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Rethinking Economic Policy for South Africa in the Age of Covid-19:
Innovative policy responses for the post-lockdown Phase

New approaches to financing the fiscus

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Considering new approaches to financing the fiscus

by

Odile Mackett
Wits School of Governance

Executive summary

This policy paper considers ways in which government can use the current COVID-19 crisis to think how it can move away from a reliance on wage labour as a revenue generation tool, while simultaneously ensuring people's social security. The paper highlights the country's reliance on personal income tax as the main source of tax revenue and the source of frustration this tax structure has been to both government and citizens alike, given the inability of the South African labour market to absorb a large share of the population into productive work.

Despite South Africa's persistently high unemployment rate and accompanying challenges related to poverty and inequality, the revenue structure has remained mostly intact, with the exception of company income tax and a gradual decline in the marginal tax rate of the top income group over the post-apartheid period. To consider alternative examples of financing the fiscus, this paper includes a discussion highlighting the tax structure of countries which are considered 'tax havens', those who rely heavily on rents from natural resources, and those with large informal sectors. The countries discussed in this paper do not rely primarily on personal income tax as a main source of revenue and thus provides a view of the many alternative ways in which resources can be mobilised in a way that is more suitable to the domestic context.

The paper primarily questions the ability of wage labour to be a sustainable source of government revenue going into the future and particularly in a post-COVID South African economy. The current revenue model has created a 'labour market trap' for both government and its citizens and acknowledging that this trap exists is the first step towards finding productive solutions out of it.

While this paper was more conceptual and did not include an empirical analysis, the actual feasibility of the key policy recommendations identified would require further analysis. These recommendations include:

- An introduction of a progressive tax rate on properties above a certain threshold value to minimise distorting effects of the tax.
- Abolishing taxes for small business corporations.
- Introducing differential rates in social grants to accommodate households which are relatively more vulnerable.
- The permanent (or long-term) implementation of an unemployment grant.
- Determining whether funds used for service delivery in areas which government has performed particularly poorly could be channelled towards increased grants or a similar distribution tool for citizens.

1 Introduction

The world has recently been hit by a pandemic which has had devastating effects for both citizens and countries around the world. The closing of borders and domestic industries has resulted in many business closures and in some instances, entire industries – such as the airline industry – have found themselves in distress. In a country like South Africa, this has led to an exacerbation of already existing social ills, such as poverty, inequality, and unemployment (Arndt et al., 2020).

The South African government has, since 1994, persistently tried to remedy these ills, many of which are remnants of colonial and apartheid era policies. Some of these challenges have been stubborn and have worsened, despite the development of policies specifically designed to remedy these ills; although some have argued that this is due to implementation failures (Van Der Berg, 2010). Unemployment, for instance has remained a problem, reaching a high of 30.1% in the first quarter of 2020, while the inequality rate has remained one of the worst in the world (Francis & Webster, 2019; Stats SA, 2020). Poverty, on the other hand, has declined somewhat (Francis & Webster, 2019; Stats SA, 2009b), although a reliance of South African social and economic policies on a functioning labour market has meant that interventions aimed at reducing poverty and inequality have had limited success. The dependence on the labour market is evident in the revenue model which the government has adopted as well as its social security model.

The revenue model relies heavily on personal income tax (PIT), with total tax revenue constituting 26.2% of government revenue in the 2018/19 fiscal year, and PIT making up close to 40% of total tax revenue (National Treasury, 2020a). This tax burden is one of the highest amongst middle-income countries (National Treasury, 2020a). Secondly, with the exception of the recent COVID-19 social relief of distress grant, South Africa's social security programmes have largely excluded able-bodied individuals of working age. This policy stance has continued, despite growing unemployment rates.

Thus, the South African government has relied heavily on the labour market not only in terms of where it gets its money from, but also in terms of how it spends. This reliance on wage employment has further been emphasised in the various economic policies which have been adopted over the years. First, the government's Reconstruction and Development Plan (RDP) (Government Gazette, 1994) viewed employment creation as the first priority and redistribution of resources as the second. While the Growth, Employment and Redistribution (GEAR) Strategy (Department of Finance, 1996) moved towards new approaches to taxation, the focus was brought back to employment creation as the cornerstone in the National Development Plan. In the NDP, employment is emphasised by placing a focus on "[m]obilising society to support the plan, and exploring a social compact to reduce poverty and inequality through investment and employment" (NDP, 2012, p. 26).

The magnitude of South Africa's unemployment problem has meant that these policy stances are unsustainable in the long run and the growing debt burden is evidence of this (National Treasury, 2020b). Further reasons why this is an unsustainable strategy include the high tax burden, the changing nature of labour markets, and recent proposals to further expand the social security programme. These issues thus imply two points of contention for fiscal policy in South Africa. On the one side, revenue generation, which as pointed out, relies on income from wage labour and the spending side, which primarily aims at addressing socio-economic challenges stemming from labour market failures.

This policy paper considers ways in which government can use the current economic and social crisis (which has shed renewed light on shortcomings within the South African economic framework) to think differently about how it can move away from a reliance on wage labour as a revenue generation tool, while simultaneously ensuring people's social security. This is achieved by studying the tax structures of countries which do not levy high or any PITs on their populations (discussed as two main categories; 'tax havens' and resource-rich countries) and countries which have large informal sectors which do not allow for the generation of the bulk of revenues from PIT. This is done not to propose a replication of the tax structures discussed, but rather to shed light on alternative ways in which a fiscus can be financed, by playing to the strengths of the domestic structure of the economy. Based on the unique challenges which South Africa faces, proposals are also put forward to generate and spend revenues in a way which is sensitive to the domestic context.

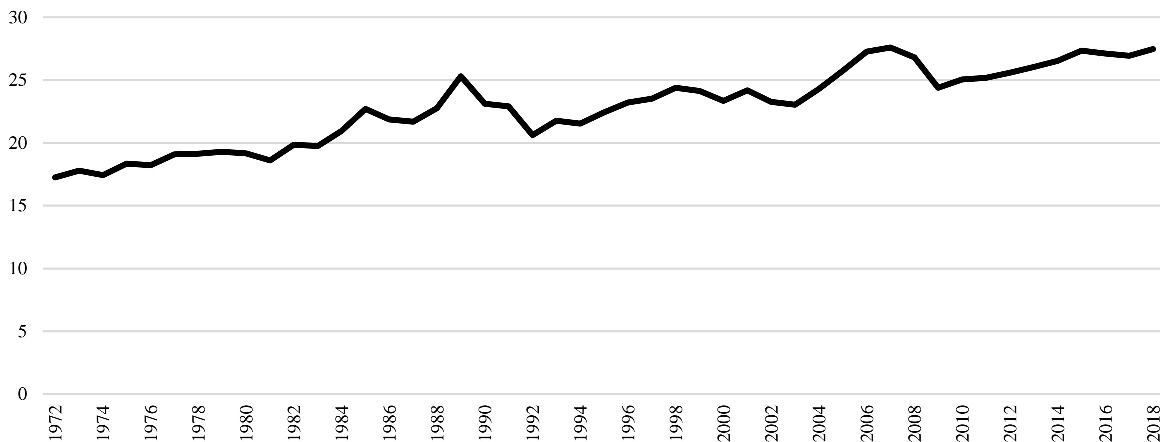
This paper starts with a brief discussion of South Africa's tax structure which is followed by a discussion of the tax structures of countries which do not have a heavily reliance on PIT. Then, a section with suggested policy recommendations which may assist in alleviating domestic challenges within the economy is presented followed by a brief conclusion.

2 A brief history of South Africa's tax structure

This section briefly discusses South Africa's tax structure with a specific focus on PIT and company income tax (CIT), although briefly touching on other revenue sources as well, in the post-apartheid era. South Africa's fiscal policy from 1994 onward was generally aimed at lowering tax rates (Barbour, 2005). Despite this move towards lower taxation, amongst its BRICS peers, South Africa had the second highest tax-to-GDP ratio in 2018 (Kejriwal, 2020). Amongst its Sub-Saharan African peers, South Africa also had a tax-to-GDP ratio well above the average for countries in the region between 1985 and 1996 (Ghura, 1998). By 1999, only Botswana and Namibia had tax-to-GDP ratios comparable to South Africa's (Fjeldstad & Rakner, 2003).

The 1996 GEAR policy had specifically set out to maintain a tax-to-GDP ratio of 25% (Department of Finance, 1996). The effectiveness of this policy is clear in the strong upward trajectory of the curve in Figure 1 from 1996. In 2017, according to OECD (2019a) statistics, the only two countries on the continent which had higher tax-to-GDP ratios than South Africa were the Seychelles and Tunisia. These countries had ratios well above the African average (17.2%) and close to the OECD average (34.2%).

Figure 1: South African tax revenue as a % of GDP, 1972 – 2018



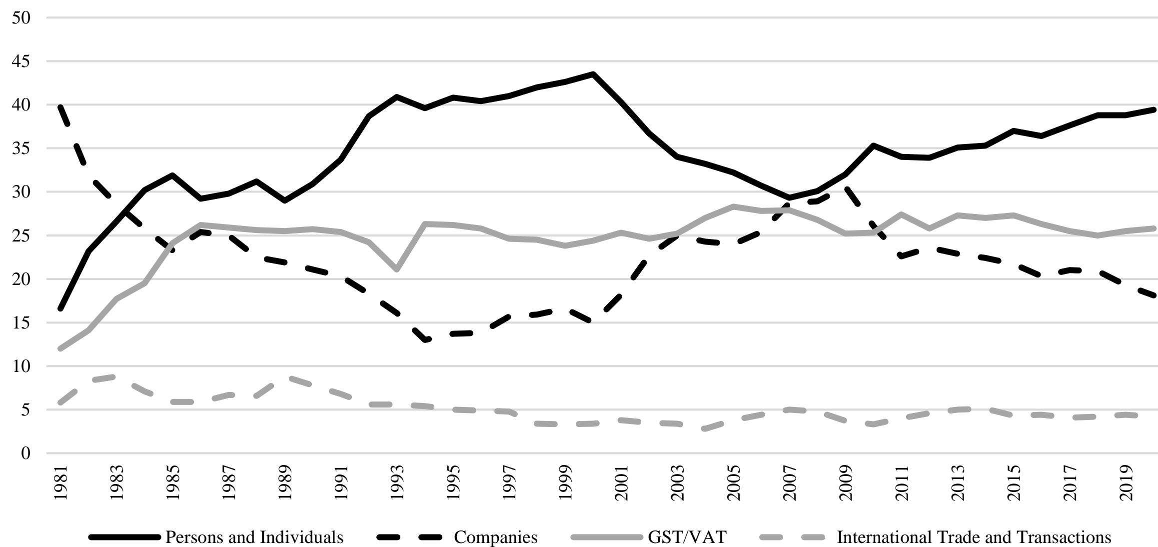
Source: WDI

South Africa's tax system is regarded as progressive and this is certainly the case in how the main source of revenue, PIT, has been taxed (National Treasury, 2020b). The share of PIT in total revenue has gradually increased since 1981 (see Figure 2). The marginal tax rate by income group has also increased gradually over the years, until 2019 when it was frozen for the first time since 1990 (SARB, 2020). Two issues arise from this pattern of taxation in the South African economy.

The first is that this revenue collection mechanism did not change as South Africa made the transition to a democratic state, particularly at the local government level which relies primarily on property taxes and user fees for basic services (Fjeldstad & Rakner, 2003). This is evident from both Figures 1 and 2, which shows no drastic changes in tax revenue patterns in the early 1990s; apart from a 5% decrease in the tax-to-GDP ratio between 1989 and 1992. This reliance reflects the assumption that enough citizens would have been absorbed into jobs where they could earn taxable salaries; thus, widening the tax base. The RDP policy specifically stated that the "expansion of the South African economy will raise state revenues by expanding the tax base, rather than by permanently raising tax rates" (Government Gazette, 1994, p. 4).

As per the policy described in the RDP, South Africa's reliance on PIT has grown over the last few decades, and the democratic government thus largely implemented a continuation of the tax regime adopted from the apartheid government. Though democratisation would allow the government to tax (and redistribute) to its citizens more broadly, many citizens were not absorbed into jobs where they could earn *taxable* salaries.

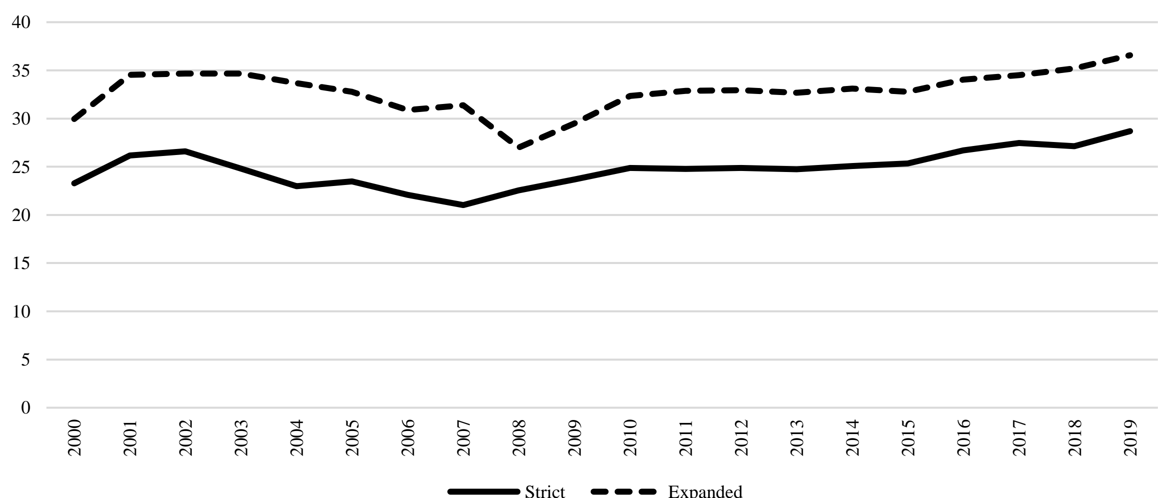
Figure 2: Main tax revenue sources as a % of total tax revenue, 1981 – 2020



Source: SARB

This tax stance geared towards an expansion of the PIT base has persisted despite consistently high unemployment rates. Between 2000 and 2019, South Africa's strict unemployment rate remained above 20%, while the expanded unemployment rate has remained (at least for the bulk of this period) about 7 percentage points above the strict rate (Figure 3). The large discrepancy between the strict and expanded unemployment rate is a phenomenon which is unique to the South African labour market and has shed light on the limited ways in which South Africa defines unemployment within its borders (following international best practice), even though authors have argued that the application of the strict definition in South African surveys are not as strict as they are in other countries (Standing, Sender, & Weeks, 1996).

Figure 3: Strict and expanded unemployment rates (%), 2000 – 2019



Source: StatsSA QLFS Trends and StatsSA (2009a). *Own calculations.*

By contrast, the tax rate on corporations and other enterprises (CIT) gradually declined from 40% in 1980 to 28% in 2014 (SARB, 2020). This strategy was again deliberate in the RDP policy, where the lowering of CIT was expected to deliver increased growth and investment within the country

(Government Gazette, 1994). This could possibly be considered to have been a successful strategy, as South Africa attracted the most foreign direct investment (FDI) on the continent between 1990 and 2004, although a number of the agreements made to attract these investments lacked sunset clauses, and many businesses became reliant on these for survival (Barbour, 2005; Cleeve, 2008). Companies in certain sectors have also benefitted from additional tax incentives, through initiatives like demarcated special economic zones, and the Youth Employment Service which offered further tax relief if they employ young people (YES, 2020).

The marginal tax rate on the top income group has also declined gradually from 50% in 1961/62 to 41% in 2015/16 (SARB, 2020). Given that income inequality is one of the largest contributors to overall inequality in South Africa, this partly explains why inequality has been interminable (Finn, 2015).

In relation to customs and excise taxes, the GEAR policy stated the following (Department of Finance, 1996, p. 10):

> Recognising the importance of effective tax administration, the new SA Revenue Service has embarked on the upgrading of its revenue and customs and excise offices, including personnel training and modernisation of information systems. This will, in due course, contribute to improved collections and greater fairness of the tax system. The improvement in economic growth, together with improved tax administration, should lead to a strong increase in tax revenue relative to GDP. This will create considerable scope to effect further reductions in the rates of personal and corporate taxation, while maintaining a ratio of tax to GDP of about 25 percent.

However, despite this, taxes on international trade remained marginal – below the 5% level (see Figure 2). It was reported that tariff protection on the manufacturing industry decreased from 15.6% to 11.8% between 1997 and 2002 (Barbour, 2005). Furthermore, in 2000 South Africa's taxes on international trade was also well below those of other sub-Saharan African countries (Fjeldstad & Rakner, 2003).

South Africa's tax regime over the last three decades is characterised by an increased reliance on PIT (and VAT) and a decrease in CIT, taxes on top income earners, and marginal revenues from international taxes. This is a peculiar tax structure design given the high unemployment and inequality rates which have characterised the last three decades. The next section will demonstrate how other countries have levied revenues within the constraints posed by their own economies in addition to highlighting the challenges which their approaches to revenue collection models pose to their economies.

3 Alternative tax structures

This section will present case studies of countries which do not rely primarily on PIT as the South African government does. For the purpose of this discussion, these countries are divided into three groups: tax havens, resource-rich countries, and countries with large informal sectors. For each category, countries will be discussed paying particular attention to the tax structure within the countries and what the main sources of revenue are. Furthermore, though there are many additional countries which could be discussed under these headings, macroeconomic data are not always readily available for the countries discussed in this section; this is particularly true for tax havens and countries with

large informal sectors. The countries included here are thus a selection of countries for which a sufficient amount of data could be sourced.

3.1 Tax havens

‘'Tax havens’ are defined as “the provision of financial services by banks and other agents to non-residents, including the bank intermediation role of taking deposits from non-residents and lending to non-residents. Other services provided include fund management, insurance, trust business, asset protection, corporate planning and tax planning” (IMF, 2000, p. 2). Many of the countries which are considered tax havens, as will become clear in the discussion, also have large tourism industries and small populations. Tax havens have had a combination of different taxes which they levied, although the countries discussed here levy low or no PIT rates. The selection of countries included here are Andorra, Anguilla, Antigua and Barbuda, The Bahamas, Bermuda, British Virgin Islands, the Cayman Islands, Montserrat, Nauru, Turks and Caicos Islands, Aruba, Belize, Barbados, and Cook Islands.

Off-shore financial centres (OFCs)

Off-shore financial services are a major source of revenue for countries which are considered tax havens, and had become an alternative for companies after the 2008/09 global financial crisis, but also became more viable with the global introduction of neoliberal economic policies (Robertson, 2020). Numerous countries around the world are considered off-shore financial havens (such as Singapore and Mauritius), although these can also exist *within* countries, such as the Island of Jersey in Hong Kong. Some countries derive significant sources of revenue from this sector, while others benefit from alternative gains made in place of direct tax revenues. Offshore financial services are characterised by financial institutions which are engaged in business primarily with non-residents, they have low tax rates for companies, little regulation, and have “external assets and liabilities out of proportion to domestic financial intermediation designed to finance domestic economies” (IMF, 2000, p. 3). In some instances, companies registered in OFCs are not required to appoint auditors or a company secretary, and transactions and details related to registered companies are often shrouded in secrecy (Tax Justice Network, 1999). In most OFCs there is also no residency requirement for the business owner (Robertson, 2020) and these countries are characterised by ease of registering a business.

OFCs primarily generate revenues from company licencing fees and for some this is a significant source of revenue. In 2018, for instance, fees, fines, and permits made up 12% of total government revenue and 18% of total non-tax revenue in Anguilla (Government of Anguilla, 2020). In addition, company annual fees made up more than 30% of fines, fees, and permits in the same year. In the Bahamas, business and professional licences made up 7% of total tax revenue (2005/06) (Central Bank of the Bahamas, 2006). While in the Virgin Islands, 51.4% of government’s revenue came from license fees for offshore companies in 2019 (Government of the Virgin Islands, 2019).

The benefits of registering an off-shore company or shell company is that transactions in many countries are shrouded in secrecy, allowing for funding of illicit activities such a money laundering. Additional taxes, which would have been due to the resident’s government could also be by-passed through registration in a tax haven. In the Cayman Islands, companies are exempt from capital gains tax, payroll taxes, property taxes and corporation taxes (Cayman Islands General Registry, 2020). As such,

resources meant for the home country are often re-directed to another jurisdiction, resulting in tax evasion and avoidance.[1]

The risks associated with being an OFC are plentiful. Many of the OFCs discussed here rely heavily on luxury tourism and their financial industries. As such, financial crises in the home countries in which many of their company directors are hosted result in exposure to volatile economic shocks in those economies; the same is true for the tourism sector. Thus, economic growth can be unstable in some of these countries, as has been the case for Anguilla, which has been highly vulnerable to external shocks and rules from international agencies (Government of Anguilla, 2019).

In addition, the establishment of an OFC requires access to a global network of accountants, lawyers, and banks which can clear international USD transactions. This not only relates to the technical expertise which accompany establishing an OFC, but also the ability for the country to establish itself as a preferred destination for off-shore investments. This has in some cases, such as the Seychelles, resulted in the employment of foreign residents (with relevant expertise) to senior posts within government revenue authorities and related government agencies; essentially resulting in the delegation of power to external agencies and individuals (Robertson, 2020).

Given the loss to home countries when money is sent off to an OFC, there have also been opposition to the dealings of OFCs by developed countries like the US, the UK, and some European countries. Antigua and Barbuda have been hurt by sanctions imposed by the US and UK in 1999 as a result of loosening money laundering controls (FinCen, 1999). Similarly, the Cayman Islands and a number of other tax havens have also been blacklist by the EU (Council of Europe, 2020). OFCs have been said to encourage 'bad behaviour' in home countries as investors exploit gaps and mismatches between the tax systems of different countries (OECD, 2020a). OFCs are thus under pressure to adhere to transnational treaties related to illicit financial flows and other activities (Rose & Spiegel, 2007).

Tourism

Many of the OFCs discussed in the previous section are small island countries with pristine beaches and have thus managed to build successful tourism sectors. In the Cayman Islands, 70% of the country's GDP was accounted for by the tourism sector in 2017 (CIA, 2020), and 50% of Antigua and Barbuda's GDP in 2005 (UNDP, 2012). Aruba's tourism sector contributed, both directly and indirectly, 87% of GDP in 2017 (IMF, 2019).

This industry is a major source of employment for the domestic population and has also paved the way for alternative revenue sources. Antigua and Barbuda derived a significant share of their foreign exchange earnings from the tourism sector (85% of foreign exchange earnings in 2007 (UNDP, 2012)). While Aruba's tourism industry has also assisted in balancing its current account (IMF, 2019). In addition, other countries have managed to levy an array of taxes related to the tourism sector. These include hotel occupancy taxes or bed taxes.

Hotel occupancy taxes, which is a tax levied on the cost of accommodation paid by tourists, made up 2.6% of total tax revenue in The Bahamas in the 2004/05 budget period (Central Bank of the Bahamas, 2006). While in the Turks and Caicos Islands (where the hospitality sector made up 34.67% of GDP in

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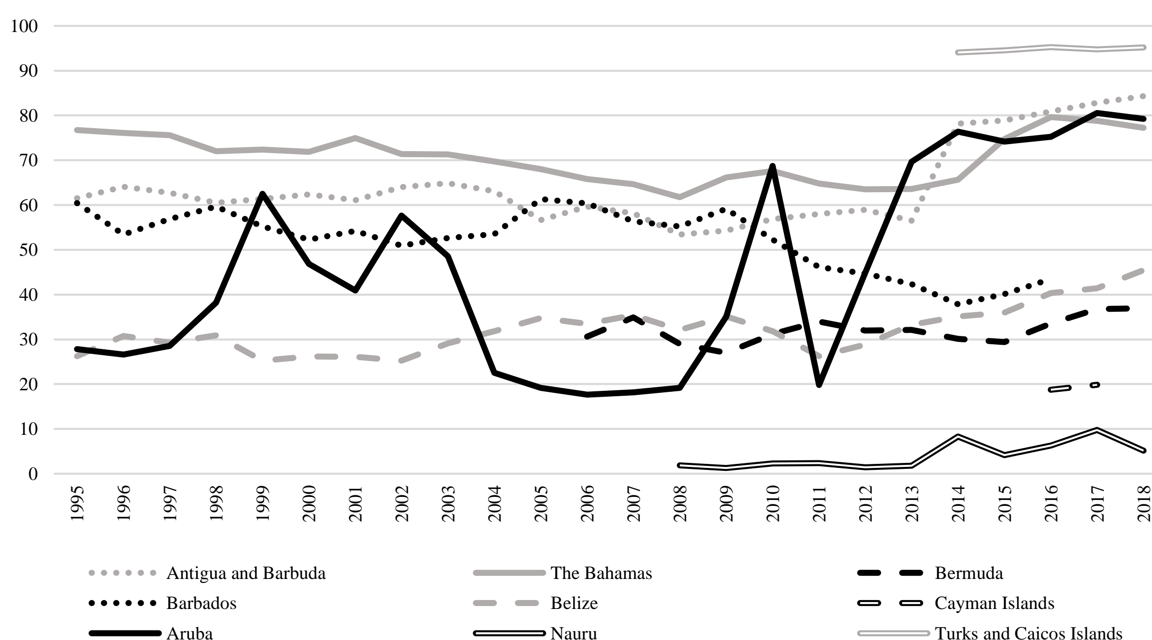
[1] Tax evasion is the illegal act of eluding taxation by individuals, corporations or other bodies, while tax avoidance is the legal act of eluding taxation through the exploitation of tax laws.

2009 (DEPS, 2014)), accommodation tax made up 24.95% of government revenue in 2010/11 and they levied at a flat rate of 12% for tourism related services (Turks & Caicos Revenue Department, 2015). In Barbados this amount is fixed, depending on the type of accommodation which is being taxed (e.g. 8.75 USD per night for apartments and guest houses) (EY, 2019).

The extent to which many of these countries rely on the tourism sector is evident in Figure 4, which shows the percentage of export receipts which are accounted for by tourism. The graph shows that since 1995 most of the countries for which there are data available (with the exception of Nauru) generated at least 20% of their export receipts from tourism. The Turks and Caicos Islands, for instance, generated close to 100% of total exports from tourism receipts between 2014 and 2018, while Antigua and Barbuda, The Bahamas, and Aruba also relied heavily on this sector with roughly 80% of export earnings derived from tourism receipts for all three these countries between 2014 and 2018.

Figure 4: International tourism receipts (% of total exports), 1995 – 2018



Source: WDI

The obvious limitations of a tourism industry, as was evident during the global financial crisis and which had been repeated again during the COVID-19 crisis, are that it relies heavily on a healthy global economy. Countries which rely on tourism – specifically catering to international tourists – tend to be worst affected by global economic shocks. These lead to a decrease in demand in the tourism sector, where work is often already precarious. The sector is, however, a labour-intensive sector and in countries where high unemployment is the norm, such a sector could alleviate problems related to high unemployment (De Beer, Rogerson, & Rogerson, 2014).

Freeports and special economic zones

Freeports and special economic zones are areas where goods can move through without having customs duties levied on them. Most governments designate special economic zones within their countries by attracting businesses and firms for the purposes of developing that particular area. This is often done with the purpose of building or expanding on manufacturing in the area. There are special cases in which an entire country is designated a freeport, as is the case for Andorra, which is a landlocked

country between France and Spain. Andorra has taken advantage of their location and do not levy taxes on retail sales. As a result, the country has become known for day visitors undertaking shopping trips by obtaining all their goods ‘duty free’. Although the country does impose a low 4.5% VAT (with a list of exceptions) and a 10% PIT on residents and 10% on corporations (Andorra Insiders, 2020). Although even with these taxes, Andorra has the most favourable tax regime in Europe. For this country, tourism is the main source of revenue (Govern d’Andorra, 2019).

Additional taxes

Other notable taxes imposed by countries which are considered tax havens include payroll taxes, customs taxes, and land taxes.

Payroll taxes

A payroll tax is often a flat tax levied on the payroll of a company, deducted for a specific purpose. Payroll tax differs from income tax in that it is often levied at a flat rate, where income tax tends to use a progressive structure. Countries which levy payroll taxes include Bermuda which derives most of its revenue from payroll tax (KPMG, 2019), these are levied on employers and self-employed persons (Government of Bermuda, 2020). They levy no PIT or CIT, but have a land tax for long-term tenants.

Payroll taxes, often disadvantage low-income earners as they are not equitably spread (OECD, 2005). Payroll taxes have in many countries, however, allowed for the expansion of social security systems, although this has also contributed to the ‘tax wedge’, which is the “gap between total labour costs and take-home pay” (World Bank, 2013, p. 274). A large tax wedge could result not only in a decrease in labour demand, but also in a decreased willingness of workers to supply their labour (or an increase in their reservation wages). The social security coverage provided by payroll taxes is also not very wide spread, particularly in countries with large informal sectors where workers would not receive this benefit. But it has been highlighted that the degree to which this wedge can be tolerated by workers depends on how much they value the social security coverage which accompanies an increasing wedge (World Bank, 2013).

Customs tax

Given the geographical features of many of the islands nations which are considered tax havens, there is little room for the development of agriculture and manufacturing industries and if they do, it is usually on a small scale. These countries thus rely on imports of various goods, and many of the revenue authorities make use of this reliance as an opportunity to levy customs taxes (taxes levied on goods imported from outside the country).

Most customs duties in Bermuda are levied at 25%, although they impose no excise taxes (PWC, 2020).[2] Customs duties made up a fifth of their tax revenue in 2019 (KPMG, 2019). Similarly, Barbados levies a range of customs taxes on incoming goods, in addition to an additional environmental levy on goods arriving in containers which are not made of renewable materials (SelectUSA, 2019). In 2017, excise tax made up 17% of the government revenue for Barbados, and VAT made up 74% (Barbados Revenue Authority, 2017).

[2] Excise taxes are levied on goods produced within a country and is an indirect tax paid by manufacturers to government, built into the price charged to consumers.

Land tax

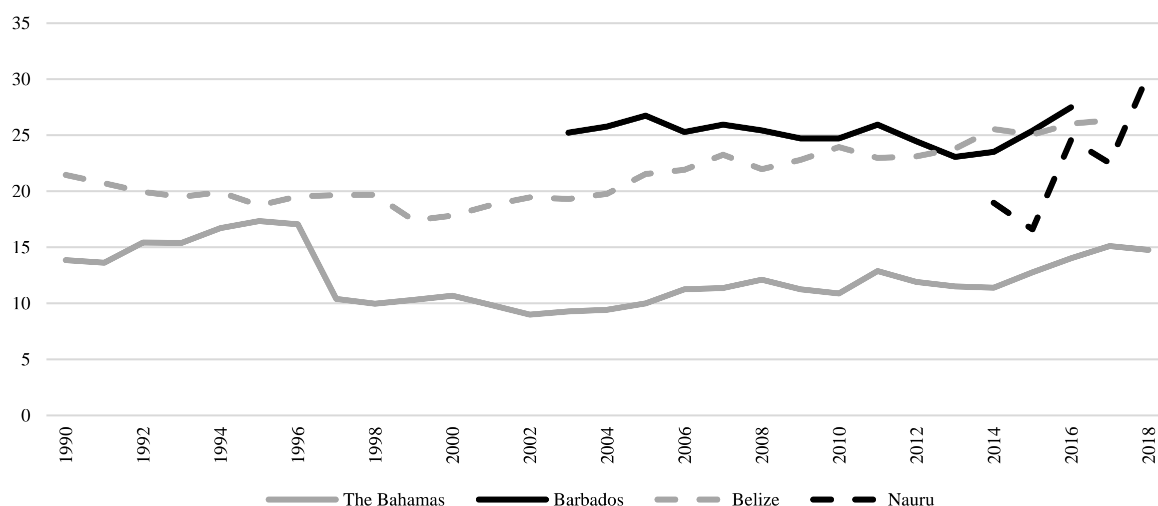
A land tax can be levied on the land of an owner, the buildings on the land, or both. These types of taxes usually require regular revaluation of the value of the properties and the buildings, where applicable (Bird & Slack, 2004). Barbados levies these taxes under two property tax categories. A land tax which is calculated based on the site value of the property and a rent registration tax which is a flat fee levied when a rental property is registered for occupation. In 2017, property taxes made up more than 7% of government revenue (Barbados Revenue Authority, 2017). While, in Bermuda land taxes made up 7.6% of revenues in 2019 (KPMG, 2019).

Other countries do not levy annual land taxes, but rather one-time stamp duties which are levied when a piece of land is purchased. This is the case in the Cayman Islands where no real estate or land taxes are levied, but rather a 7.5% stamp duty levied on the purchase price or fair market value of the property (Deloitte, 2020a). In the Turks and Caicos islands, stamp duties make up roughly 8% of annual government revenue, although recently the bulk of these were waivered due to the pandemic (Ministry of Finance, 2020).

These types of taxes have been reportedly easy to collect and form the main source of revenue for local government authorities (Lantmäteriverket, 2008). Although this also allows for collection of information related to the ownership of land and the degree to which land-use is sustainable within a country.

Though data on tax-to-GDP ratios are not readily available for most countries discussed, Figure 5 shows that tax-to-GDP ratios for the tax havens were generally lower than that of South Africa, as well as the OECD average. This demonstrates that these countries had found alternative sources of revenue.

Figure 5: Tax revenue as a % of GDP (Tax havens), 1980 – 2018



Source: WDI

From the discussion it is abundantly clear that tax havens often serve as havens for companies run by individuals who are non-resident. This creates a degree of vulnerability which leaves them exposed to external macroeconomic shocks. These countries also differ from South Africa as they generally do not have the degree of poverty and inequality which has plagued South African society, but also have small populations and relatively low unemployment rates.

3.2 Resource rich countries

Many countries have built their wealth on extractive industries, and rely on export revenues to fund government activities and act as a source of foreign exchange reserves. This section presents a brief discussion of countries which have managed to build immense wealth from their extractive industries and thus had no need to levy PIT. However, as the discussion will reveal, these countries have not been spared from levying additional taxes to top-up government revenues, and building alternative industries to diversify their revenue sources.

The countries included in the discussion here are Bahrain, the United Arab Emirates (UAE), and Brunei.

Extractive industries

Bahrain developed the first post-oil economy in the Persian Gulf which resulted from decades of investing in banking and tourism. Many of the world's largest financial institutions have a presence in the country's capital, with the finance sector being the largest non-oil sector in the country (Ministry of Finance and National Economy, 2020a). Bahrain is the fastest growing economy in the Arab world, and has actively started moving away from a dependence on oil revenues (Government of Bahrain, 2008). Petroleum production and processing is Bahrain's most exported product, accounting for 60% of export receipts, 70% of government revenue and 11% of GDP.

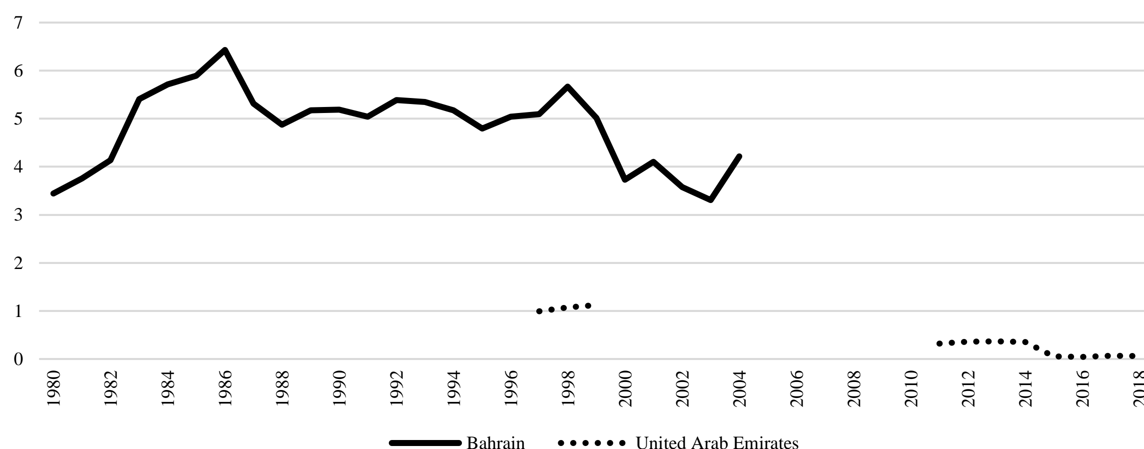
In Bahrain, oil and gas companies are taxed 46% on income derived from the sale of hydrocarbons and derivative products. There is no PIT or taxes levied on any corporations working outside the extractive industry (Ministry of Finance and National Economy, 2020b), although they recently adopted a VAT at the beginning of 2019 (Ministry of Economy, 2019). In addition, employers and workers must pay social insurance contributions.

In the UAE, the export market is key to the wealth of the country. The extractive industry (crude oil, natural gas) contributed 30% of GDP in 2018 (Ministry of Economy, 2019), while the tourism sector contributed 5.2% of total GDP in 2016 and the government views this as a strategic growth sector (U.AE, 2020). Though the government levies no payroll taxes, stamp duties, wealth taxes, inheritance taxes, or individual income taxes, they have started levying a 5% VAT since early 2018 (Deloitte, 2020c).

Brunei also derived more than 50% of GDP from oil and gas revenues in 1995 (IMF, 1996). This country levies no PIT, VAT, or property taxes, although a stamp duty is levied along with a corporate tax rate which decreased from 22% (2011) to 18.5% (2020) (AEC, 2011; Deloitte, 2020b; KPMG, 2016).

As a result of the limited tax regimes adopted by these countries, their tax-to-GDP ratios tend to be low. Bahrain and the UAE, the only countries for which some data were available both had a tax-to-GDP ratio of less than 10%. Figure 6 shows that Bahrain's highest tax-to-GDP ratio was in 1986, when it reached a maximum of 6.4%, but that this had generally been on a declining trend to 2004; the last year for which data are available. In addition, based on the limited data available for the UAE, this country relied on a tax-to-GDP ratio of less than 1% between 2011 and 2018.

Figure 6: Tax revenue as a % of GDP (Resource-rich countries), 1980 – 2018

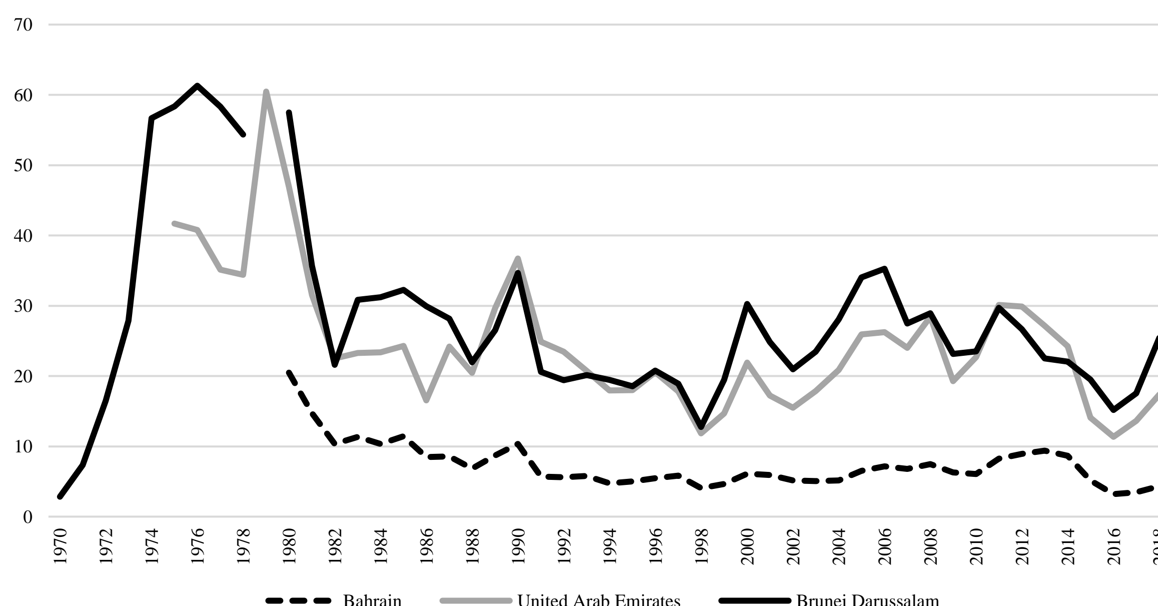


Source: WDI

The obvious risk associated with a reliance on natural resources is that the vast majority of them deplete, particularly the types which are being relied on by Bahrain and the UAE. Furthermore, this industry, like tourism, makes countries vulnerable to external economic shocks. This is evident in Figure 7 which shows the effects which the energy crisis in 1979 (which led to a six-year decline in the global oil price) had on the natural resource rents of the UAE, Brunei, and Bahrain.

Extractive industries rely on having access to export markets and leave countries vulnerable to external shocks and fluctuations in international commodity prices, as Brunei experienced during the COVID-19 crisis as a result of a decrease in global demand (Ministry of Finance and Economy, 2020). These countries also rely on tourism to some extent, although some also have small manufacturing industries which are aimed at servicing the domestic market, or only account for a small fraction of export earnings demand (Ministry of Finance and Economy, 2020).

Figure 7: Natural resource rents (% of GDP), 1970 – 2018



Source: WDI

3.3 Countries with large informal sectors

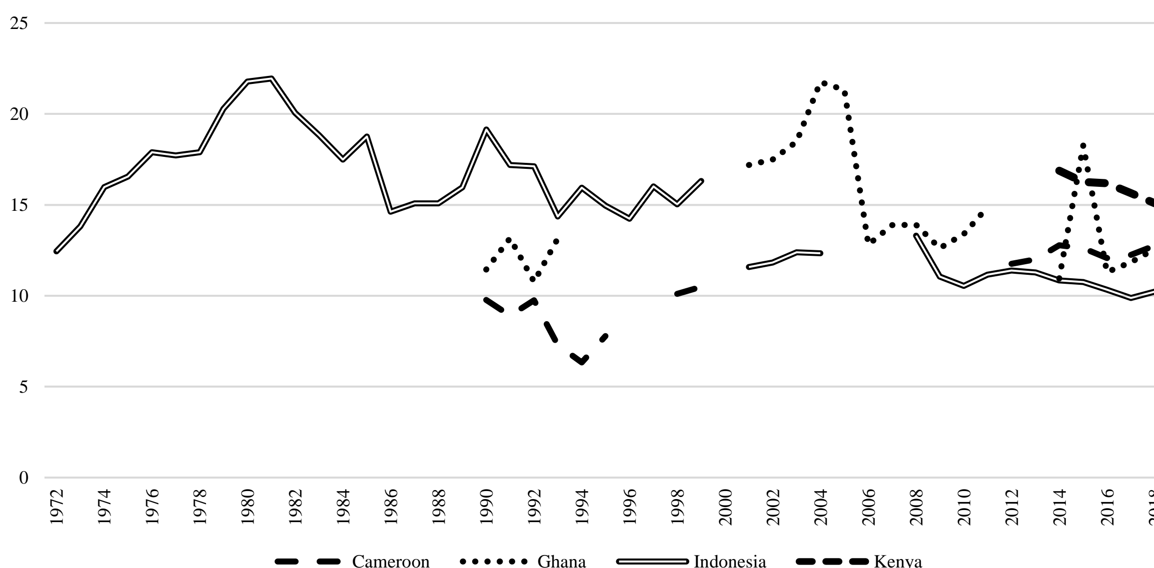
Countries with large informal sectors have experienced unique challenges in relation to taxation and such countries are often characterised by a small tax base in terms of their capacity to levy *direct* taxes. The definition of informality is an ongoing discussion in the literature (Henley, Arabsheibani, & Carneiro, 2006; Hussmanns, 2004), although in countries which already have diminished capacity to collect accurate and regular data on economic activity, enumerating informal sector activity becomes an even greater challenge.

The extent to which a country's economy is informalised is often determined by household survey data in which certain attributes of respondents' employment are investigated to determine whether the individual forms part of the formal or informal economy (Henley et al., 2006). The degree to which micro entrepreneurship is a feature in the economy is also an indicator of informal activity. Whether considering informality from the employment or entrepreneurship angle, governments require accurate data to assess the size of their tax bases.

Countries which have large informal sectors have thus often found it challenging to collect PIT; given that PIT requires being employed in the 'formal' sector or a space in which government can accurately enumerate the activities of workers. Countries which are discussed here rely on their informal sectors for tax collection, although do not necessarily have low PIT rates.

In addition, they have low tax-to-GDP ratios, as is characteristic of developing countries. In 2017 the tax-to-GDP ratio in Kenya was 18.2%, for Ghana it was 14.1%, 14.4% for Cameroon and 11.9% for Indonesia in 2018 (OECD, 2019d, 2019c, 2019b, 2020b). Taking a longer historical view of the tax revenues as a percentage of GDP shows (though with limited data) that these ratios have remained largely below 20%, with Cameroon recording a tax-to-GDP ratio as small as 6% in 1994 (see Figure 8)

Figure 8: Tax revenue as a % of GDP (countries with large informal sectors), 1972 – 2018



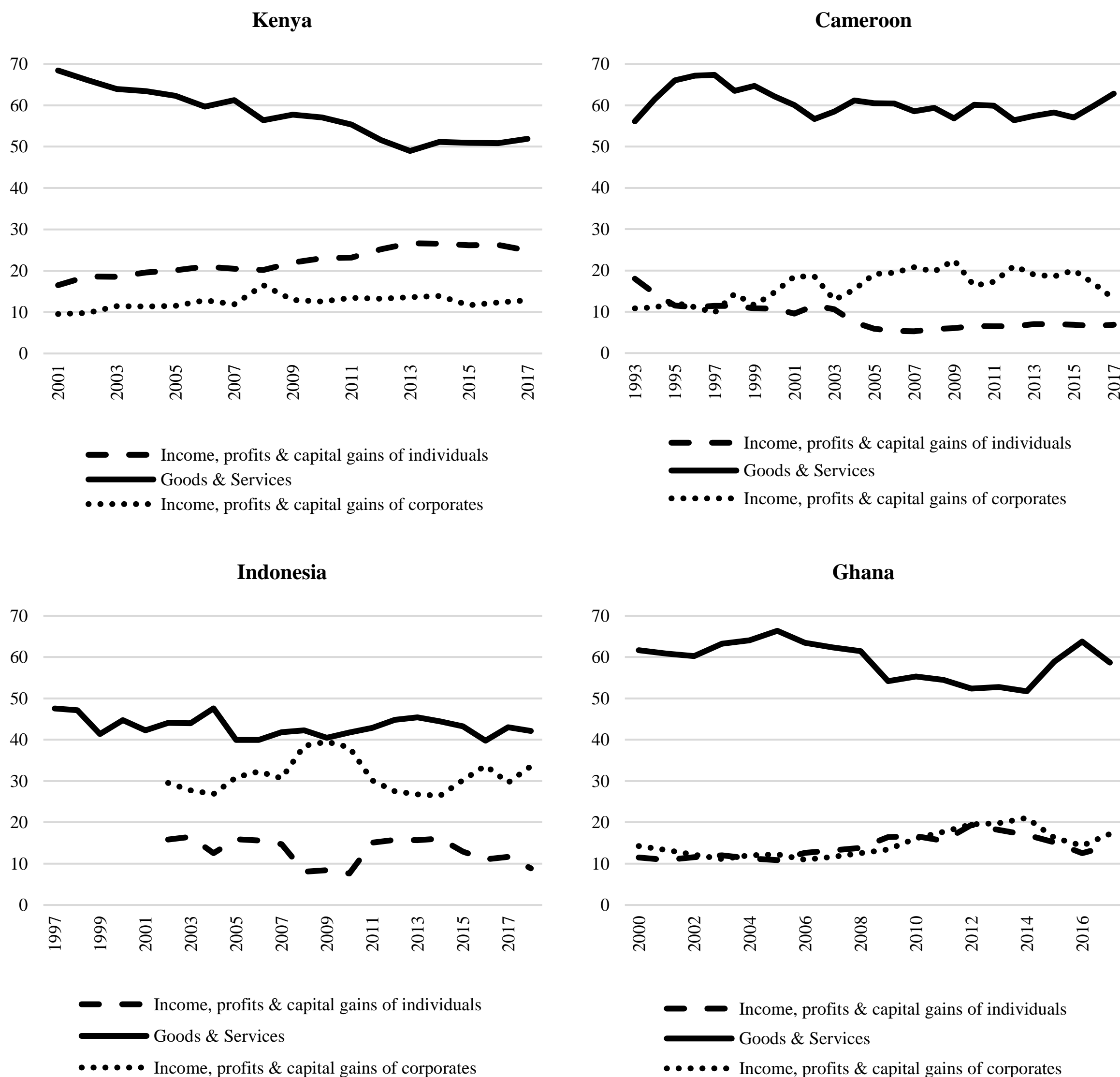
Source: WDI

Looking at the types of taxes from which these countries derive the bulk of their tax revenue, it is clear that they rely primarily on taxation of goods and services. These countries have thus recognised the

limitations of their revenue collection models and have channelled resources to revenue areas which would be most optimal in terms of revenue collection. This is also evident in the tax revenues on corporates, which exceeded those of individuals in Cameroon and Indonesia (see Figure 9). With the exception of Kenya, taxes on individuals have remined below 20% for the last two decades.

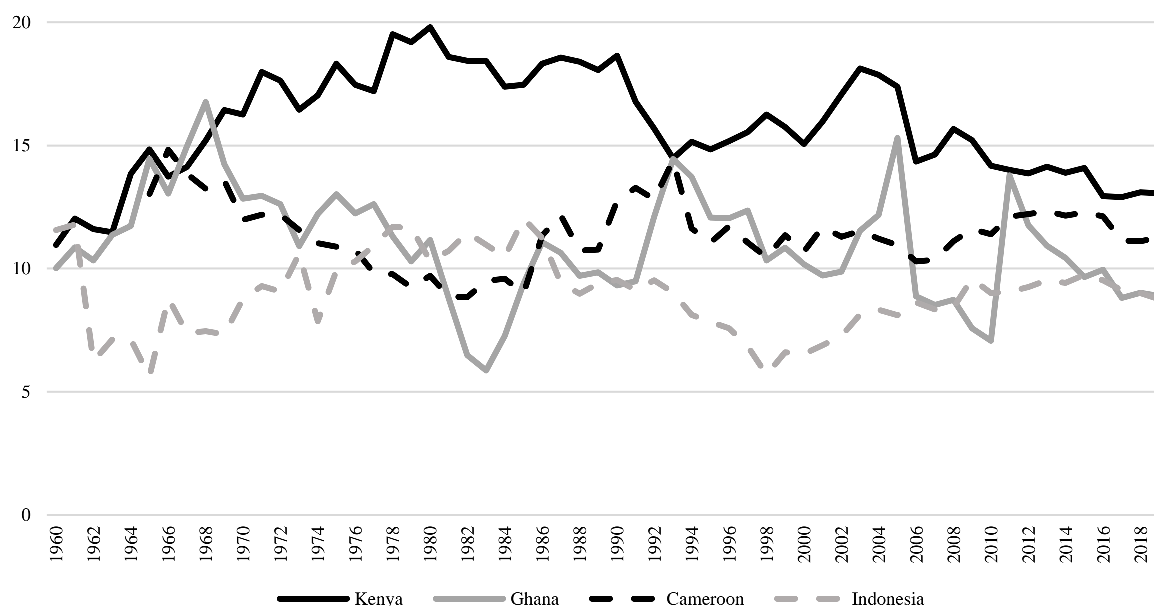
All these countries do have PIT rates which are on par with developing countries (roughly 30%), although derive only a small share of their revenue from PIT.

Figure 9: Main tax revenue sources as a % of total tax revenue (Kenya, Cameroon, Indonesia, and Ghana), 1993 – 2017



Though these tax regimes allow for a move away from a reliance on formal employment in order to levy PITs, a characteristic of the countries discussed in the section is that they have diminished capacity in terms of government expenditure. Figure 10 shows that Kenya, which was also the country with the highest PIT share as a percentage of total tax revenue, also had the highest share in final government expenditure from 1994 to 2018, although this share had declined from 14.8% (1994) to 13% (2018). Ghana's final government expenditure share had also been on a declining trend since the 1990s, while Indonesia and Cameroon's share had slightly increased over the same period, although remained quite low in 2018 (11.25% for Cameroon and 8.75% for Indonesia).

Figure 10: Final government expenditure (% of GDP), 1960 – 2018



Source: WDI

3.4 Key take-aways from country case studies

The main take-away from studying the tax structures of other countries is not to suggest that South Africa should replicate the tax structures of these countries, but rather to demonstrate that each country is unique. This implies that South Africa should, as many of the countries discussed here have, play to its strengths in terms of its tax regime. Each of the countries discussed have experienced the advantages and disadvantages which accompany the tax regimes which they have adopted, although they have traded these gains and losses off against one another to determine which regime would be most efficient for them.

From the examples discussed, one could consider the countries which are considered 'tax havens'. While the establishment of OFCs within their borders have generated large revenues for their government purses, deriving these benefits have come at a cost. These include being blacklisted by certain developed nations and being vulnerable to international economic shocks (the same applied to their tourism industries). However, the gains made from developing these risky financial services sectors have been greater than the losses, but this has required that they lean into the decision to focus on those industries which have delivered their yields.

Another aspect which should be derived from the country discussions is that once a decision had been made to take a particular economic route, these countries built the infrastructure necessary to develop their tax regimes accordingly. This is similar to the infrastructure commitment made to the South African Revenue Service in the GEAR policy when the government aimed to increase tax efficiency. This was also evident in the strategies which were adopted by the resource-rich countries. In Bahrain, for instance, higher CITs were only levied on oil producing countries, as the government recognised this sector as a major source of revenue. This required the development of a policy stipulating differential rates in CIT and the accompanying infrastructure which could manage this type of tax collection. This would have, however, rendered their CIT regime less efficient, an argument which is often made to argue against the implementation of differential tax rates and the consequent high

administration costs these are expected to yield. However, as with the OFCs, Bahrain anticipated net gains despite efficiency losses and have built extraordinary wealth from their tax regime as a result.

Similarly, countries with large informal sectors which rely on VAT as a main source of revenue, have identified the weaknesses within their tax regime, although have managed to find ways to levy from activities within their economies which they know can provide them with a consistent revenue stream.

The difference between South Africa and the countries discussed here is that they have played to their strengths in their revenue models and been purposeful and successful in areas where they wanted to increase their revenue capacity. Countries with large informal sectors, for instance, do not persistently attempt to rely on PIT as a main revenue source, similarly, countries which are heavily endowed with natural resources have taken advantage of non-tax revenues and also levied taxes on companies which are involved in the extractive industries.

It must, however, be noted that for many of these countries public expenditure is constrained (e.g. The Bahamas), although with the relatively low unemployment, poverty, and inequality rates, their governments do not need funding for large social spending programmes. In time of crises, like the aftermath of COVID-19, it does, however, become important for governments to have access to resources to assist the population to weather external shocks. Abundantly clear from the countries discussed in the previous sections is that they also rely heavily on areas of revenue which is either being clamped down on, which is not sustainable in the long run, or would not be a feasible solution to carry the country through a period of external economic downturns – such as the global financial crisis of 2008/09 or COVID-19. Many of them have already, however, moved towards alternative revenue sources or diversifying their economies where they are too concentrated. Thus, none of the regimes are perfect, although it is important for policy makers to remain agile and put in place systems which can ensure their economies are not entirely vulnerable to persistent, long-term problems.

4 Policy options and recommendations

The challenge for South Africa lies in developing a revenue model which is sustainable in the long-term, but also one that can address poverty and inequality. None of the countries discussed in the previous section share the extent of South African's socioeconomic challenges and South Africa's challenges are two-fold on both the spending and revenue sides. This section will briefly discuss a possible alternative revenue stream and an area in which tax relief can be provided. In terms of spending, recommendations are made for adjustment in social spending which could yield better outcomes in relation to poverty and inequality.

It is important to bear in mind that the suggestions made here should not be thought of in terms of the absolute welfare effects this will have on one particular group of people. In the context of high inequality, it is important to consider collective welfare, meaning that where some may gain, others may lose. This trade-off is an inevitable part of an economic system, and the ability for losers to stomach their losses is an important sacrifice for the benefit of living in a peaceful democratic society.

4.1 Revenue

There are a number of considerations for the government on the revenue side. The first includes an adjustment to an already existing wealth tax and the other an adjustment to the CIT structure.

Wealth taxes

The possibility of levying a wealth tax had been discussed very early into the democratic regime (Terreblanche, 2018), although research in the area has been ongoing. Wealth, according to Van Den Heever (2019), lies in asset ownership and can include bank deposits, property, intangible assets, insurance and pension plans, ownership of unincorporated entities, and financial securities. It has also been defined as "non-financial and financial assets over which ownership rights can be enforced and that provide economic benefits to their owners" (Chatterjee, 2019, p. 843). While Terreblanche (2018, p. 3) had initially motivated for a wealth tax based on the role it "could play in addressing inequality as both a structural and symbolic mechanism, rather than as a revenue-raising tool", South Africa's unsustainable fiscal position has resulted in debates raising this as an important source of additional revenue which could simultaneously address inequality. This is further justified given that the marginal tax rate on the top income group has gradually decreased over time.

The debate relating to *wealth* inequality moves beyond the traditional approach of viewing inequality primarily as a function of inequality in labour market outcomes (i.e. *income* inequality), and it has further been shown that wealth inequality in South Africa is in fact greater than income inequality (The Davis Tax Committee, 2018b). Research has shown that a large proportion of South Africa's inequality stems from wealth inequality given the restrictions which people of colour had on asset ownership in the pre-democracy era (Lange, Wodon, & Carey, 2018; Mbewe & Woolard, 2016; Orthofer, 2016). These include restrictions on home ownership, business ownership and, the inability to save extensively given that most were paid poverty wages. Although the complexities of determining wealth is one of the challenges facing the possible implementation of a wealth tax. An additional challenge includes access to reliable data which could provide an accurate depiction of the extent of asset ownership in the country (Van Den Heever, 2019).

A wealth tax in South Africa has been discussed in light of a dual purpose: (1) increasing revenue for the fiscus and (2) addressing the extreme inequality in South Africa. In order for a wealth tax to achieve the former objective without distorting gains related to the latter objective, careful consideration must be taken of where those with extreme wealth store their assets. It is the inability to address this delicate balance which resulted in The Davis Tax Committee identifying problems with a number of wealth taxes suggested. However, as with many policy recommendations in South Africa, the introduction of additional wealth taxes would need to be accompanied by an increase in administrative capacity.

The lowest hanging fruit in relation to wealth taxes are additional municipal property rates (levied as a percentage of the value of the property). Municipal property rates are amongst the least distorting taxes in terms of economic efficiency. In addition, as stated by the Davis Tax Committee (2018b), information related to the value of properties are available at the municipal level. A challenge related to municipal rates include it being detrimental to those who hold most of their wealth in property (primarily the middle-class) as well as those who may have income constraints (farmers who obtained land via land redistribution policies, pensioners etc.). In such instances, exemptions can be introduced and though this would decrease the efficiency of the tax, the loss in efficiency would need to be weighed up against the benefits derived from the administration of such a tax. Property taxes can additionally be applied

on a progressive basis, reducing further distortions this could cause for those who are only able to obtain relatively low-priced properties or buy through the Finance Linked Individual Subsidy Programme for low-income earners.

This tax would need to be accompanied by the introduction of a consistent property valuation framework across municipalities as well as mechanisms to reduce the incidence of corruption in relation to the valuation of properties at the municipal level.

Company income tax increase

Arguments related to South Africa's CIT have largely related to gains in terms of economic growth and employment. South Africa's CIT has been argued to be relatively high, specifically in the Sub-Saharan African region as well as in comparison to its main European trade partners. As a result, discussions have related to whether CIT should be decreased or not, an increase being presumably out of the question given the already uncompetitive rate currently levied in South Africa (28%).

A number of arguments have been made for the consideration of a decrease in the CIT rate, these include the fact that South Africa's CIT rate is relatively higher than those of its regional partners, that lower rates can increase FDI (leading to higher economic growth), and that lowering rates could result in higher compliance and consequently less profit shifting by companies (Katz Commission, 1996; The Davis Tax Committee, 2018a).

Though many of the arguments related to the change of South Africa's CIT are valid, there are certain underlying assumptions which need to be fleshed out and balanced with the socioeconomic challenges which face the country. The first relates to the effects of growth. Studies have found that an increase in FDI only affects economic growth by a small margin in South Africa (and on the continent more broadly), that it negatively affects economic growth and welfare for the extreme lower quantiles, and that FDI could have the effect of crowding out domestic investment (Awolusi & Adeyeye, 2016; Khobai et al., 2017). In addition, evidence has also shown that growth in the South African economy has not necessarily been a panacea for development and employment (Burger & Von Fintel, 2009; Mahadea & Simson, 2010) – hence the persistent poverty and inequality. These are important considerations given that the argument for a reduction in CIT is based on its potential to attract FDI and the consequent economic growth (followed by employment) which will accompany it.

Secondly, arguments for a reduction in CIT rely heavily on comparison to other countries, while neglecting other comparative advantages (also considered by potential investors) which South Africa has in the region, and the fact that South Africa has historically been better at attracting FDI despite its uncompetitive CIT rate in the region (Sunde, 2017; UNCTAD, 1999); suggesting that the CIT rate is not the only consideration for investors. These include a relatively superior macroeconomic climate, a stable inflationary environment, well developed infrastructure as well as a stable and developed financial structure – all of which decrease the risk premium of investing in South Africa relative to other countries within the region. Though these make for a competitive environment, development of the South African economy also bears fruits for its neighbours.

In the current economic climate, however, it is reasonable to suggest that an increase in CIT is not desirable (although this argument tends to persist through good and bad economic times). Alternatively, South Africa could consider making a commitment to the companies they claim are the backbone of employment creation and innovation in the economy – small business corporations (Ramukumba, 2014;

Seda, 2016). Small business enterprises are currently taxed at a progressive tax rate, depending on the size of their profits (Expatica, 2020). However, given the challenges small business owners face during times of distress and their personal exposure to the financial vulnerability posed by the business, the government could consider abolishing taxes for these companies altogether. This could also assist in making them more competitive in the South African domestic market which is characterised by oligopolistic market structures (Lee, 2010; Nkosi, 2013; Standing et al., 1996).

4.2 Spending

In addition to the revenue side, further gains can be made towards addressing inequality and poverty from the spending side.

Increase social grant coverage

Though South Africa has made great strides in the application of its social security programmes and successfully reduced poverty rates, this has not been sufficient to eradicate all socioeconomic challenges (Armstrong, Lekezwa, & Siebrits, 2004; Leibbrandt, Finn, Argent, & Woolard, 2010; Rogan, 2016). According to the latest available Living Conditions Survey (2014/15) almost half of the South African population lived below the upper-bound poverty line and nearly 20% of households relied on social grants as its main source of income, according to the 2018 General Household Survey (Stats SA, 2019a, 2019b).

The benefits of social grant beneficiaries have to an extent been 'diluted' by the responsibility which some grant-receiving households have to the unemployed (Armstrong et al., 2004; Surender, Noble, Wright, & Ntshongwana, 2010). However, the COVID-19 crisis has shed light on the plight of the unemployed, leading to the roll-out of short-term relief for unemployed individuals. Although, many of the beneficiaries of this grant will remain unemployed in the foreseeable future, given the current scale of job shedding (Adams-Prassl, Boneva, Golin, & Rauh, 2020; Jain, Budlender, Zizzamia, & Bassier, 2020; Ranchhod & Daniels, 2020). It is for this reason that many have called for an extension of the grant, some also making renewed calls for a basic income grant, based on previously explored evidence (Barchiesi, 2007; South African Government, 2020). Though a basic income grant, which is based on a flat rate which all citizens have access to, may assist in relieving poverty, a flat structure does not serve equity goals nor is such a structure always financially feasible, given its scale. An argument can thus best be made for a permanent continuation of the unemployment social relief of distress grant from which the same benefits of usual consumption expenditure can be derived (e.g. contribution to VAT), a recommendation which has been forthcoming from certain spheres within the government and civil society alike.

Secondly, the same problem posed by a universal basic income grant, could potentially be applied to the current grant system. Though the grants are aimed at the economically deprived, poor individuals make up a substantial share of the population and within the general 'poor' category, there are different degrees of deprivation. Women-led households tend to be worse off than male-headed households and African households tend to be worse off than households of other race groups (Leibbrandt et al., 2010; Rogan, 2016).

These *patterns* suggest that a flat grants structure is not suitable to address the inequalities which exist at the (large) bottom-end of the income distribution. A progressive approach to grants could assist in ameliorating this challenge, although might pose a challenge in relation to the criteria used to identify

which households or individuals are deserving of a greater grant amount. One way in which this can be trialled is an area in which an urban and rural community co-exist. The distribution of a higher grant amount to rural inhabitants, could alleviate the additional poverty burden they carry, often in the form of being further away from economic activity and being worse-off in relation to service delivery shortfalls within their communities. Such a program would best be trialled on a small scale and the relative efficiency losses from moving away from a flat grant structure weighted up against the gains made by the rural community.

Expansion of direct benefits rather than indirect benefits

An additional recommendation, and perhaps deserving of more careful and further consideration than the first two spending recommendations in terms of feasibility, relates to giving people more cash-in-hand, and moving away from government providing *all* basic services, which has in many instances been inefficiently done. Studying VAT increases in South Africa's recent history, for instance, researchers found differential effects when modelling an increase in VAT and an increase in the basket of zero-rated goods, versus abolishing the zero rated basket of goods and using those gains to provide cash-in-hand to recipients of the child support grant instead (Gcabo et al., 2019).

While the findings of this study are not necessarily of significance, it does raise questions around the assumption of government's job to provide basic services; specifically given that the government has failed in many areas to provide such services efficiently and effectively. One could consider whether funds used for the service delivery areas which government has performed particularly poorly in could be channelled towards increased grants or a similar distribution service for citizens, who may benefit more from procuring these services themselves through a sector characterised by regulated pricing.

Such a move may not only be potentially empowering to citizens who may experience greater freedom in consulting service providers of their choice, but also shift government more into a regulator function rather than a service provider function; something which the current government has not always shown proficiency in. A recommendation of this sort would naturally require further investigation and a trial of such a system within a small area.

5 Conclusion

This paper outlined the challenges which the South African government has created in its revenue system by continuing to rely heavily on employment creation as a source of continued revenue generation and a solution to the poverty and inequality which faces the nation. The COVID-19 crisis has shed renewed light on these persistent social ills, but has also provided an opportunity for policymakers to think differently about how they want to address these problems. This is evident in the social relief of distress grant which was introduced to unemployed individuals for the first time, despite continued calls over the last few years for a basic income or similar grant.

This paper provided a brief overview of South Africa's tax structure as well as a summary of countries which have adopted alternative tax structures. The take-aways from studying these countries were not that South Africa should replicate their tax structures but rather consider the losses being incurred by the currently distressed fiscus and look at areas where revenue can be collected and spent in ways that result in greater gains towards a reduction in poverty and inequality.

A persistent theme throughout the paper is the government's drive towards employment creation. The assumption made in this paper was that employment creation for the purposes of providing revenue to the fiscus, and reducing poverty and inequality was not a tenable solution in South Africa; and the last three decades of persistently high unemployment rates is evidence thereof. A reliance on wage employment is not sustainable for a number of reasons, including the fact that the nature of labour markets is changing globally and that the COVID-19 crisis has also resulted in unprecedented job losses; this is in addition to a growing public debt burden. Though these are not new phenomena, the COVID-19 crisis has brought this issue to the fore for the South African government.

Though the policy recommendations made in this paper require further analysis to establish feasibility, the COVID-19 crisis and accompanying job losses does present an opportunity to interrogate our philosophical assumptions around wage employment. This is particularly important given that a continued heavily reliance on PIT will mean that government will continue to set forth policies aimed at driving people into a failing labour market. The COVID-19 crisis has also sparked debate about the shortcomings of linking social security and other services to labour market outcomes. Though South Africa had capitalised on its universal health care during this time, job losses have shown the extent to which government expects its citizens to rely on labour market outcomes to attain many other constitutionally guaranteed services (such as housing). In many instances, money has been put aside in the fiscus for these provisions, although government has not been able to deliver on these provisions for various reasons. The implications of this is also evident in the growing number of service delivery protests (Alexander, 2010; Nleya, 2011).

Rather than asking *how* employment growth can be attained, taking a step back and asking *why* employment should be attained at all may move us closer to productive solutions to the socioeconomic problems which characterise the economy. If the reasons for being employed is for people to survive and for government to finance the fiscus through taxation of the employed, then the current socioeconomic ills will continue well into the future. Removing the *need* to work could prompt more productive discussions about how the extent to which government's service delivery function is necessary and how best to deliver these services. This could also move us toward the inclusion of alternative forms of work, such as informal work and unpaid reproductive work which is often the work of the marginalised in our society (Benería & Floro, 2005; Bhorat & Goga, 2013; Glenn, 1985; Rakovski & Price-Glynn, 2010).

The current economic policy framework has thus created a 'labour market trap' for both government and its citizens. This trap has resulted in government being in a position of dependence on PIT. To sustain this revenue source, the government will be forced to continue adopting policies which are aimed at creating jobs in an economy which is unable to absorb the current labour force at a time when the nature of the labour market is changing. For citizens, this trap represents the need to have some sort of link to the labour market to ensure survival, whether it be the need to be employed or having access to an employed person to share in their resources. The inability for the labour market to absorb workers as it should is thus a source of frustration for both parties.

Though this paper does not provide a concrete picture of what a South African society free of this labour market trap looks like, it does highlight the unsustainability of the current approach to doing business. An acknowledgement of this problem will allow for room to explore alternatives which would be more suitable for the unique structure of the South African economy.

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