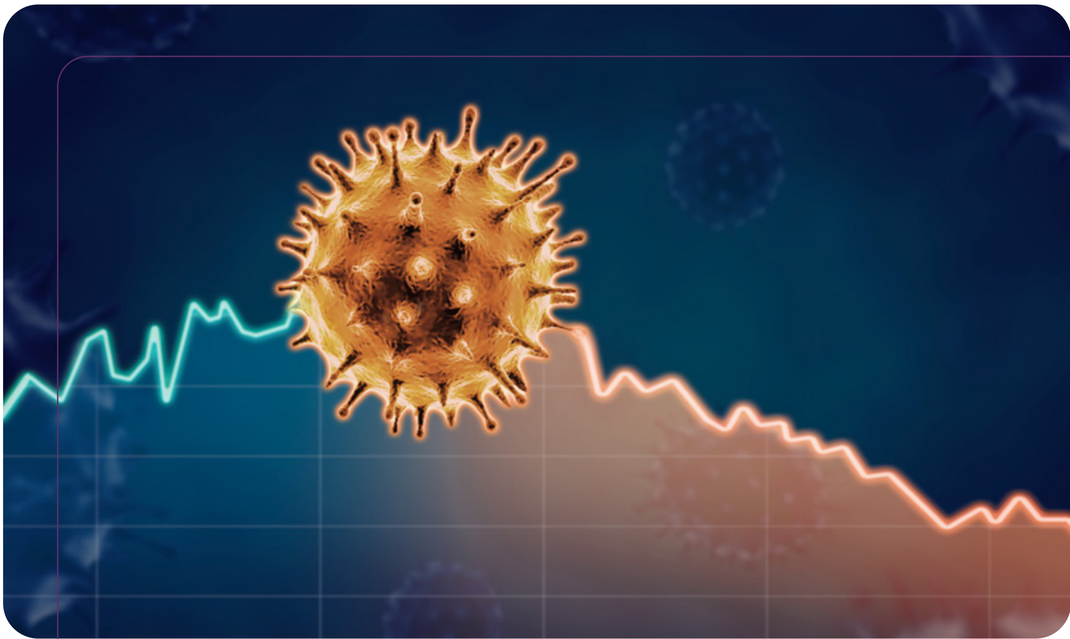
TAX COLLAPSE AND THE POST-COVID ECONOMY

The consequence of a near-total cessation of economic activity and then a somewhat haphazard partial reopening of the economy is wreaking havoc with South Africa's tax base.

By Tania Ajam and Dennis Davis



The serious economic impact of the lockdown policy response to the Covid-19 pandemic has, understandably, generated substantial policy debate in the media and academia. Conspicuously absent from most of these discussions is an acknowledgement of an imminent tax collapse, which not only is unprecedented in modern South African fiscal history but also poses huge economic challenges for the country.

In a statement at a media briefing on 5 May 2020, Edward Kieswetter, Commissioner of the South Africa Revenue Services (SARS), announced that losses of 15% to 20% of tax revenue are anticipated, which amounts to R285bn in fiscal year 2020/21. This is roughly in line with the Bureau of Economic Research's forecast of R280bn.

Given the highly uncertain nature of the pandemic's trajectory (the Department of Health expects the infection rate to peak only in September) and the duration and nature of the risk-adjusted lockdown, this tax loss estimate could very well be a material understatement, with actual losses approaching R300bn or more.

Debate has mostly focused on the finance requirement of a comprehensive Covid-19 response package. Regrettably, many contributions to this debate have completely ignored not only the additional financing requirement consequent to the tax collapse but also the unfunded revenue requirements carried over from previous years, which will further swell the deficit and debt to gross domestic product (GDP) ratio and render a fiscal trajectory that was already unsustainable pre-Covid-19 even more unsustainable.The longer the lockdown continues at its various limiting levels (lockdown level 4 at the time of writing with lockdown level 3 projected to start on 1 June 2020), the greater the negative impact on the tax system and the greater the probability of drawn-down government cash balances, a debt standstill, and having to resort to month-by-month cash rationing (in a worst-case scenario). At the end of February 2020, the National Treasury reported that cash balances stood at R304.5bn. These comprise sterilisation deposits held at the South African Reserve Bank (SARB) and other cash balances on the public sector balance sheet, which could be drawn down as bridging finance.

> "With every day of lockdown, the probability of a V-shaped recovery recedes further."

The prime objective of South Africa's coronavirus response must be to manage infections and save lives by preventing the public health system from being overwhelmed. But the consequence of a near-total cessation of economic activity and then a somewhat haphazard partial reopening of the economy is wreaking havoc with South Africa's tax base.

Although a loan from the International Monetary Fund (IMF) – together with the World Bank and New Development Bank (NDB) – could help shore up South Africa's post-covid economy, heated controversy surrounds the issue. The controversy centres on the question of whether South Africa would compromise its sovereignty by acceding to the IMF's loan conditions. The facilities for which South Africa has applied are not contingent on particularly onerous conditionalities. Whatever the merits of such a source of finance, the heart of a country's sovereignty lies in its tax base. Unlike many other developing countries dependent on donor funds, South Africa has had a fairly robust, resilient and diversified (albeit shrinking) tax base on which to draw. Tax proceeds are critical for financing the progressive realisation of socio-economic rights and sustained levels of social relief. In the absence of a robust tax base, these become the unfulfilled promises of the transformative constitutional project.The Covid-19 public health response highlights the shameful fact that the right to water and food, enshrined in the Bill of Rights, holds far too little substance for the vast majority of the population. The coronavirus pandemic and the lockdown response did not cause poverty and inequality, but it will amplify it further, as jobs and livelihoods are destroyed.

The disgraceful neglect in overcoming the problem of apartheid spatial geography means that any lockdown is unlikely to be effective over a sustained period, as the majority of the country lives in crowded, insalubrious conditions of a kind that, for all too many, has changed little in 26 years of democracy.

As the fiscus becomes more and more dependent on borrowing at the risk-premium-driven high interest rates required to compensate foreign investors to invest in South Africa's junk bonds, the proportion of interest spending in the national budget will escalate sharply. This will crowd out social expenditure and infrastructure investment, and, in turn, make it even more difficult to honour the promises contained in the constitution.

With every day of lockdown, the probability of a V-shaped recovery recedes further, as the short-term cash flow problems of companies, which may be a symptom of illiquidity, crystallises into insolvencies and permanent job losses.

South Africa's system of multi-level government (national, provincial and local) and its complex intergovernmental fiscal system and medium-term expenditure framework are absolutely dependent on revenue certainty for municipalities and provincial governments. This, in turn, is predicated on a stable fiscal framework, which is ultimately based on the ability of SARS to mobilise the necessary revenue. Any contraction of the tax base has immediate consequences for many fiscally distressed municipal and provincial governments, which have already borne the brunt of fiscal adjustment to finance the profligacy of captured state-owned entities in the Zuma era.