Fees Can Fall –

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The political budget crisis and alternatives to austerity – Part One

The national political crisis unleashed by the student rebellion should be seen as a call for a fundamental shift in economic policy, starting with the way in which government raises, allocates and spends resources. Now that government has agreed to the "0%" increase, the scrapping of registration fees in January should follow. The debts that poor students have amassed should go the same way. No longer should university administrations, in an attempt to force students to pay such debts, block participation in exams or withhold their degree certificates. It is critical that government set a tight time frame to budget for and implement fully-funded, free higher education.

In the midst of the student occupation of parliament, the Minister of Finance tabled the Medium Term Budget Policy Statement (MTBPS). The MTBPS is also known as the Mini-Budget because it provides insight into what next year's 2016/17 budget is likely to be as well as the spending plans of government up to 2018. The current spending priorities presented by Minister Nene will not address the ongoing downward slide in the quality of key social services such as health, education and social protection.

For example, Treasury continues to speak about introduction of a national health insurance (NHI) "with full implementation in 2025/26" and again makes the promise to publish the long awaited White paper on financing the NHI by the end of the 2015/16 financial year. Yet, there are no signs of critical changes in the budget allocations that would be required, both in relation to the public service sector and the rest of the economy, to make the NHI a reality. Treasury officials continue to acknowledge privately that, in order to implement NHI, structural increases in the ratio of tax revenue to GDP of at least 3 percentage points would be required. For the fifth year running, no such structural change is indicated in the Mini-Budget.

Simple delivery of the NHI would require an increase, not a cut, in "the public sector wage bill". To get rid of so called "ghost employees" is critical, but delivery of quality primary health services requires more doctors and nurses, and the integration of 70 000 community health workers as paid employees. Delivery of quality education to thousands of public schools with more than 40 learners in a class room requires more teachers. And a respond to the social impact of unemployment, gender based violence, drug abuse and gansterism requires more social workers and not less.

Instead, the mini-budget has outlined a spending plan for 2016 to 2018 that projects tax revenue as a share of GDP at a conservative rate of just 26% over the three year period. This translates to a government policy that does not see any increase in public services but merely the maintenance of the status quo. The student uprising demonstrates that, politically and socially, this policy will not deliver "status quo". There is now a deep crisis of service delivery. And whatever happens to the percentages, the absolute numbers of the unemployed and poor will grow as they have been growing. In the 3rd quarter this year there were 467,000 more unemployed people (according to the expanded definition) than in the same period in 2013, according to the latest Quarterly Labour Force Survey.

Here is another way of demonstrating the essence of the current trajectory: The Treasury projects that the economy (GDP) will grow in real terms by 1.8% over the next financial year. Government spending will increase by just 0.9%, according to a Mini-Budget diagram (p.25). In other words, the Treasury is signalling that the government sector will shrink as a share of the whole economy.

Is this "austerity" or not?

In March of this year, Treasury's Deputy DG, Michael Sachs, argued strongly against Gilad Isaacs in *Daily Maverick* that the 2015/16 budget wasn't an austerity budget, although it declared a cut in the baseline expenditure of R25bn over two years.

Now, this 2016 – 2018 Mini-Budget plans for a smaller public sector as a share of GDP. The need for the polar opposite is obvious. We would argue that this means austerity. In addition, a control of tables in the Mid Term document, against Treasury's 6% inflation forecast for the next financial year, makes us question the official 0.9% increase in spending. The "Consolidated fiscal framework" (p.24) in 2016/17 gives an increase by 0.7% in real terms, not "0.9%". "Expenditure by public service sector function" (p.5) grows by 0.6%, not "0.9%" next fiscal year. The Consolidated fiscal framework from a third perspective (p.48) reveals a decrease of -1.2%, after inflation, in non-interest public spending. From yet a fourth perspective, the fall in real spending is as much as -1.5%, or R18 billion in real terms from this budget year to the coming 2016/17 (p.35). This is austerity also in a narrow technical sense. As for the function "Post-school education and training" there can be no discussion about that.

Post-school education suffers a cut in real terms two years in a row, even when using the Treasury's three year forecast of 5.8-6% inflation per year. The Minister of Higher Education has not been able to defend his turf against the Treasury's knife. To a Communist Party General Secretary this should be embarrassing and it contradicts SACP strategy of reform from within the state. In the third year, 2018/19, the budget allocation to post-school education will be back to the level it was this year, i.e. the level that triggered the plus 10% fee increases and unleashed the long overdue national political crisis of fiscal policy.

But the numbers say more. As many of us have been made aware by the student rebellion, there is something called the "Tertiary education inflation index" published by Statistics SA. This index provides a much more accurate measure of real inflation in post-school education than CPI or the GDP deflator.

In March 2015, "education inflation" stood at 9.3% per annum when official inflation stood at just 4%. Let us for argument's sake assume that education inflation will be only 9.5% annually in the coming three years despite official inflation rate expected to be unusually high. We can then make the following diagram. The Mini-Budget presents an impossible three year financial plan for the Department of Higher Education.

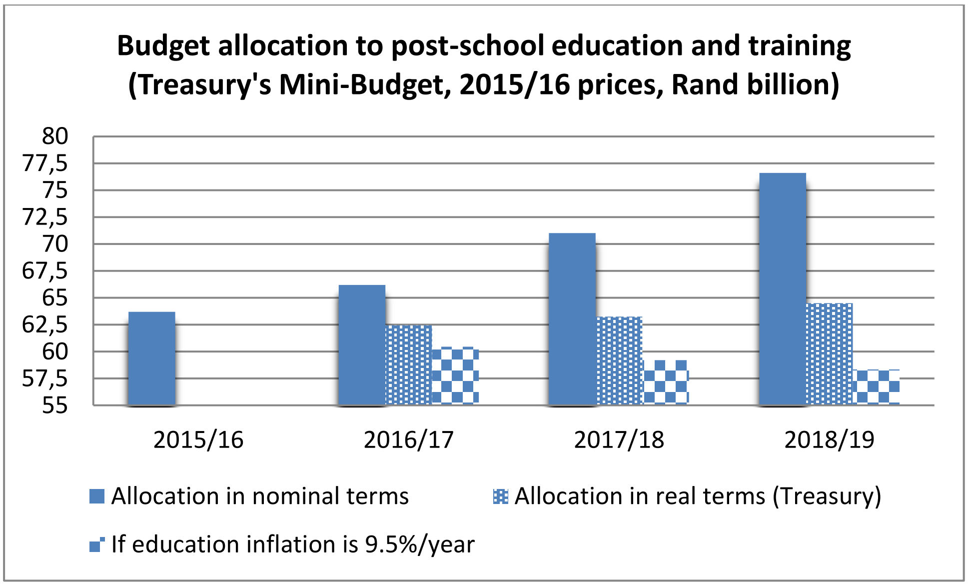

Diagram 1: The future of post-school education (Treasury MTBPS & own calculations)

This austerity plan for higher education is scattered for time being, thanks to the most amazing student upsurge. What can come in its place?

Save for MPs of EFF, who fought a lonely battle for radical alternatives in the 27 October parliamentary debate on the fees crisis, all other parties share the Treasury's conservative spending framework. The poverty of thinking is revealed when we consider how opposition parties, together with Treasury, the credit ratings agencies, the investor think-tanks and the mainstream business media all share the view that more resources to higher education only can be financed by reallocations, re-prioritisation and greater spending efficiencies. Strictly no additional taxes and especially not directed at the wealthy. Especially strange to watch are the contortions of DA MPs, who passionately, although opportunistically, stand in support of the student rebellion while being firmly opposed to any increase in taxation.

Nevertheless, long lasting and game changing increases in the tax revenue are needed. This is what “structural change” means. This change must take place, no matter to what extent and in what timeframe corruption can be curbed. And of course, as long as the public sector isn’t strong enough to provide basic services, but relies on “partnerships” and tenders, corruption will remain rampant.

In fact, the Treasury gives a lead in the Mid Term Budget document to one such game changing move. It says that there was “a strong growth in the PIT [personal income tax] as a result of less-than-full fiscal drag relief and fairly high wage growth, particularly for high income earners” (p.44).

2015/16 must be the first fiscal year in a decade when tax brackets, due to an error of forecasting, have been revised upwards a little less than the inflation rate and not more. Since 2000, when the top tax rate was also revised downwards in two steps from 45 to 40%, the opposite has been the case. Under the slogan of “compensating for fiscal creep”, the same life style – to the extent that CPI reflects this – has been taxed less and less for more than a decade. In 2005, when inflation stood a 4%, the top tax bracket was raised from R300 000 to R400 000, or by 33%!

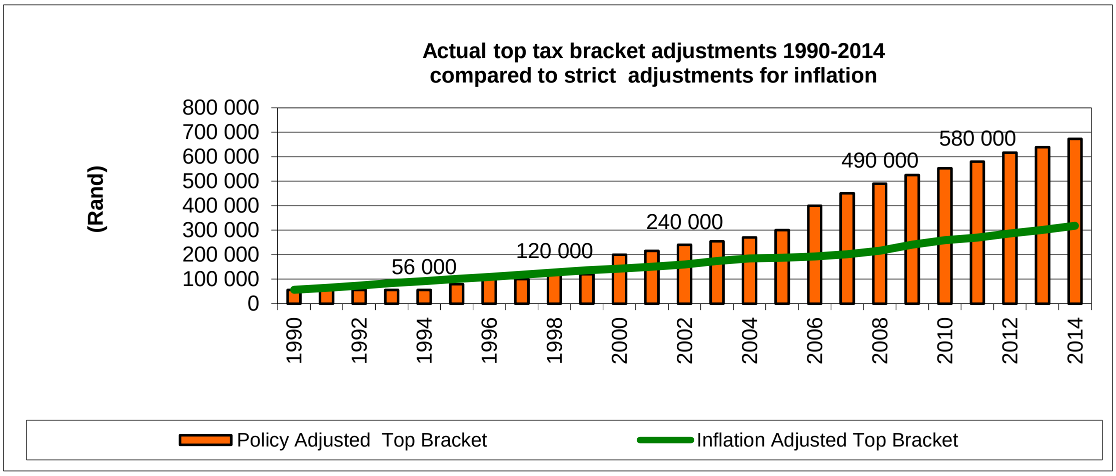

Diagram 2: The changing politics of the personal income tax (Source: The Treasury, Stats SA and own calculations)

It is thus a complete myth that tax pressure on the small middle class and the rich has increased. The exact opposite is the case. Even the increase of the four highest tax rates by one percentage point (so that the income above the top tax bracket placed at R701 300 today now is taxed at 41%), was, in aggregate, neutralised in the 2015/16 budget: the tax brackets were lifted by 4.2% (-R8.5bn in revenue) and the tax rebates for private medical insurances were increased (minus -R920m). The combined result of these two measures and one percentage point increase in tax rates (+R9.42bn) was budgeted to produce nothing, exactly zero Rand. When asked about it in February, Treasury officials claimed it was a mere coincidence! All the R8.3bn net addition to revenue 2015/16 was budgeted to come from increased taxes on petrol, cigarettes and alcohol. This is no exception. Unless they are speaking about a chain-smoking, alcoholic millionaire, driving a 3 ton car, MPs should be interrupted with "a point of order" if they complain again about the increasing tax pressure on high income earners. Indeed, the so called "sin taxes" and the taxes that affect transport hit the low income worker harder than the average millionaire. They are "flat taxes", just like VAT.

If the government had kept the personal income tax stable since 2005/06 – only raising tax brackets strictly at the rate of inflation –personal income tax would have added more than R150 billion to the present budget! This is what conservatism can achieve, in contrast to the itchy fingers of neo-liberal radicalism. As we write this, the discussion is about the 0% increase in fees that is projected to cost the social sector R2.6 billion. Higher education fees amount to R26-R28 billion per year.

Freeze tax brackets to pay for free education

The single most important measure to be taken in the coming fiscal year should therefore be a **tax bracket freeze**. The Treasury should refrain from adjusting brackets upwards 6% (the forecast rate of inflation). Depending on wage agreements, this would yield more than R10bn in the coming fiscal year. Every year that this "bracket freeze" stayed in place, gains in revenue would be added at a growing rate. The second year of bracket freeze would yield more than R20 billion. The third year the addition would be well over R30 billion. It would definitely pay all student fees. This measure should stay in place for as many years as it is needed and politically possible.

In politics it is of course easier to cut a tax than to increase it again to its previous level, if you wait too long. But the emergency situation in higher education and in public health, to name only two areas of crisis, should at least make it political possible to tax a certain standard of living at the same rate as it was taxed some years ago.

In part two of this article, we shall outline some other sources of financing, including a suggestion for a change in the free market borrowing policy of the Treasury, which is a main reason for the austerity policy most clearly visible in the cuts of higher education funding.

The political budget crisis and alternatives to austerity – Part Two

In the first part of this article we suggested a "tax bracket freeze" as the single most important measure to be taken in the upcoming fiscal year. The Treasury should refrain from adjusting brackets upwards 6% (the forecast rate of inflation). Depending on wage agreements, this would yield about R10 billion in the coming fiscal year. Every year that this "bracket freeze" stays in place, gains in revenue would be added at a growing rate. The second year of bracket freeze would yield more than R20 billion. The third year the addition would be well over R30 billion. It would definitely pay all student fees. This measure should stay in place for as many years as it is needed and politically possible.

To reintroduce the 45% tax bracket for incomes above R1 million would yield R5-6 billion (based on the 2014 Tax Statistics). An important point must however be made about our millionaires. In 2013, there were about 4,200 individuals registered for an income of R5 million or more. Their average income (3,337 tax forms assessed) was R9.5 million and the tax they paid was R3.7 million per person. Cap Gemeni's "New World Wealth" 2014 report estimates that there are about 48 800 High Net Worth Individuals ("HNWI") in South Africa. A HNWI has an income of more than R7 million or R70 million in accumulated wealth. If only 10 000 of these HNWIs paid income tax like the 3,337 income millionaires did in 2013, instead of hiding outside the tax system, this would yield an additional R37 billion in tax revenue.

A bracket freeze in the present 2015/16 budget would have meant R44 to R72 in additional tax per month, starting from R74 650 per year (under which no PIT was paid) to some R500 000 in taxable income per year. It is not difficult to mitigate this cost for employees who are earning more than R6 100 per month.

First, if we assume that the reversal of a decade of political tax cuts will pay for higher education, formally employed parents who pay fees for their youngsters will of course only gain. Second, for others and for all whose income is too low to pay PIT, the scandalously amassed surplus of over R70 billion in the Unemployment Insurance Fund could be used by scrapping the 2% tax on wages up to R14 000 per month for four to five years, depending on when the

UIF managers get their house in order. UIF should start to pay back the money to tens of thousands of unemployed workers who demand their unemployment insurance but are denied it by lethargy and maladministration. The UIF has funds of over R150 billion and, again, an idle surplus of R70 billion despite an official unemployment rate of 25%.

A proposal like the one above, but temporarily limiting the UIF to a payroll tax up to R1000, was in fact put on the table in the 2015/16 budget, but rejected in NEDLAC by both Labour and Business for reasons unknown to us.

The measure would soon give an injection of more than R15 billion to working class consumption per year, corresponding to the full 2% UIF fee. Like any payroll tax, the 2% UIF fee and the 1% SETA are paid entirely by the workers even if the employer formally pays half of it (UIF) or all of it (SETA). What the employer pays in payroll taxes is fully discounted in wage negotiations. Economy students know this after having studied “the incidence of a tax”. Trade unionists involved in wage negotiations also know it.

For this reason we question the honesty of the call for “the private sector” to pay a separate tax to education. It is very hard to believe that this government will increase the present 28% tax on profits (CIT). Whether it is a new and separate payroll tax or an earmarked increase of the SETA levy that is on the table, which seems likely, it is not a “tax the rich” measure. It will be a tax on all the formally employed, no matter how low their wages are. As long as there are obvious alternatives available that really “tax the rich” and the wages of the vast majority are terribly compressed, those alternatives must of course be preferred as a matter of pure decency.

We have focused on personal income tax to show what is immediately possible in February if there is political will, and also to stress the individual responsibility of the citizens for the well-being of all. We have not suggested here increased tax on profits or a “speculation tax” on financial transactions, which we are strongly in favour of. As things stand, increases in tax rates on corporate profits would just produce more creative accounting and aggressive tax planning. We venture to suggest that an isolated call for “the private sector to contribute”, in a situation of an entrenched regime and culture of tax evasion and avoidance, is meaningless, empty “radicalism” (unless it is a call for corporate charity). Tens of billions of rand are lost in SA every year (out of a global total which the IMF estimates at $200 billion) even with current corporate taxes.

This is the environment for corporate taxation today: Post Box companies owned by multinational corporations are allowed to send ludicrous invoices to other firms in South Africa from tax havens, bringing down the taxable profits of the latter. On top of the maze of "legal" transfer pricing, outright illegal financial flows amounted to over R300bn in 2012 (Global Financial Integrity 2014 report).

Considering that there is a three month window to the budget speech, it is enough to say right now that in February a progressive government would:

- announce full public disclosure of the finances of all the daughter companies of corporations in SA.
- announce an end to corporate secrecy and "The Right 2 Know".
- Require that the audited financial reports of outfits in tax havens that receive regular payments from a daughter company in SA be handed in to the authorities by the mother company that owns them both. AIDC has suggested this to the Davis Tax Committee. Let us see what happens to the revenue from corporate income tax when the scandals start to pile up in the media.

The 14% **VAT** must also be mentioned. It is suggested that an increase of 1 percentage point would yield another R15bn. VAT is a "regressive" tax. It takes a larger share from a working class income than from the incomes of high income earners. The Mini-Budget speaks about approaching changes in taxes "with caution", but the Treasury makes it clear that an increase in VAT is one suggestion on the table. The student rebellion against the fee increases gives "caution" a new meaning which perhaps they had not envisaged when they wrote the Mini-Budget document. VAT increases should now be in the dustbin.

As for a **tax on wealth**, Stephen Grootes forgot the property rates on residential houses when he discussed the subject on 29th October in the Daily Maverick. This is already a tax on wealth and it contributes about 20 percent to the income of the bigger municipalities. In 2011, AIDC published a short report on what an increase of this tax could give to the City of Cape Town 2010, if the tax rebate on house values was increased from R200 000 to R600 000 and the property rate doubled from about 0.55% to 1.10%. Rebates and exemptions for the disabled and pensioners would remain in place, and the result would be over R2 billion in additional resources to the City. The reform would be neutral at R1 million in house value and lower the rates for house values between R600 000 and R1 million. Such proposals on how to get rid of the bucket system, the shack lands and the Special Ratings Areas in wealthier areas, which contradicts the anti-apartheid principle of One City One Tax Base, should be an issue before the local elections, August 2016.

The dictates from credit rating institutes

We have argued that the R10bn worth bracket freeze would alone pay for the R2.6bn shortfall from “0% increase” and for scrapping the registration fee in January. No additional borrowing is needed. Introduction of a new 45% tax bracket for incomes above R1mn would directly create R5-6 billion of additional revenue at the current rate of tax compliance among the rich. This income would grow if SARS and the Hawks could bring thousands of income millionaires into the tax system, ending their tourist existence in this country, so that they start to act like citizens (from a tax point of view).

So how would credit ratings institutions and capitalist investors react to such a “left turn” in fiscal policy? This question applies to anything that the government says or does and poses the whole problem of the free market borrowing policy practiced by the Treasury. The paradigm imposes on a government that it should meet all borrowing requirement through the “free markets”. When it does so, the old saying “The one who is indebted is not free” applies and the Credit Ratings Institutions become the Chief Wip. Or as Karl Marx put it: “The state debt is the golden chain by which the bourgeoisie controls the state”, but even he surely didn’t imagine the power exerted on developing countries by a credit ratings institute in Washington.

It is because of this self-imposed serfdom that the Treasury has to say twice in the Mid Term Budget document that its “central fiscal objective over the medium term is to stabilise the growth of debt as a share of GDP”. The credit ratings institutions are speaking through its mouth. The Treasury only has to puff the air and move the lips and the tongue. To achieve that central objective, the budget deficit is to be brought down from 3.8% to 3% of GDP over three years.

If the budget deficit was allowed to just stay at the present 3.8% of GDP, there would be an additional R22bn in year one, R28.7bn in year two and R42.2bn in year three, based on Treasury’s projections of GDP development.

Now, would that make the state debt unsustainable in the long run? First, this depends on whether the government can be blocked from pursuing its mega project policy, centred on the environmentally disastrous expansion of coal production and mining in general, like the expansion of the Durban harbour (R250bn). Secondly it depends on what interest rate the state is paying, which is why the credit ratings institutes are so powerful. They “set” the interest rates with their credit rating of a state.

The Mid Term document shows that the Treasury is paying an average of about 6.8% on the whole state debt. The previous Budget Review showed however that interest on long term state bonds can be as high as 8.5% – 8.75%. Now, for ideological and political reasons the government doesn’t want to borrow anything at a regulated interest rate. However, it should do so from the R1.8 trillion amassed in the Public Investment Corporation (PIC). The government controls the PIC as its single shareholder.

Since its “corporatisation” 10 years ago, the only so called “prescribed asset” that PIC has is the imperative to invest at least 10% abroad. To shift a sizeable part of government’s borrowing to PIC – perhaps at the pace indicated by the yearly borrowing requirement (without reforms increasing tax revenues) of R160-R180 billion three year forward – is an obvious policy option. That the R1 trillion plus nuclear power plans – that will lead to short or medium term financial and long term environmental disaster – is probably crowded out by this move is a bonus side effect.

Over a three year period the PIC should be obliged to put, say, 50% of its assets in long term state bonds that will not be traded. The government would borrow from itself at an interest that secures pensions, as well as social stability and well-being for all (without which it isn’t so fun to be a pensioner in a future South Africa). The size of this prescribed asset is a matter of discussion and of the effects of tax reforms that structurally increase the tax revenue to GDP at above 30%. A 0.5 percentage point decrease in the average lending rate on the state debt yields **R11bn – R13bn** per year for the next three year period.

The Treasury, as well as any true opposition who is not just opportunistically complaining despite being in agreement with the whole paradigm that has led to this situation, has three months to work on alternatives to austerity. This concerns the demand for free higher education, the crisis in the basic school system, the future of the National Health Insurance (NHI) and a range of other issues, like the struggle against outsourcing taken up by the students, now recognised by Wits officials as “an exploitative practice”. Neither should the proposal for a Basic Income Grant (BIG) be forgotten. Everything is linked together in an economy of inequality, mass poverty and economic apartheid. Many students study when being hungry. They share their grants with the family back home so that they can pay for school uniforms without starving (Daily Maverick 26 October).

“Let the ruling classes tremble”, at an alliance between the students, the working class communities that are coughing up the fees and the outsourced workers at our higher learning institutions.

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