been showing that budget cuts undermine the role of the state in fulfilling its Constitutional obligations.

8.2. Successive Ministers of Finance have continued to implement austerity without any major improvements to the country's social and economic challenges or being directly held accountable for its outcomes.

8.3. **The IEJ recommends** that the Committee asks the National Treasury to produce evidence that shows the human rights impacts of its policy of austerity as well its impact on the economy.

8.4. **The IEJ recommends** that the National Treasury put on record how its implementation of austerity measures is in line with principles of Gender Responsive Budgeting, given its impact on gender inequality.

9. Policy Recommendations

The IEJ believes that the government needs to adopt a developmental-based budgetary framework. This requires the National Treasury to:

- Use fiscal policy to address unemployment, poverty, and inequality as part of a pro-employment macroeconomic framework as opposed to narrow debt stabilisation.
- Reverse austerity. Budget allocations must be in line with population growth and CPI.
- Fully absorb the public sector wage bill into additional spending (not just partially) in order to not suck up funds that should be spent elsewhere.
- Expand spending and targeting it where immediate economic and social gains can be made.
- Conduct a thorough review of fiscal spending, especially its impact on growth and employment.
- Undertake a transparent, consultative and evidence -based state reconfiguration.
- Increase the SRD to the FPL and insert the budget for the ongoing provision into the MTEF, while working with stakeholders for pathways towards a UBIG and pursuing additional sources of finance and tax revenue for UBIG.
- Promote a more equitable tax structure by implementing a wealth tax and ending tax breaks for the wealthy.
- Renegotiates for haircuts and debt restructuring with Eskom creditors and any other appropriate creditors.
- Use Public Climate Finance to address the Energy Crisis and Just Energy Transition.
- Produce evidence that shows the human rights impacts of its policy of austerity as well its impact on the economy.
- Put on record how its implementation of austerity measures is in line with principles of Gender Responsive Budgeting, given its impact on gender inequality.

The Institute for Economic Justice (IEJ) is a progressive economic policy think tank committed to advancing economic justice, systemic change, and the equitable distribution of resources to ensure rights realisation and planetary wellbeing.

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