



Making Fiscal Policy ‘Work’

CAN FISCAL POLICY DO MORE TO ADDRESS POVERTY, INEQUALITY,
GROWTH & JOBS IN AUSTERE TIMES?



Triple Challenges Are Center Stage



Poverty

Every night **12 million** South Africans go to bed **without food**



Inequality

1 in every 17 individuals in **Sandhurst** have wealth in excess of **US\$30 million (R400 million)**

Alexandra's average household income is **< R2 700 a month**

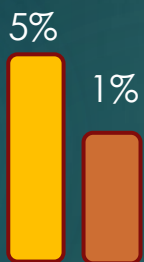


Unemployment

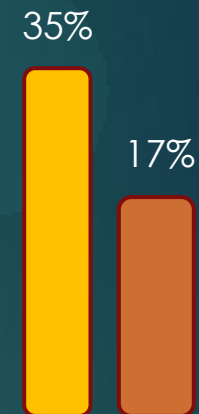
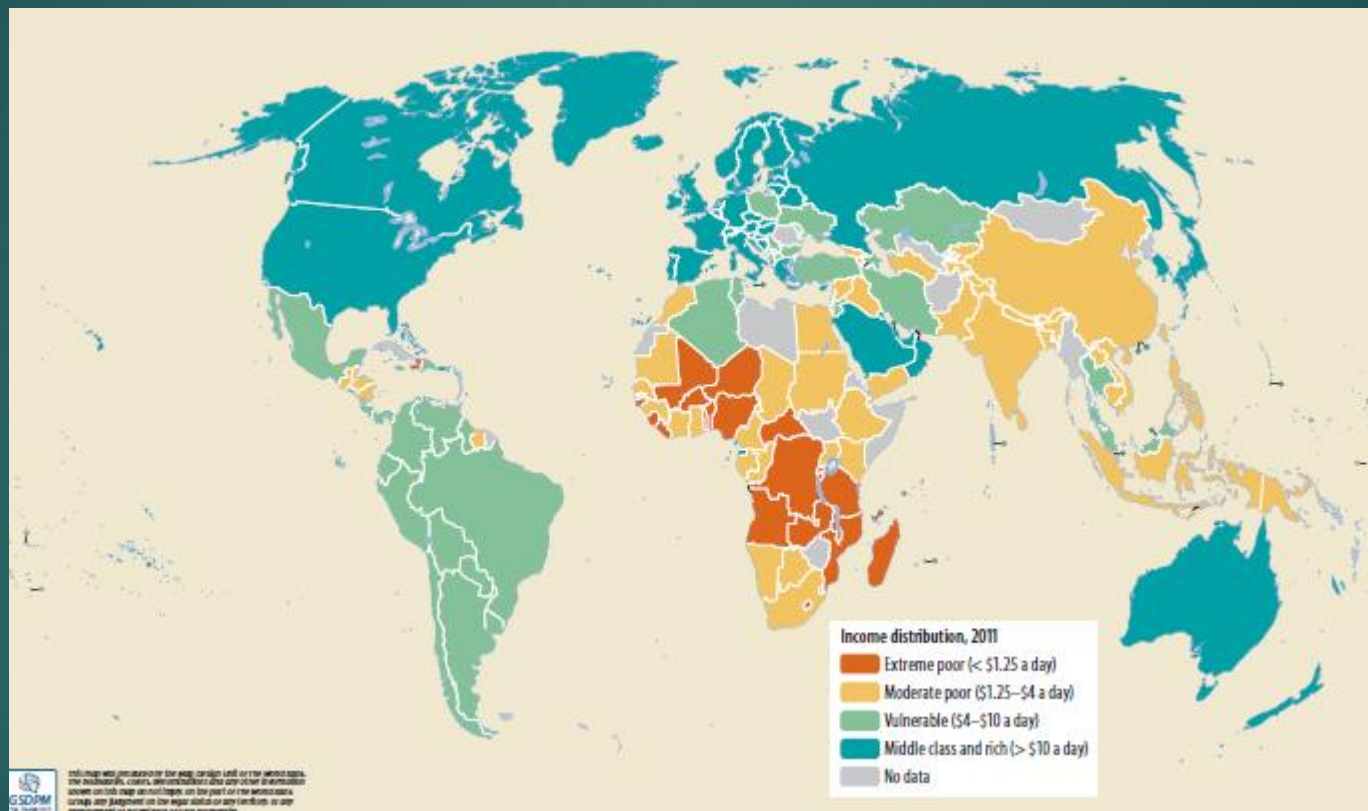
There are **more people unemployed** (expanded definition) in South Africa than the **combined population** of Botswana, Namibia, and Lesotho



Challenge 1: Poverty High For A Middle Income Country



Upper Middle Income



South Africa



Poverty Headcount Ratio at \$3.10 a day (2011 PPP) (% of Population)

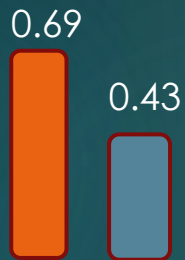
Poverty Headcount Ratio at \$1.90 a day (2011 PPP) (% of Population)



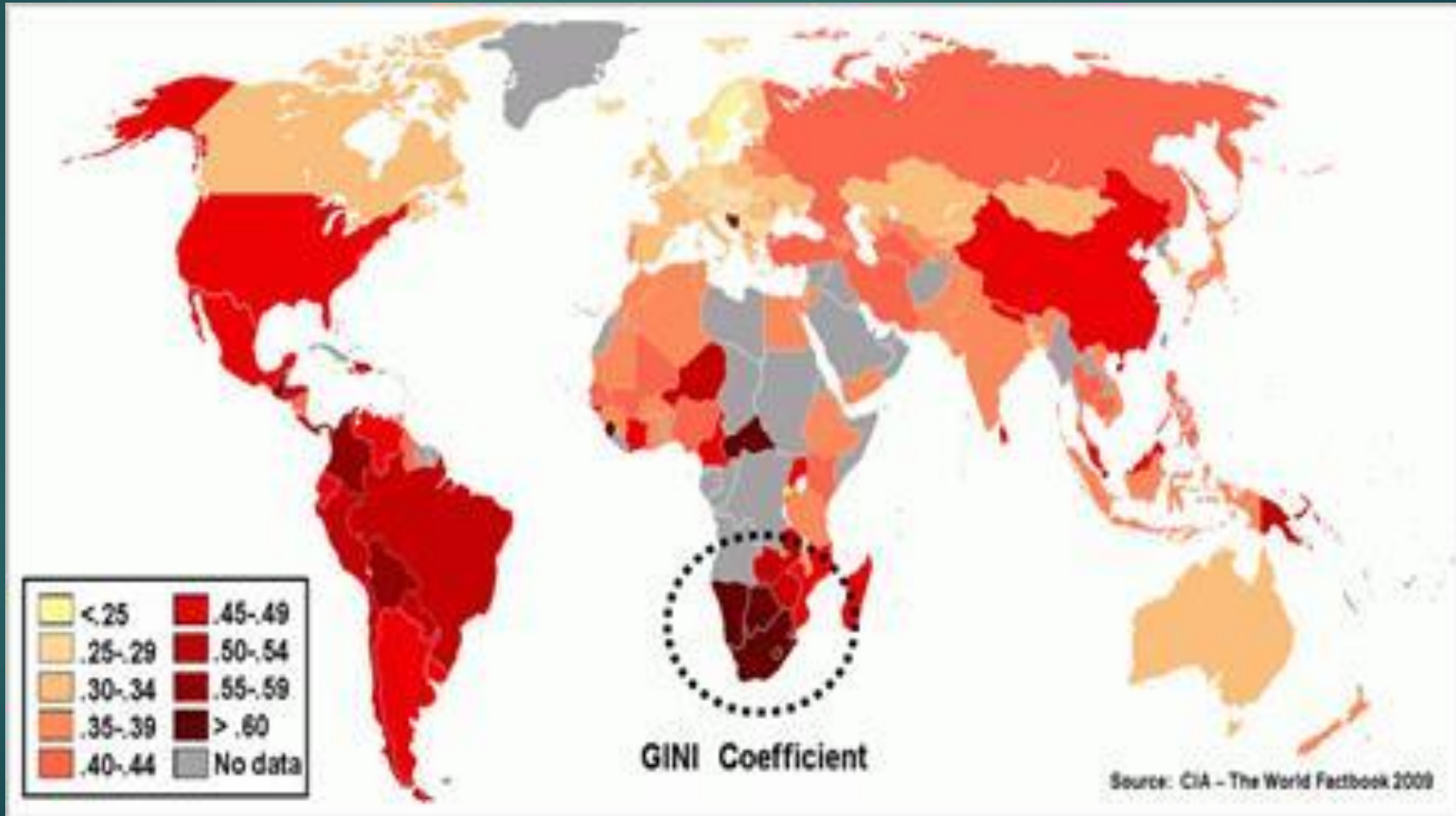
Challenge 2: Inequality

World's Most Unequal Country

UMIC
comparison:



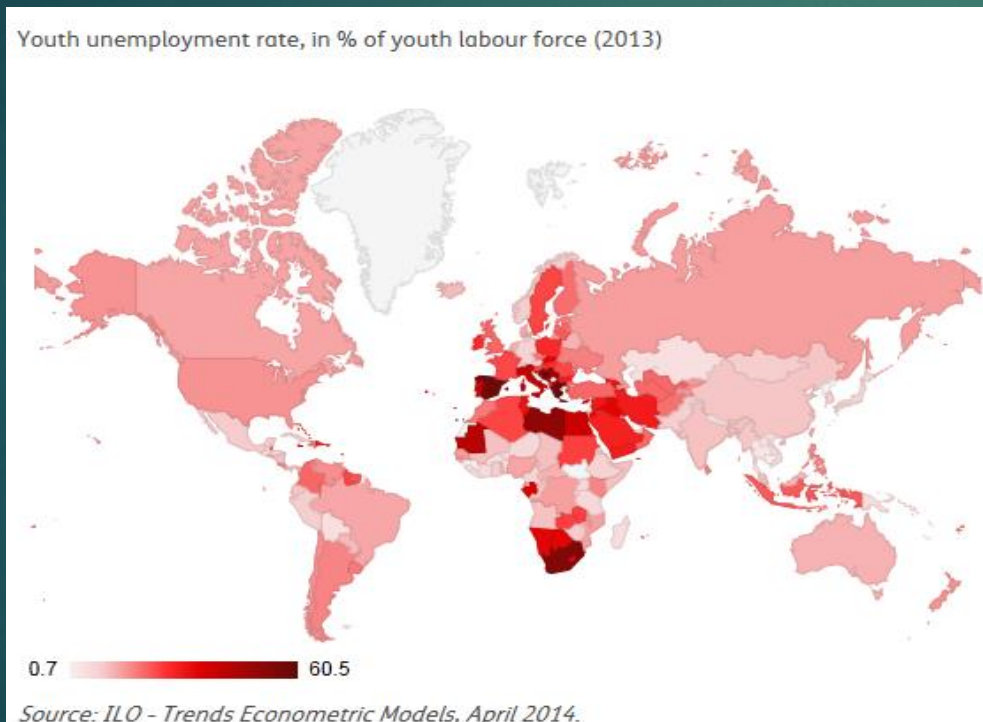
- South Africa
- Upper middle income country average



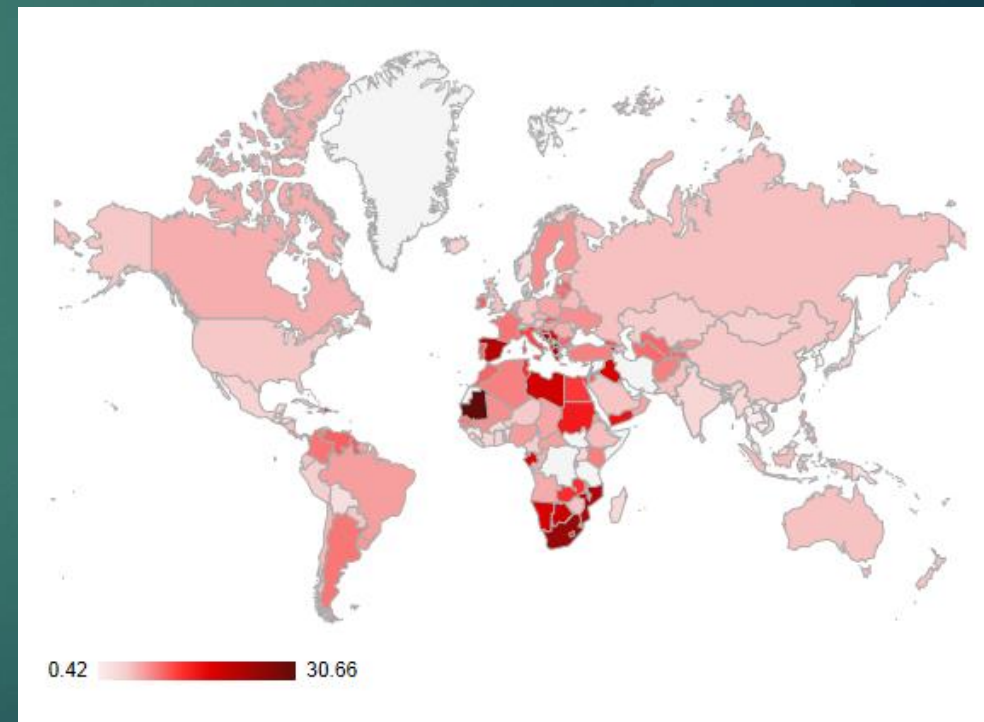


Challenge 3: Unemployment Is High By Global Standards

Youth Unemployment Rate



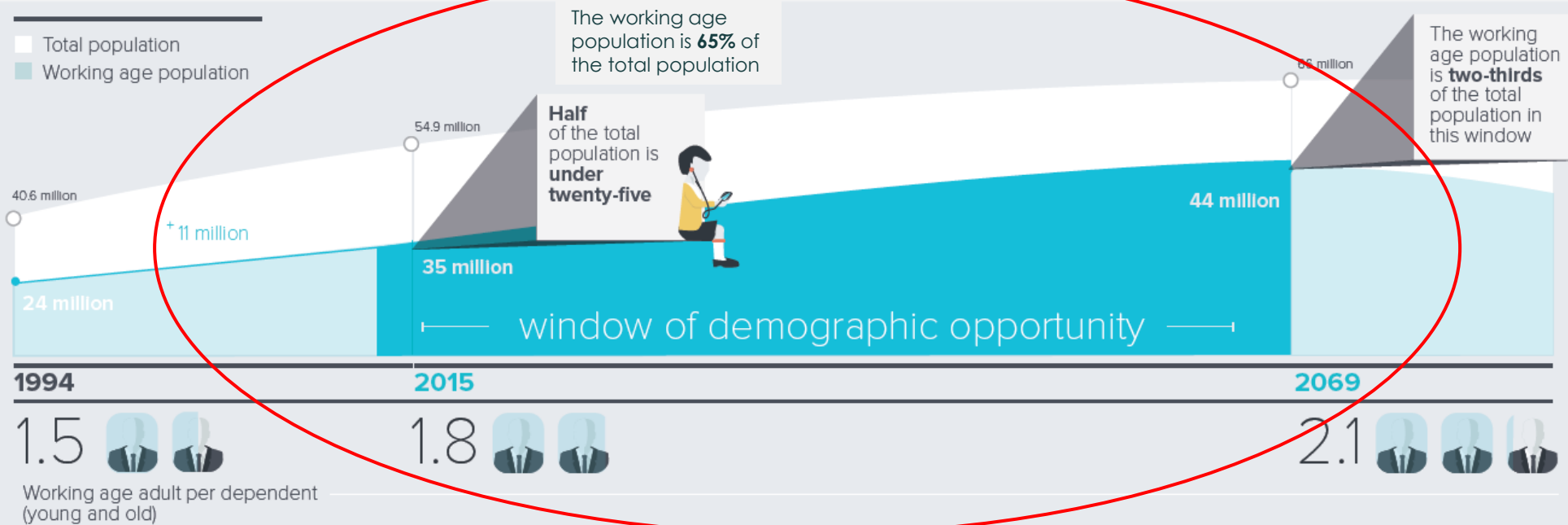
Unemployment Rate in 2019





Demographic Change Implies Jobs Challenge Will Grow

South Africa's working age population is high and will rise by another **9 million** in the next 50 years



Sources: UN Population Prospects, 2013 and Statistics South Africa



As South Africa Currently Fails to Generate Enough Jobs



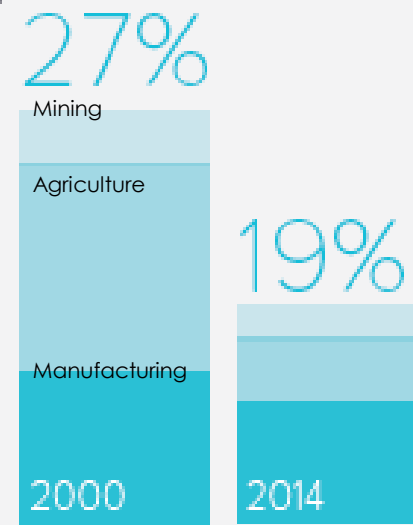
Since 2000

Only **2.8 million** out of the **8.3 million** extra working age population found jobs

Today

Only **40%** of the working age population work

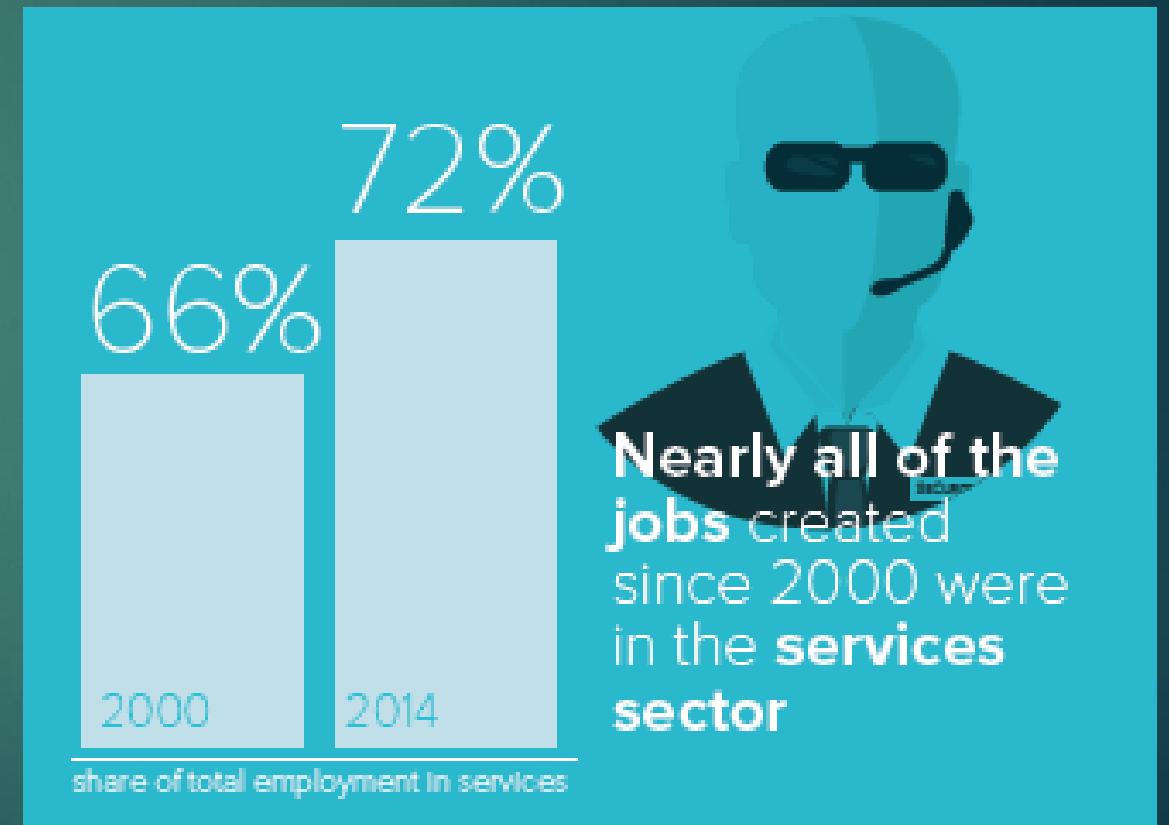
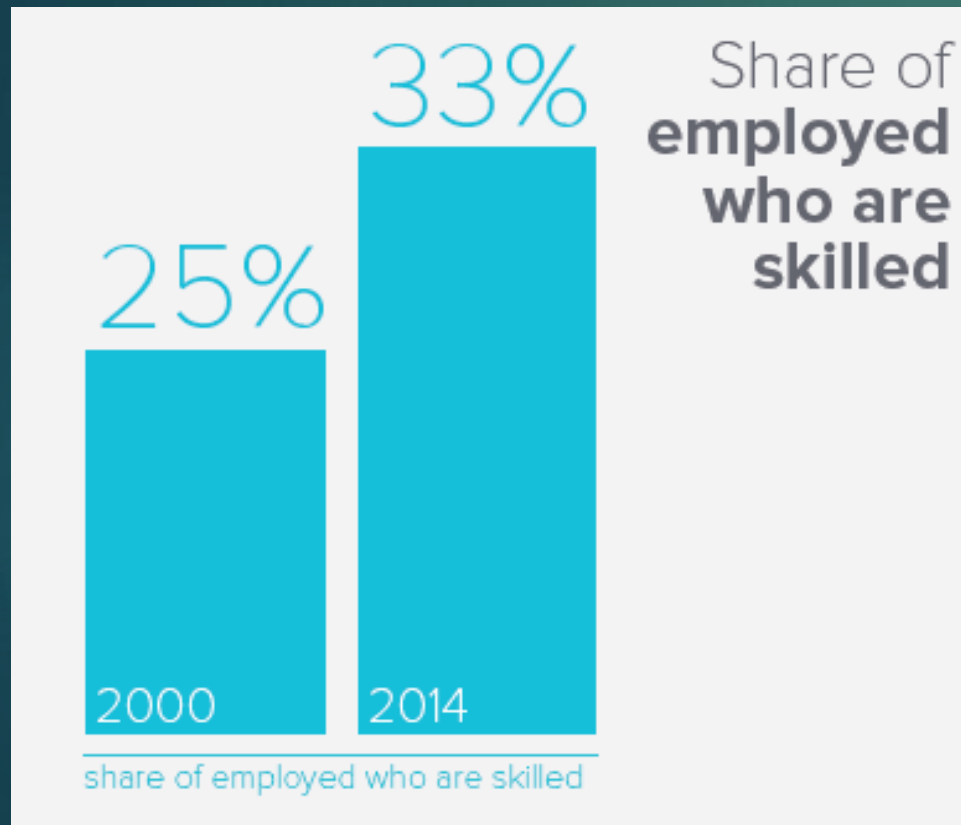
Jobs were lost in agriculture, manufacturing and mining



share of total employment in agriculture, manufacturing & mining



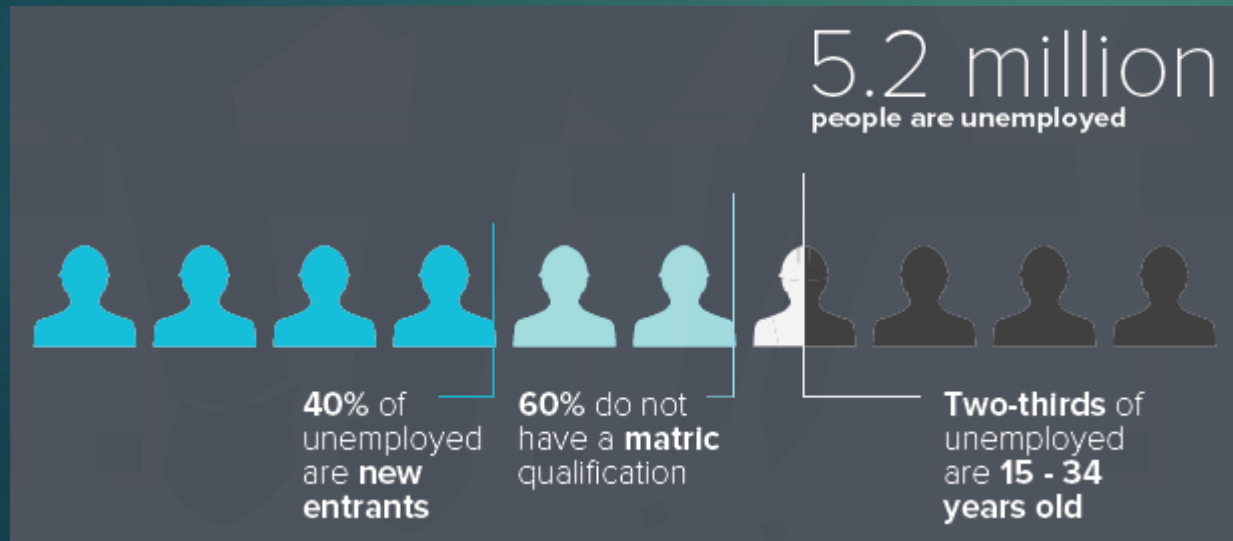
Job Creation Has Become More Skilled





Leaving Many Unskilled Youth Facing The Prospect Of Unemployment

South Africa Unemployment Rate **25.5%**
Upper Middle Income Countries Average **11%**



Source: Statistics South Africa, Labor Force Surveys

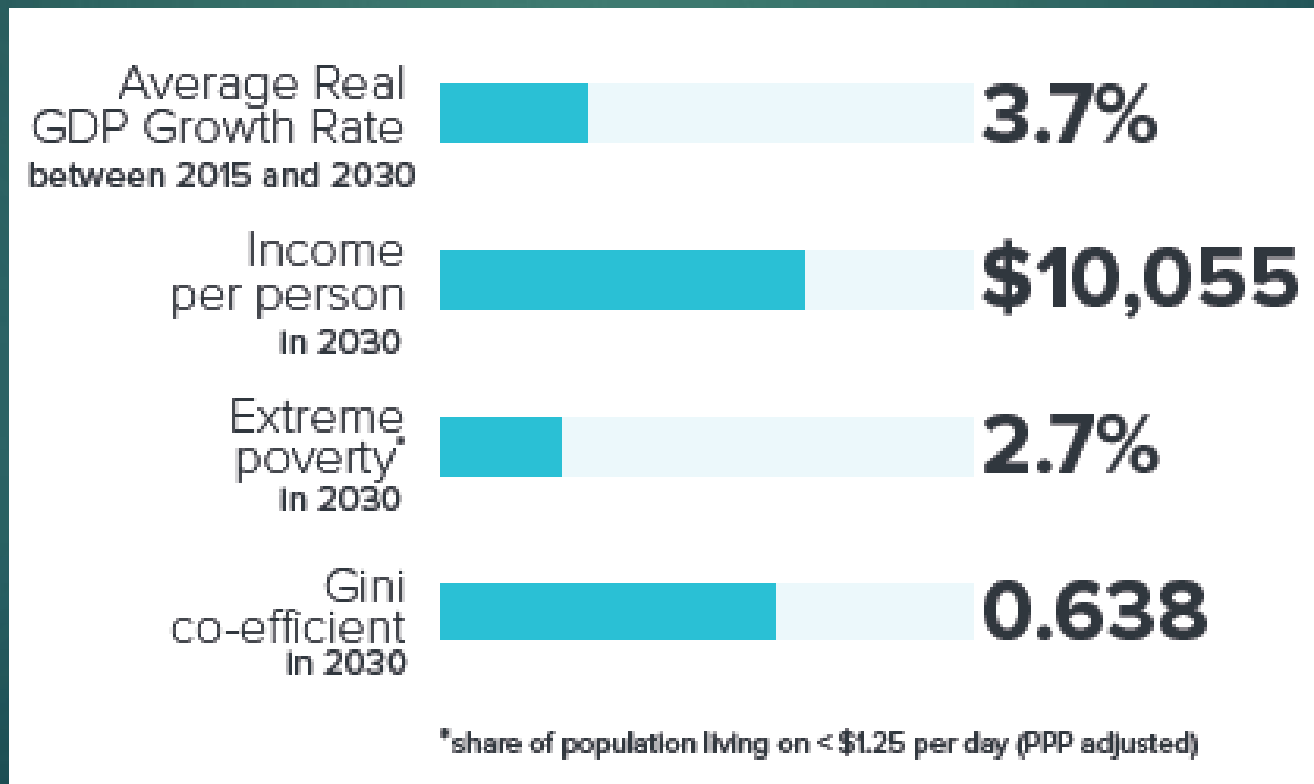


Source: Statistics South Africa, Labor Force Surveys



Absent Job Creation Growth Dividend Missed Inequality & Poverty Remain

By 2030:





How Can Fiscal Policy Address The Triple Challenges In Austere Times?

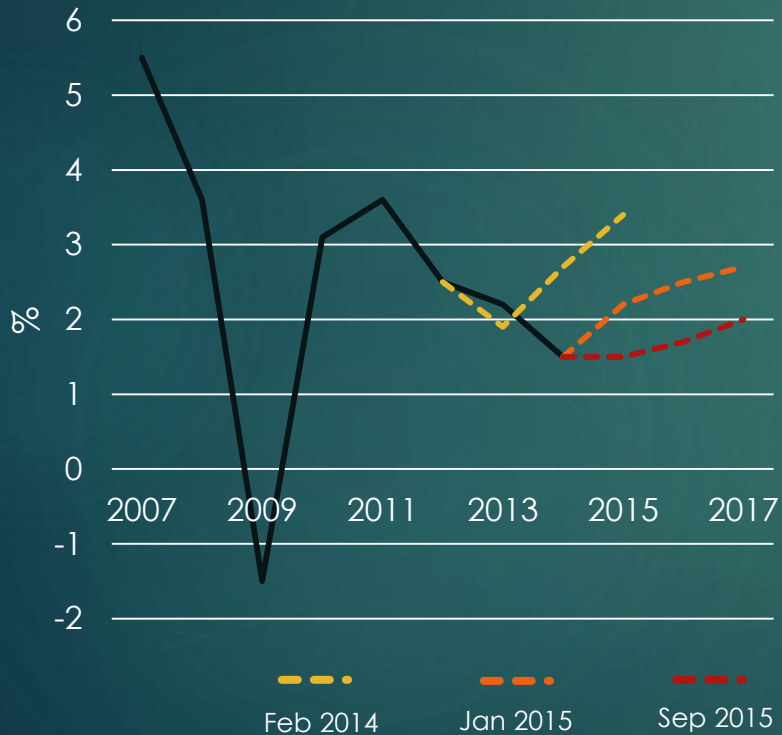


Growth Has Slowed Sharply...



Growth Stalls As..

Real GDP Growth



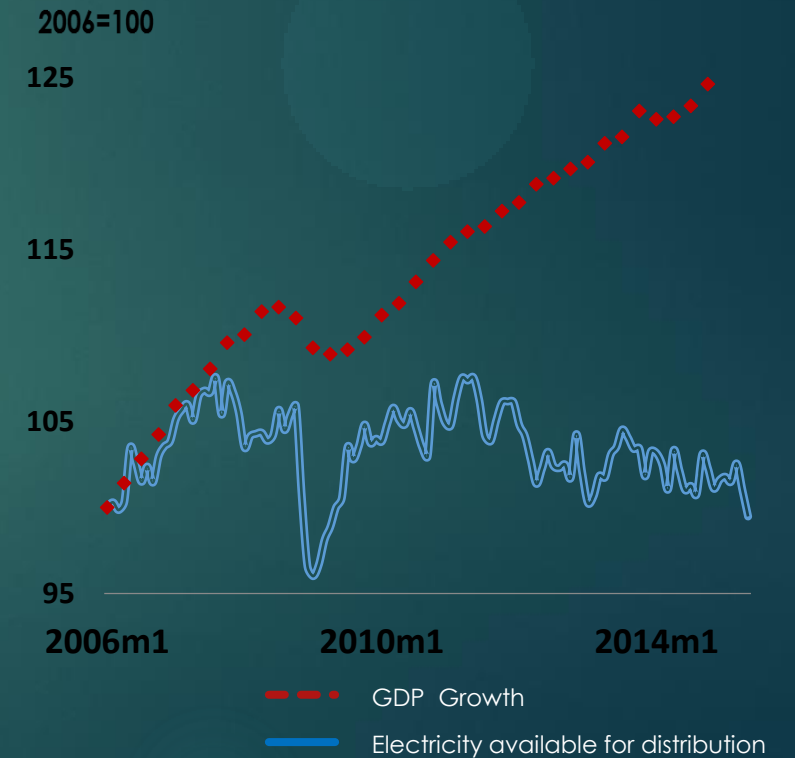
Commodity Prices Fall

Price Shock for Key Exports
% Chg. From Peak to September 2015



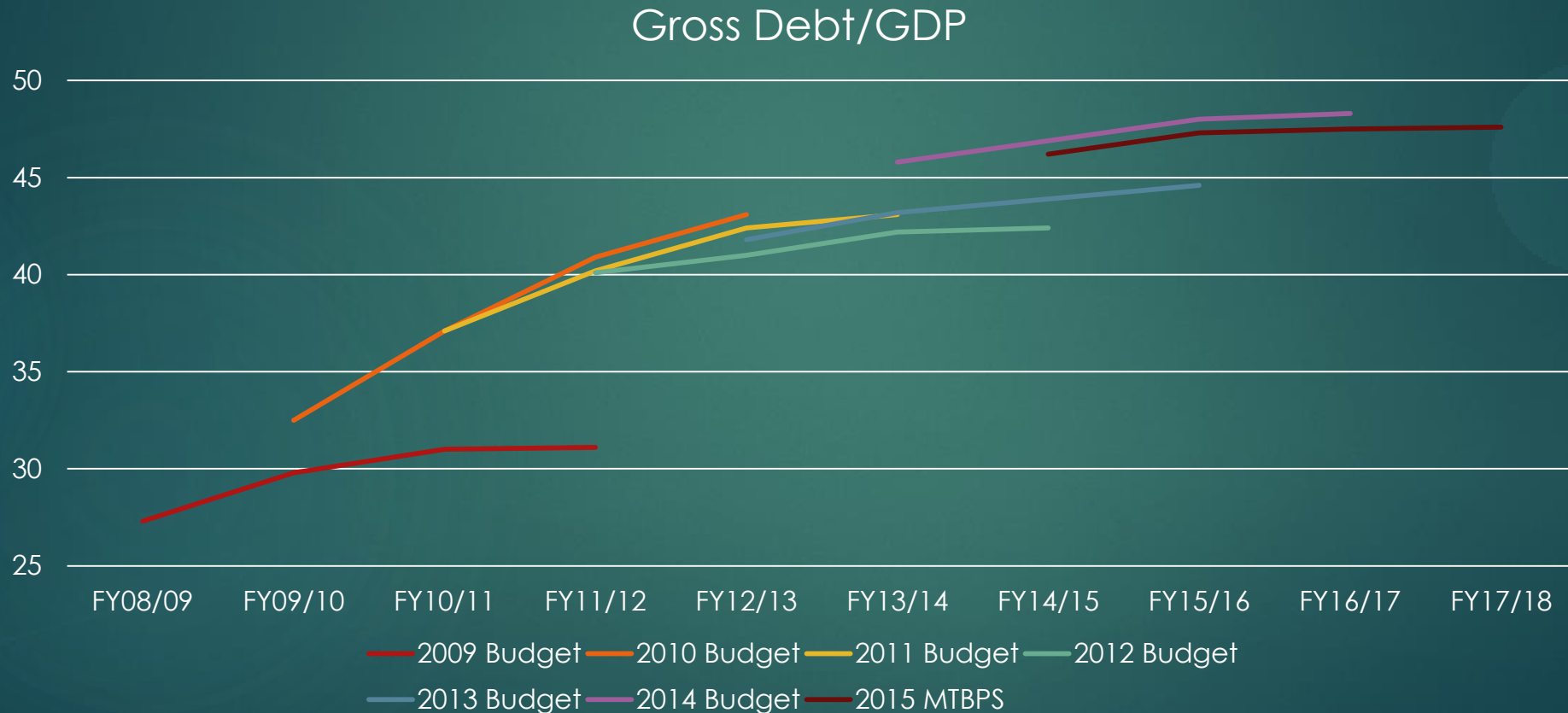
& Infrastructure Bites

Electricity available for distribution trails GDP





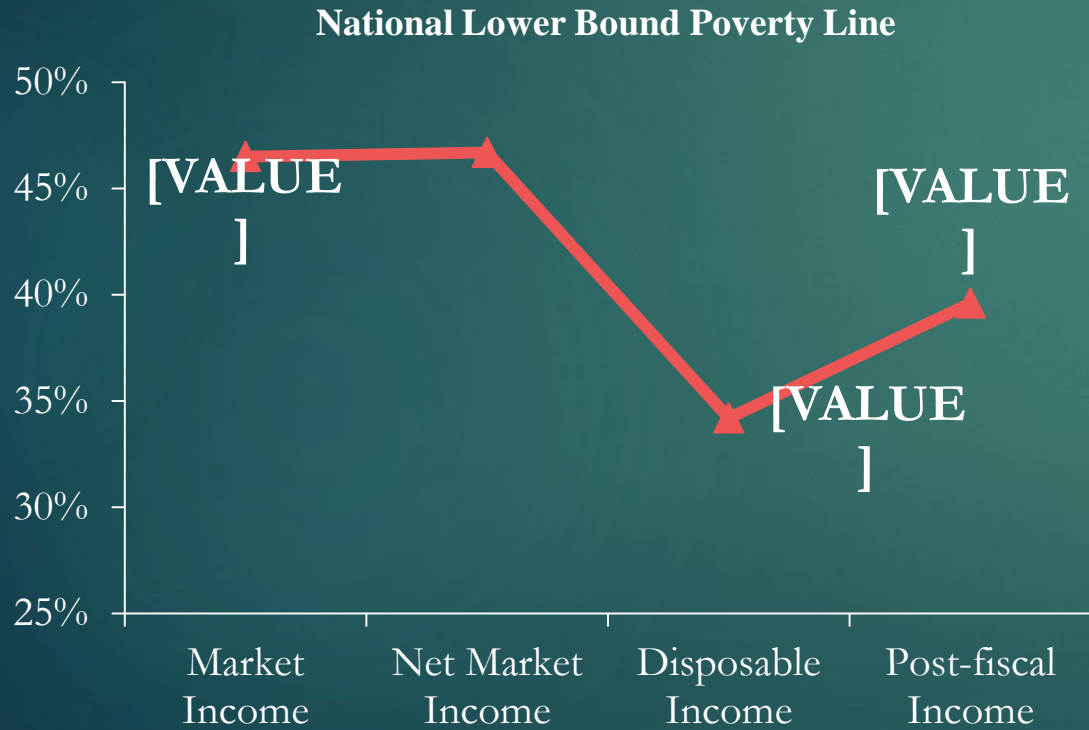
....Exhausting Fiscal Space Adjustment Will Imply Hard Choices





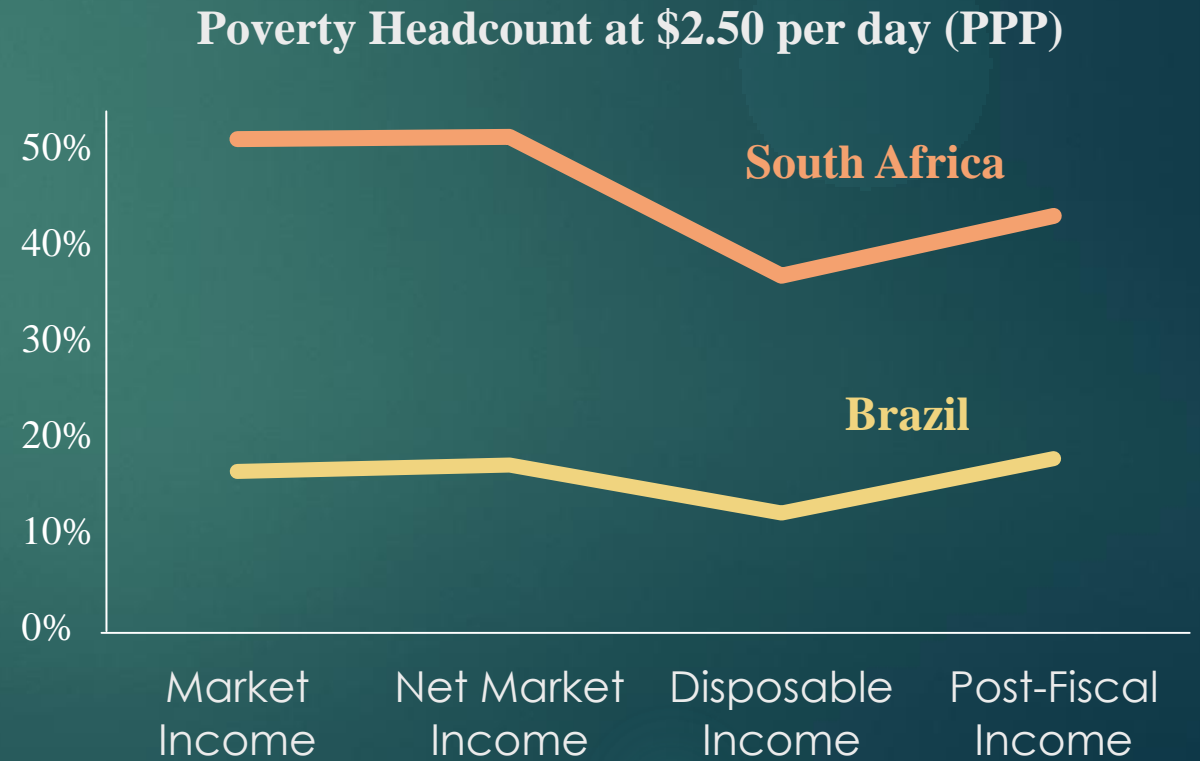
Challenge 1: Cash Grants Do A Lot To Alleviate Poverty So Safeguard

Fiscal Policy Helps Alleviate Poverty



Source: South African Economic Update 6

Impact on Poverty Larger Than Brazil



Source: South African Economic Update 6



Challenge 2: Taxes & Cash Grants Narrow Income Gap But 0.77 Gini Requires Jobs

Taxes & Spending Lower Gini



Reduction Large But Gini Is Still Higher Than Elsewhere





Challenge 3: How Does Fiscal Policy Support Growth and Jobs?

ASSESSING GROWTH & JOB IMPACT OF FISCAL INTERVENTIONS



Fiscal Instruments & Private Sector

Taxes

- Corporate
- Labor
- Indirect

Infrastructure

- Raises Demand
- A Public Good
- Expands Productive Capacity Private

Social Benefits

- Social Benefits (Health and Education)
- Pensions
- ALMP
- Education
- Health



Just One Example: How The Corporate Tax System Works

IS THE CORPORATE TAX SYSTEM SUPPORTING INVESTMENT AND JOB
CREATION?

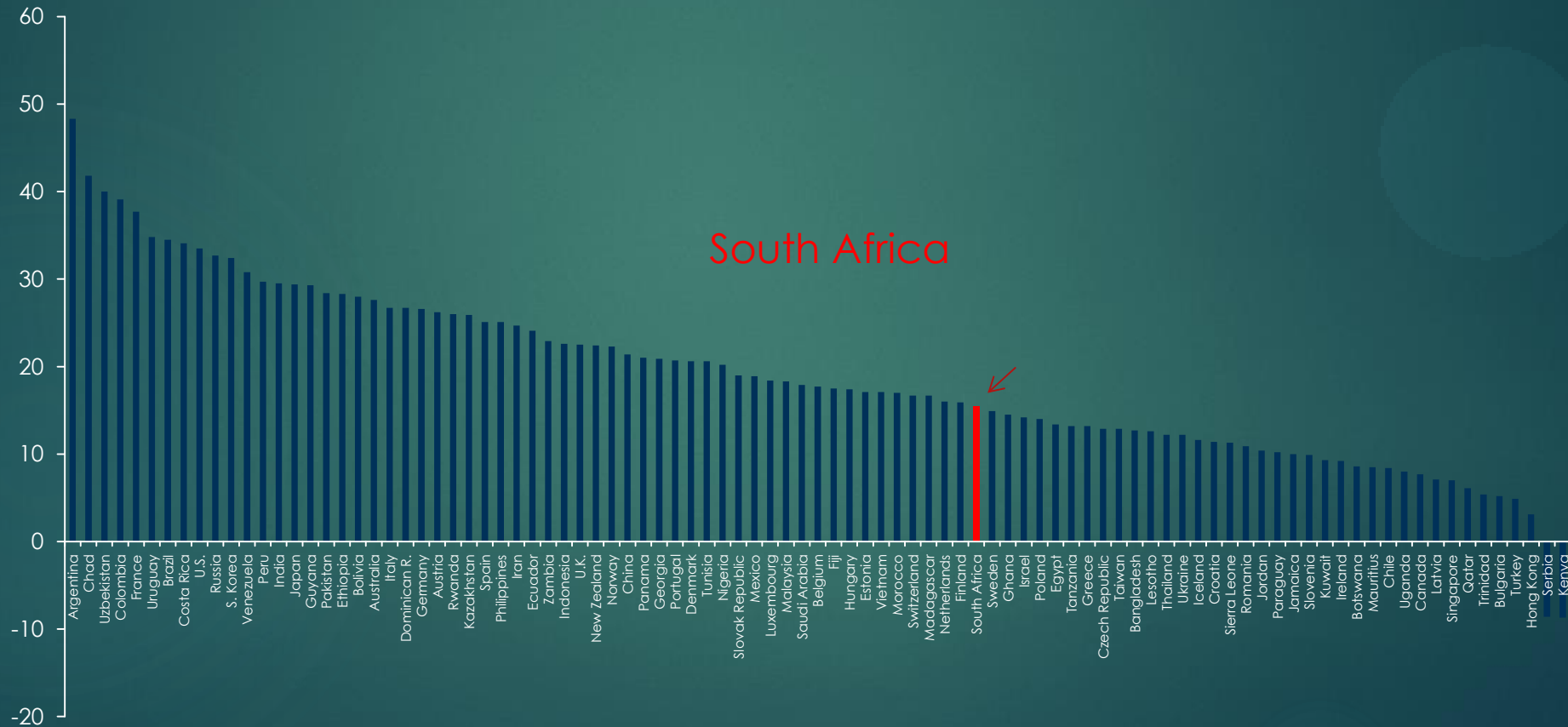
What Is A Marginal Effective Tax Rate?

- ▶ A Tool That Measures Burden of Tax On The Marginal Investment
- ▶ With Taxes Rate Of Return Has To Rise So After Tax Investor Can Still Pay Cost of Finance + Depreciation
- ▶ METR: Return On Marginal Investment Equal Return on Risk Free Investment
- ▶ METR=0 But Revenue Collections Are Positive: Tax Is Collected On All Investments Earning Above Normal Returns
- ▶ METR Can Be Negative Implying Marginal Investment is Subsidized



Finding 1: Effective Corporate Tax On Manufacturing Is Competitive

Effective Corporate Tax Rates By Country, 2014

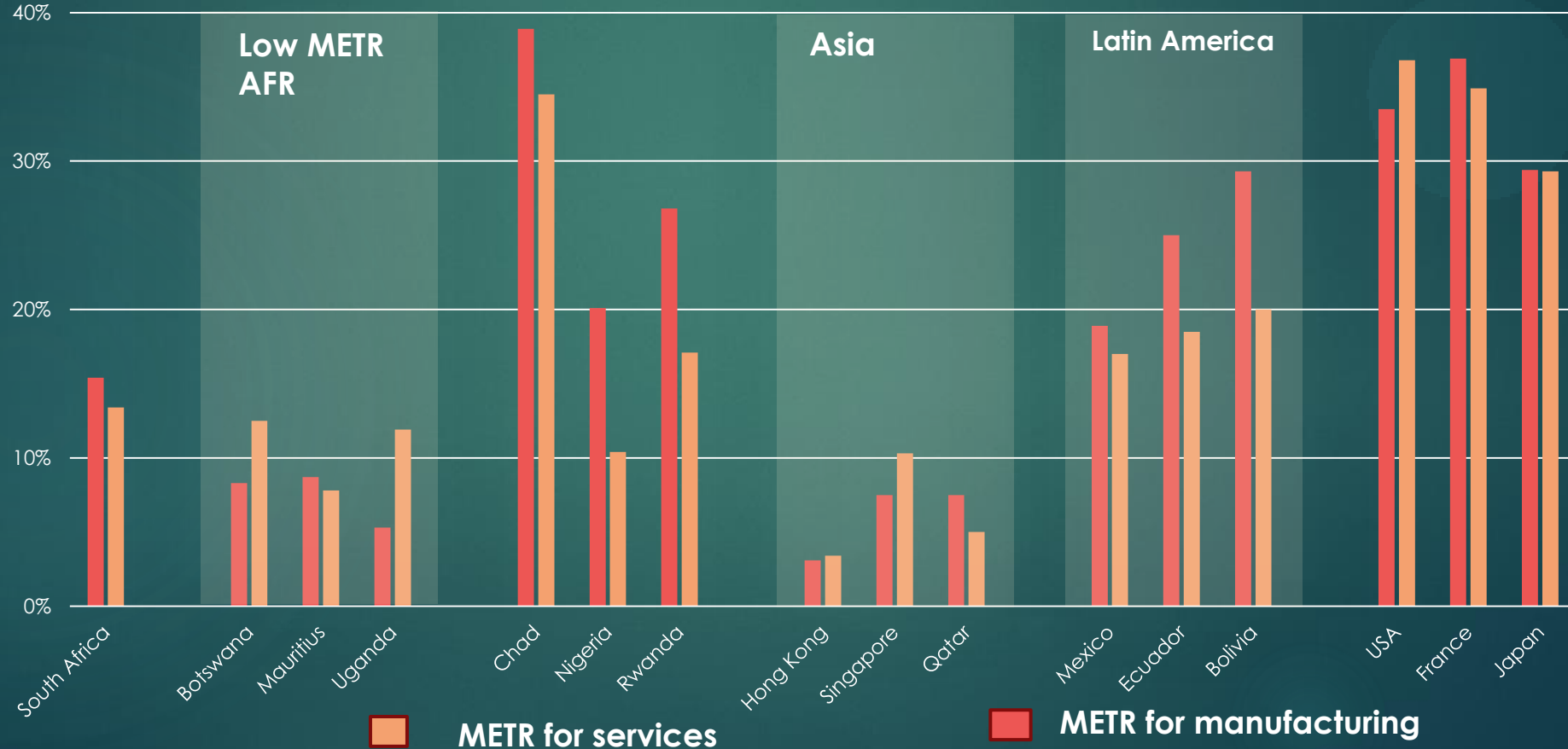


Source: Chin and Mintz, 2014



Finding 1. Effective Tax Burden On Services Compares Well

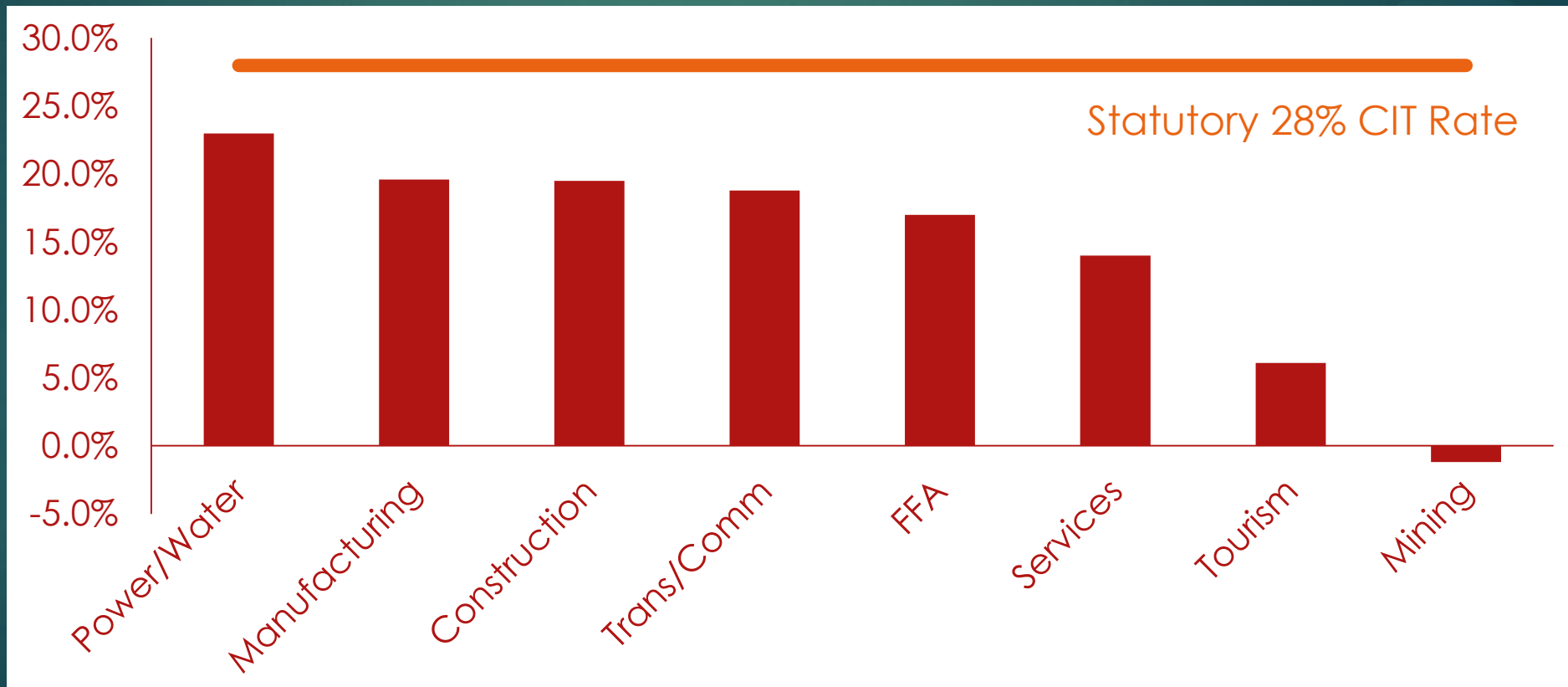
World Wide Manufacturing and Service METRs





Finding 2. Depreciation Allowances Work To Reduce Effective Tax Burden

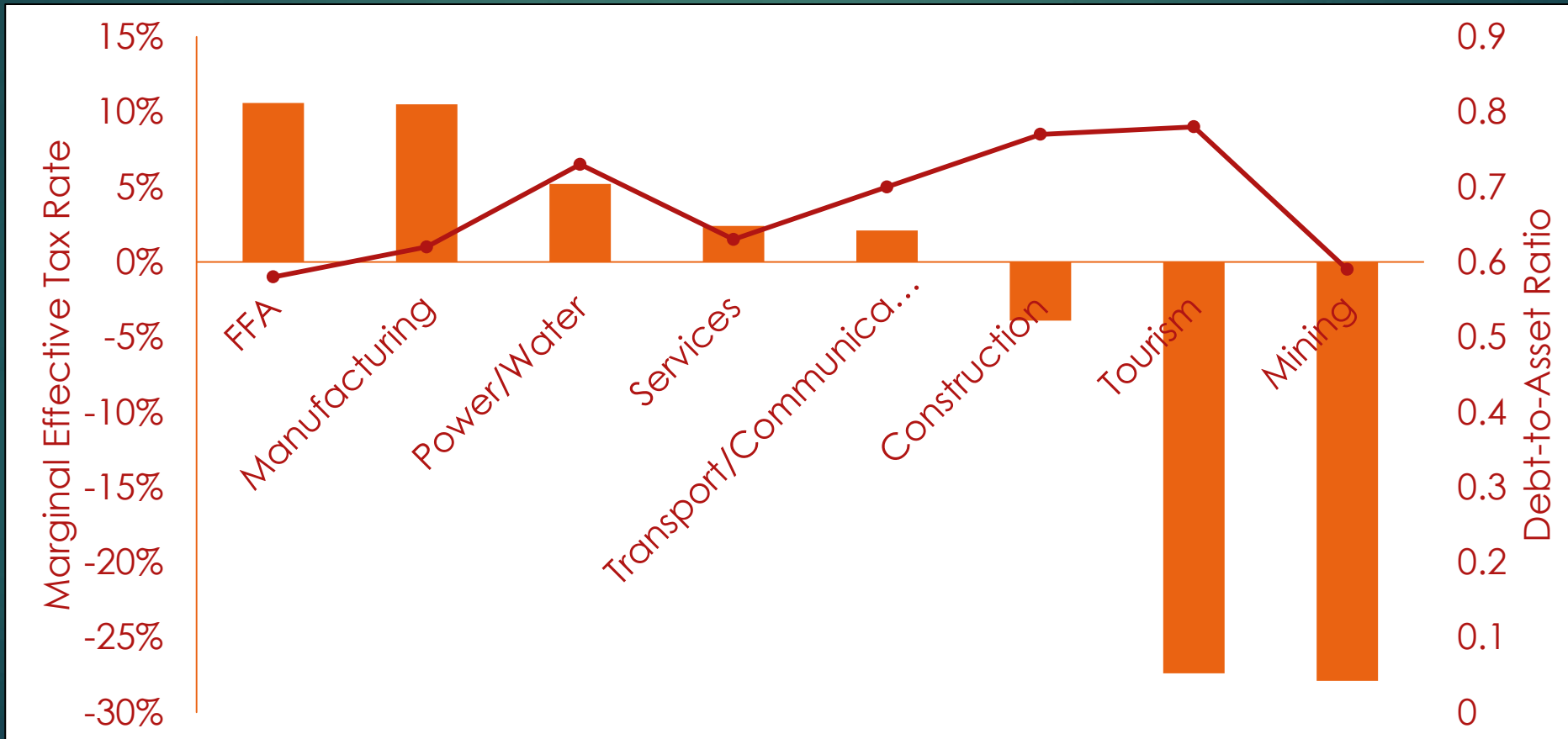
Marginal Effective Tax Rate on Capital By Sector





Finding 3. Interest Deductibility Reduces Effective Burden Further

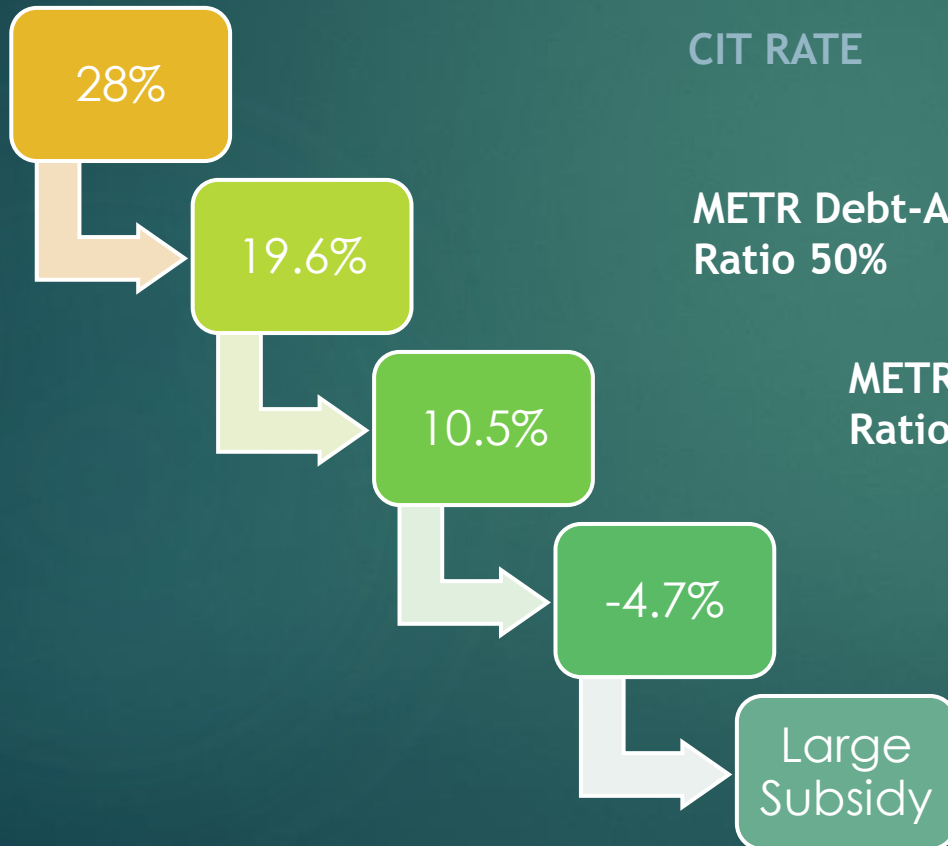
Marginal Effective Tax Rate Using Actual Debt-Asset Ratio of Each Sector



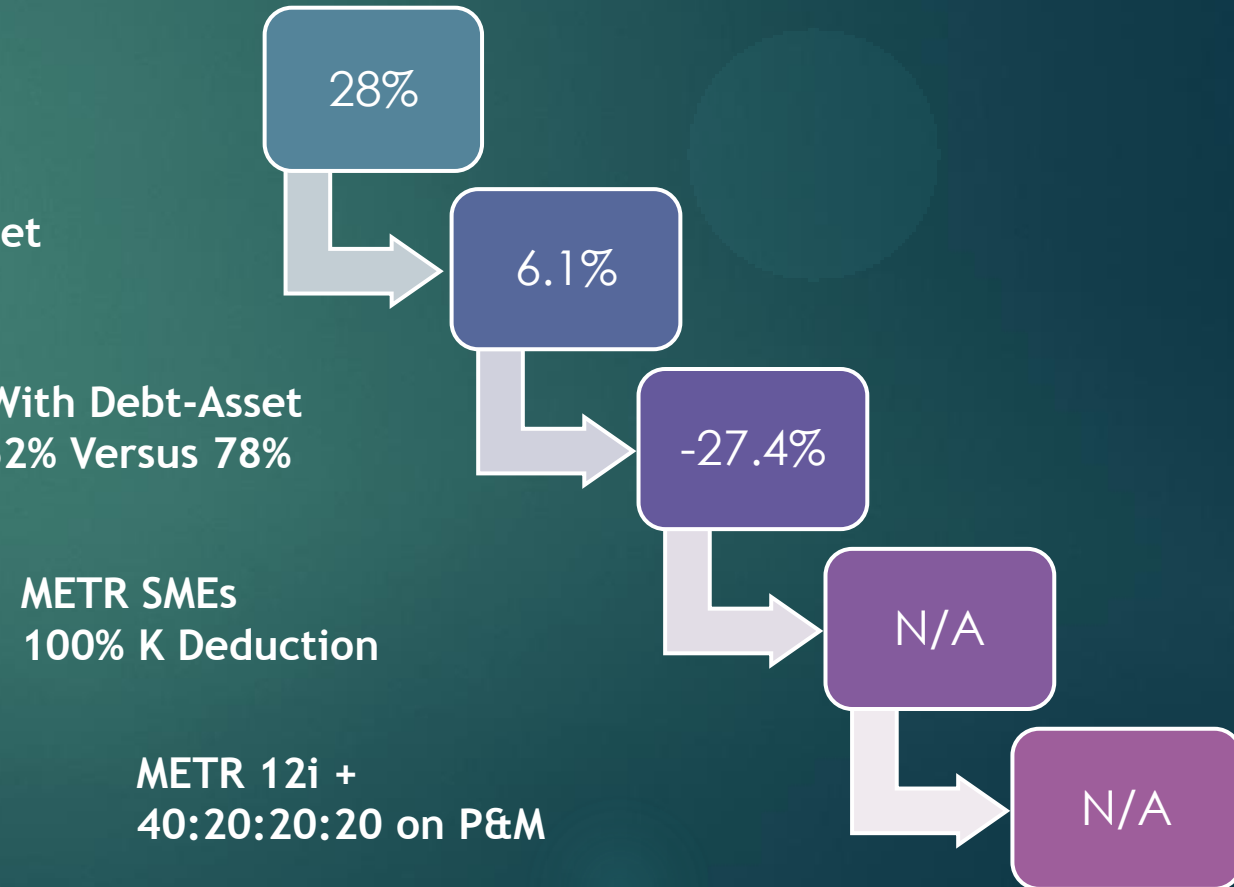


Finding 4. Some Incentives Result In A Large Tax Subsidy To Investment

Manufacturing



Tourism



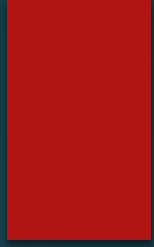
CIT RATE

METR Debt-Asset Ratio 50%

METR With Debt-Asset Ratio 62% Versus 78%

METR SMEs 100% K Deduction

METR 12i + 40:20:20:20 on P&M



But Does It Work?

HAVE FIRMS THAT BENEFITTED FROM ACCELERATED DEPRECIATION ALLOWANCES & OTHER TAX BENEFITS INVESTED MORE?



Is Corporate Tax System Encouraging Investment?

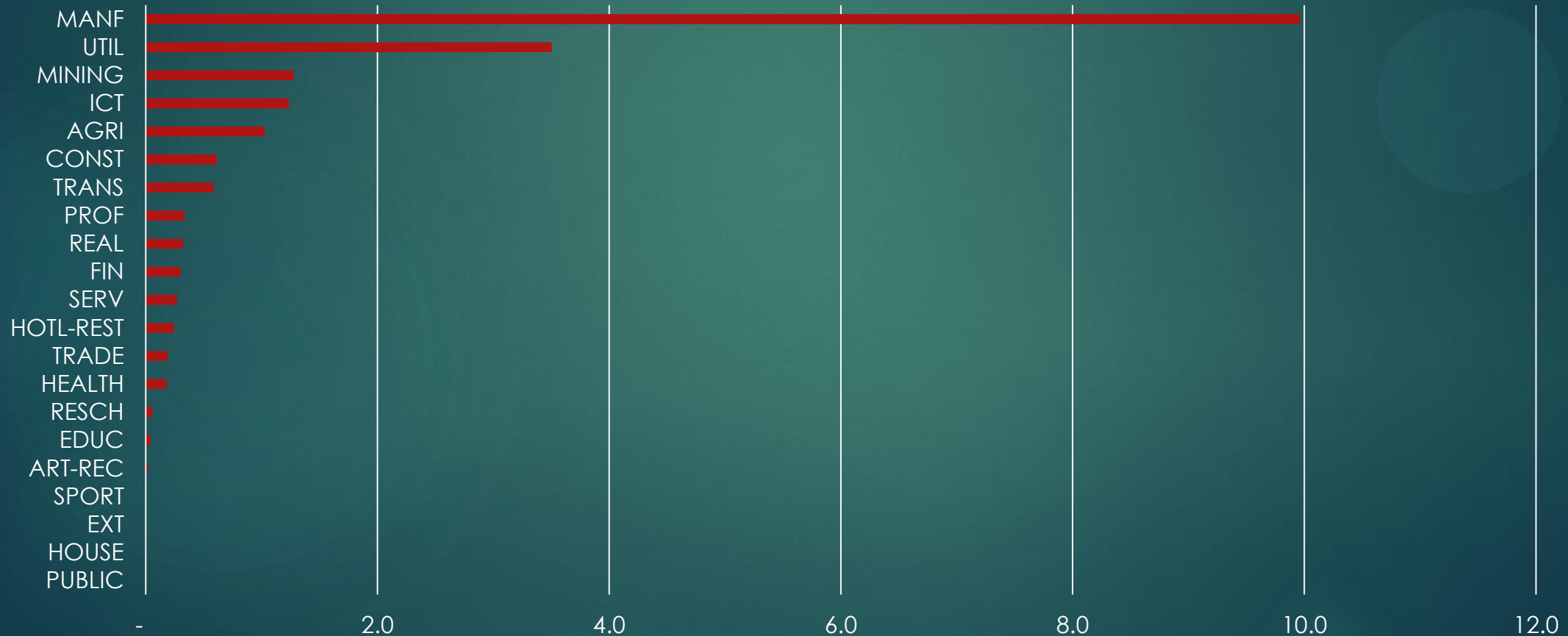
344,000 Firms With 2 Million Observations From 2009 to 2012

Reduced To A Sample Of 201,687 Observations Covering 74,515 Firms

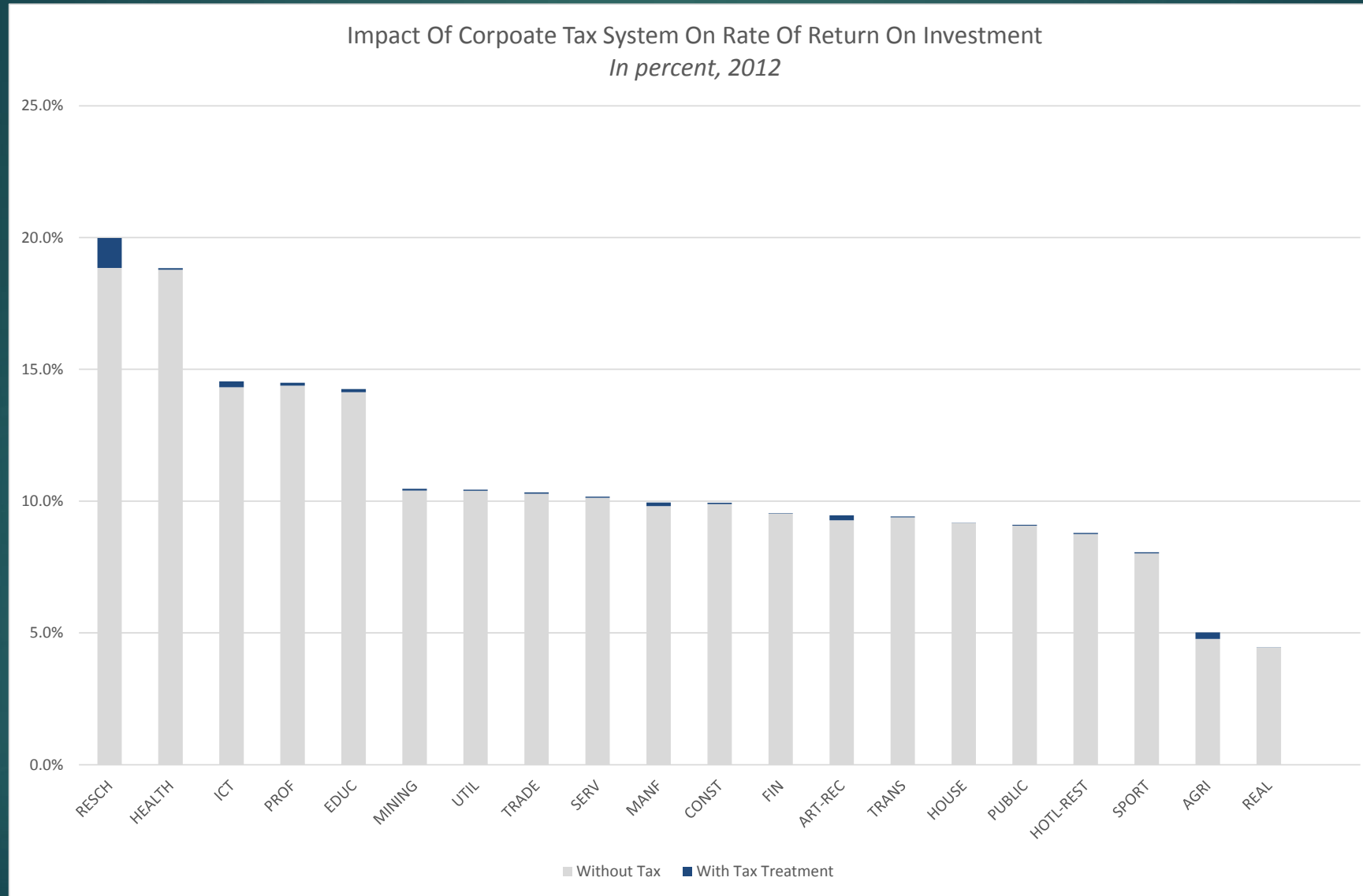


3 Sectors Received 73% Of Tax Forgone From R72 bn in Deductions

Foregone Tax From Incentives Claimed 2009-12
In Rand Billion



How Tax System Impacts Rate of Return



Tax Factors That Impact Firm's Cost Of Capital

Asset Structure

- Buildings (64.5% of Total Assets)
- Plant & Machinery (24.5% of Total Assets)
- Other Assets (11.0% of Total Assets)

Standard Allowances

- Building: 5% depreciation over 20 years
- Plant and Machinery: Straight Line Depreciation Over 5 years
- Wear & Tear Allowance On Plant & Machinery

Additional Incentives

- Manufacturing Accelerated Depreciation Allowance (12 bc) (40:20: 20:20)
- SME Accelerated Depreciation 12e (100% Year 1)
- Machinery, Ship, Aircraft Allowance
- Urban Development Zone Deduction

Leverage

- Actual Debt-Asset Ratio Reported in Tax Return

...Causes User Cost Of Capital To Vary

Example: Metals, Machinery, Equipment

User Cost of Capital Ranges From A Low Of 6% To A High of 20%





“ Investment Rises by 2.8%
For Every 1 PP Drop In
Firm’s Cost Of Capital ”

EVIDENCE FROM FIXED EFFECTS REGRESSION BASED ON 201,687 OBSERVATIONS COVERING 74,515 FIRMS.

Investment Response By Sector To Tax Induced Changes in Cost of Capital

High Response
(Coefficient > 1.5%)

- Agriculture
- Manufacturing
- Services (Private & Public)

Medium Response
(Coefficient < 1.5%)

- Construction
- Utilities

No Significant Response
(At 5% level)

- Mining



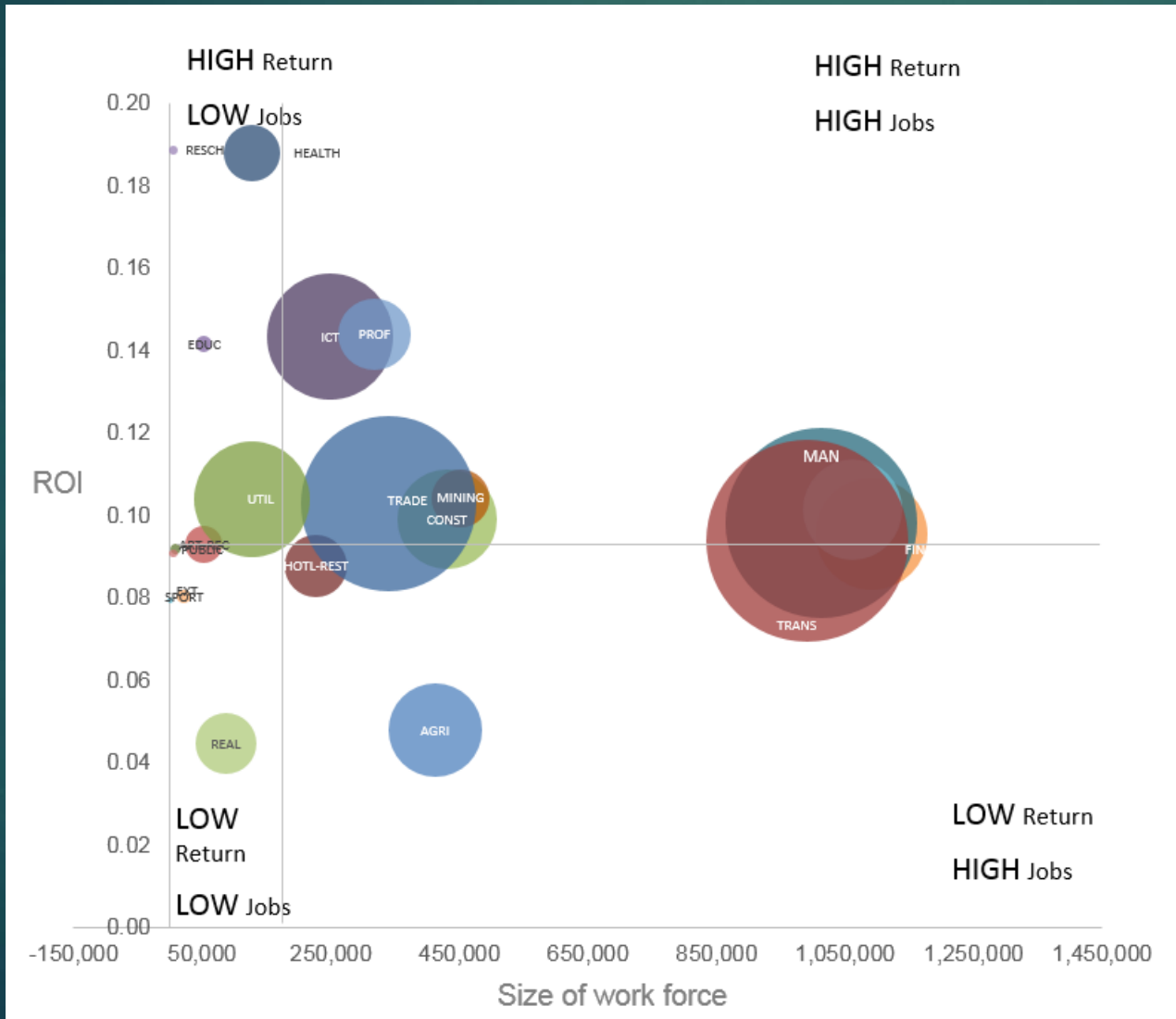
Is The Corporate Tax System Helping Job Creation?

Supplement Cost of Capital by Firm From CIT Tax Returns

With Formal Sector Jobs Impact From PIT Tax Returns



How Are Tax Benefits Targeted? Investment Returns + Jobs Potential



There are a few job intensive sectors where incentives could help raise returns on investment

Clear Case?
Agriculture

On Boundary?

Transport
Construction
Hotels



**We Just Assessed The Corporate
Tax System
Fiscal Spent R4.2 bn in 2011/12**

**Customs Incentives For The
Motor Vehicles Sector
Fiscal Spent R16.3 bn in 2011/12**

Evidence Suggests

Tax System Lowers Marginal Effective Tax Burden On Investment

Impact Of Tax System On Rate of Return Is Minimal: Other Economic Factors Matter More

Investment Does Respond Strongly To Tax Induced Changes in Cost of Capital

But Benefits In The Corporate Tax System Not Necessarily Going To Most Labor Intensive Sectors

Conclusion

In Times Of Austerity Evidence Based Analysis Can:

Help Evaluate If Policies Have Intended Impacts

Can Help Shed Light On Potential Trade-Offs Between Policies That Aim To Address Poverty, Inequality and Unemployment

Thank You

We Would Like Thank You All Who Contributed and Supported This Effort

SARs

DTC

National Treasury