Fiscal Policies for South Africa: A Look at Trade Union Proposals

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Trade unions in South Africa play a significant role in the economy. Trade unions have been active in responding to the fiscal policies of government. Unions argue that their proposals for the budget will increase economic growth and support job creation. Criticism of trade union views on the budget has focused on the affordability of these proposals, and on their impacts on business growth. Your essay should review recent submissions from trade unions, and provide a critical analysis of their proposals. Will trade union alternatives on the budget support economic growth and economic inclusion?

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"The important role of union organizations must be admitted: their object is the representation of the various categories of workers, their lawful collaboration in the economic advance of society, and the development of the sense of their responsibility for the realization of the common good."
-Pope Paul VI

1. Introduction

There are three distant entities whose interactions with one another drive the economy of a nation. These entities are; the government, the private sector and civil society. The interests of civil society are represented by trade unions. Trade unions and government have a similar raison d`être; to promote economic growth and economic inclusion so as to provide a better living standard for all citizens. But often there is a difference in economic opinion with regard to the best fiscal policies that can make the nation realise this dream of a thriving, stable and inclusive economy.

South Africa currently faces three major challenges, commonly referred to as the triple crisis; poverty, inequality and unemployment. COSATU[1] has made several fiscal policy submissions to the national treasury, which they argue to be the best responses to the above mentioned challenges.

This essay will review the proposals and dissect their financial pragmatisms and overall economic implications, focusing particularly on COSATU's counter proposals to the Youth Wage Subsidy and their call for a reformation of the tax system.

2. The Youth Wage Subsidy

The unemployed rate in South Africa is a high 24.9% (Stats SA, March 2014). The population group most severely affected is the youth. The unemployment rate among South African youth is 54.5%, which is ridiculously high in comparison to the global youth unemployment rate of 14.8% (International Labour Organisation, 2012).

The National Treasury introduced the Youth Wage Subsidy[2], where an employer is subsidised for hiring a young person, aged 18-29 years, to compensate the employer for the risk that comes with the young person's lack of experience and skills and hence unknown productivity (a demand side remedy). The national treasury argues that though the subsidised employer is only obliged to hire the worker for a minimum of 12 months, it is likely that the employee will be able to find other work with the experience attained (a supply side remedy)[3].

COSATU Proposal

COSATU proposed that the R5 billion budgeted for the YWS would be better spent as additional funding to young people's education by offering them a stipend that encourages them to opt for furthering their studies rather than entering the labour market after matriculation. COSATU fails to recognise that funding for further studies is already provided through NFSAS[4], where a living allowance is offered to eligible students.

COSATU further argued that YWS will give employers an incentive to replace current workers with subsidised employees, and to recycle subsidised employees without providing them with training and permanent placing, causing substitution and displacement effects respectively. Furthermore they argued that some employers will be paid subsidy for an employee who would have been hired even in the absence of the subsidy programme (deadweight loss), and that the assumption that there is a difference between start up wages and productivity among the youth is inaccurate.

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[1] COSATU, Congress of South African Trade Unions is the largest union in South Africa with around 2.2 million members (2012 figures, COSATU Draft Organisational Report)
[2] Under the Employment Tax Incentive Bill
[3] See figure 2
[4] National Student Financial Aid Scheme

The National Treasury recognises these indirect effects and designed the Youth Wage Subsidy to minimise them (Employment Tax Incentive Bill, 2013). The substitution effect is somewhat exaggerated as inexperienced workers are not substitutable for experienced workers due to the significant difference in their productive value (National Treasury, 2011).

In Denmark, measures such as; requiring the hiring of the subsidised worker to have overall increase in firm's number of employees, imposing upper limits to the number of subsidised employees relative to usual number of employees and requiring employee representative to approve subsidy where implemented to prevent substitution and displacement effects (Rotger & Arendt, 2010).

As with many other necessary market interventions, deadweight loss can be expected. But the Democratic Alliance argues that even when taking into account the deadweight loss, the cost-per-employment-opportunity is still lower than with other alternative policies (DA, 2012).

In South Africa, the mean entry-level wage is 60% of the average wage. In other OECD nations, it is 37% [5] (OECD). Hence, entry level wages in a majority of South African firms are greater than the relative productivity of the new employee. The YWS subsidy lowers cost of the labour to the new employee, making it more affordable for firms to hire these young workers (National Treasury, 2011).

3. Personal Income Taxes

Tax systems are one of the most heated debates in Welfare Economics. COSATU recommended that the current tax system be made "more progressive" by introducing a category for the "super rich" (The Principle of Rawlsianism). COSATU further proposed that a form of progressive taxing should be used in place of government's electronic tolling.

The Upside

Taxes play a major role in raising revenue and funding government expenditure. South Africa's Personal Income Tax collection for the 2012/13 fiscal year (2012 tax year) was recorded at R276.7 billion , 34% of the total tax revenue (National Treasury and SARS, 2013). The tax revenue was 25.3% of GDP (Stats SA, 2013).

Taxes also provide a way of correcting "inequalities" in wealth distribution, particularly for South Africa, where the economy is characterised by high Gini coefficient, estimated at 0.631 for the year 2009 (World Bank)

Weller and Rao argued that taxes assisted in keeping output from extreme vacillations (2008). Swanepol and Schoeman (2002) concluded that "South Africa's tax revenue and the output gap are highly correlated", hence the taxation system had been an "influential automatic stabilizer".

Weller and Rao argued that increasing national saving through progressive taxes instead of international capital inflows lead to a less volatile financial markets (2008). They further argued that taxes granted policymakers greater freedom to implement counter-fiscal policies.

[5] See Figure 3

The Downside

There are several notable disadvantages of high tax rates. Depending on the elasticity of taxable income, high tax rates may discourage economic participation by decreasing financial incentives while large tax revenue generation can crowd out domestic capital available for investment in production (Weller and Rao, 2008).

Furthermore there is some evidence that high tax rates may induce migration (Young and Varner, 2011).

> "The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed to a burdensome tax, and would remove his stock to some other country where he could either carry on his business, or enjoy his fortune more at his ease…" Adam Smith (The Wealth of Nations, 1776)

High tax rates may also result in a decreased tax revenue as high income earners may choose to avoid and evade paying their due taxes[6] (Panades, 2003).

Recommendation

Jean Baptiste Colbert writes, "The art of taxation consists in so plucking the goose as to get the most feathers with the least hissing."

The statutory top marginal PIT rates in 2009 was 40% for South Africa (SADC, 2011), an average of 29% for SADC countries [7] (SADC, 2011) and an average of 41% for other OCED countries (OCED, 2011). Hence South Africa has a relatively high tax rate. Furthermore, Mandy (2012) concluded that South Africa's tax system was "extremely redistributive**".** High and middle income earners received an estimated 10% of their PIT in the form of public services from government (Mandy 2012). Therefore it would be economically unreasonably to introduce a "more progressive" tax system.

3 Financial Transaction Taxes

COSATU also called for Financial Transaction Taxes (FTT's) (including Capital Gains Tax) to be introduced to "limit short term transactions and promote productive investment".

The Upside

There are several advantages to implementing FTT's, of which the most notable is raising revenue. FTT revenue proportion in South Africa has averaged 1.95% between 2001 and 2008 (Darvas and Weizsacker, 2010). Other, less evident, advantages include promoting financial market stability[8]. Darvas and Weizsacker (2010) argued that FTT's add to the costs associated with short-term trading, and hence reduce markets size and lessen volatility by lowering the frequency of speculative and short-term trading.

Furthermore, Jones and Persuade argued that FTT's can enhances economic growth since they encourage investments of much longer term (2012).

[6] Given that avoidance and evasion costs are low.
[7] Excluding South Africa
[8] Following the Global Financial Crisis of 2008, there were numerous debates concerning the role of FTT's in maintain stability in financial markets

The Downside

On the other side of the debate, Almenberg and Wiberg found that FTT's can hamper economic growth by increasing costs of capital to businesses (2012). They added that businesses depend on trading financial derivatives to hedge risk and fluctuations in exchange rates and commodity prices, therefore FTT's could reduce their financial ability to protect themselves against extreme market movements. (Almenberg and Wiberg, 2012).

Recommendations

South Africa has achieved considerable success with its financial transaction tax system. Hong-Kong, Taiwan and South Africa collected the greatest revenue from these taxes relative to GDP, 2%, 1% and 0.5% respectively (IMF, 2011). But further increases to FTT rates could be detrimental. Darvas and Weizsacker found that there were significant positive outcomes from a small Pigouvian FTT (2010)

Furthermore, the correlation between FTT's and financial market stability is unclear (Almenberg and Wiberg, 2012). And the argument that FTT's promote long term investment is not convincing since there is no clear link between the frequency of trading shares or bonds and the long term investment decisions that a frim makes. (Almenberg and Wiberg, 2012). Ironically, FTT's may reduce investments by inducing capital flight.

4. BRICS Nations

South Africa scored the highest for tax system and budget allocation among BRICS nations[9] (Sustainable Government Indicators, Country Studies, 2012), further evidence that the national treasury's fiscal policies are appropriate.

5. Conclusion

The economic implications of trade union alternatives show that such fiscal policies will not advance economic growth.

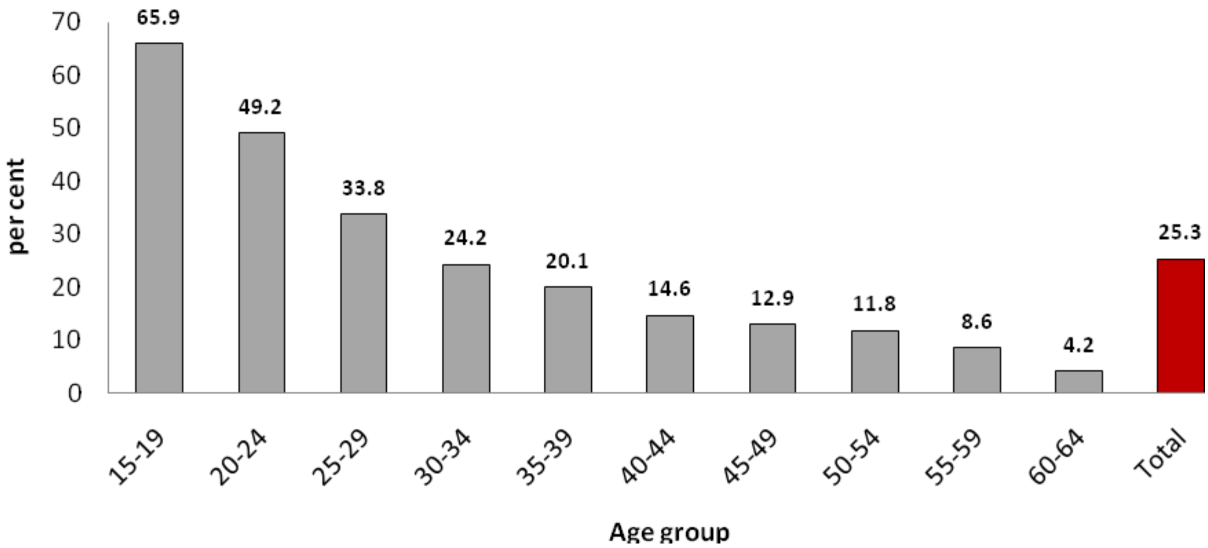
The major focus of fiscal policy in South Africa is growing the economy to achieve the essential objectives of the National Development Plan. Education is the long term solution to unemployment, however, the Youth Wage subsidy will play a critical role on a more short term basis.

Implementing higher FTT rates could hamper economic growth by limiting capital, while a "more progressive tax system" is like sharing a cake by giving a bigger slice to someone at the expense of someone who worked harder in baking the cake. We should rather focus more on providing opportunities for everyone to contribute in baking the cake. That way we will all have a bigger cake to share.

[9] See Table 2

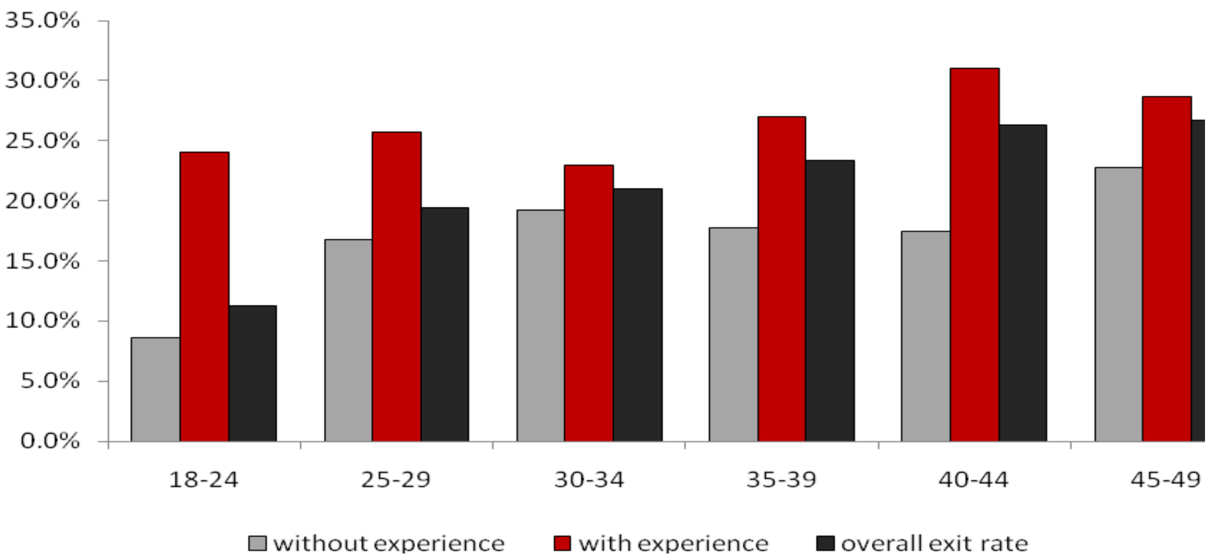
6. Appendix

Figure 1: Unemployment rates are much higher for the youth



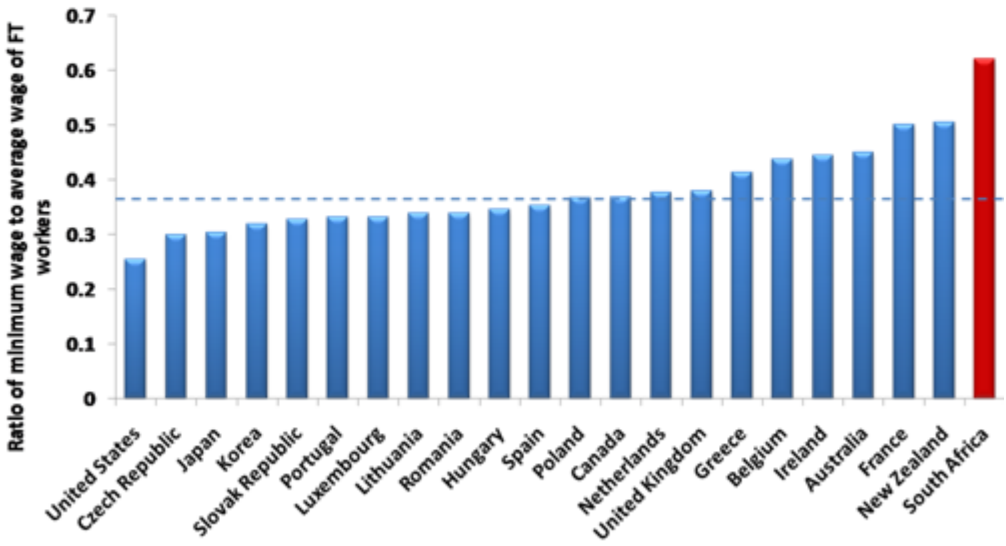
Source: Statistics South Africa Quarterly Labour Force Survey, September 2010

Figure 2: Exit rates from unemployment with experience and without experience



Source: Statistics South Africa, Labour Force Survey panel data

Figure 3: Ratio of minimum wage to average wage of full time workers.



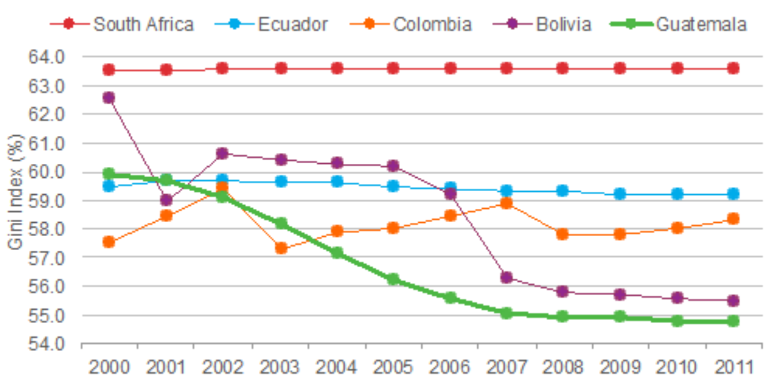
Source: OECD

Table 1: Income Tax for 2014/15 (Individuals and Trusts)

Taxable Income (R)	Rate of Tax (R)
0 – 174 550	18% of taxable income
174 551 – 272 700	31 419 + 25% of taxable income above 174 550
272 701 – 377 450	55 957 + 30% of taxable income above 272 700
377 451 – 528 000	87 382 + 35% of taxable income above 377 450
528 001 – 673 100	140 074 + 38% of taxable income above 528 000
673 101 and above	195 212 + 40% of taxable income above 673 100

Source: SARS, Pocket Tax Guide, 2014

Figure 4: Top five Gini coefficients in the world



Source: Euromonitor International from national statistics

Table2: Ranking BRICS economic and labour governance

Scores Country	Economic S5	Labor S6	Enterprise S7	Tax S8	Budget S9	Average score	Rank
China	8	7	7	6	6	6.8	1
Brazil	7	8	4	4	9	6.4	2
India	7	4	6	6	6	5.8	3
South Africa	6	3	3	7	8	5.6	4
Russia	2	4	2	6	8	4.4	5

Sources: SGI country studies. | BertelsmannStiftung

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