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SUBJECT: **Substantive Tax Policy Proposal: Reject New Wealth Tax**

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This submission is made by IRR Legal whose purpose is to vindicate the constitutional values of the Republic of South Africa and radically transform the rainbow republic's unemployment record from one of the world's worst, to one of the world's best. The Institute of Race Relations is sole member of IRR Legal.

The substantive proposal of this submission: do not introduce a new wealth tax in South Africa. A variety of reports indicate that the National Treasury has been urged to introduce a new wealth tax, including in this round of substantive policy proposals. In counterpoint this proposal argues for the preservation of the current taxation system absent any additional new form of wealth tax. The headline conclusion presented here is that such a tax would be counterproductive.

In more detail, first there will be a review of South Africa's Gross Fixed Capital Formation (GFCF). This will expose a dire gap exactly where the fuel for sustainable development should be. Reasons will be provided to articulate why a new wealth tax risks exacerbating South Africa's underinvestment problem.

Next there will be a review of household savings, the ratio of household savings to household disposable income, and economist Thomas Piketty's famous wealth-income ratio. This will show that while there is great wealth and income inequality in South Africa the relevant measure of high levels of wealth stock *relative to income flow*, which is the basis of modern wealth tax arguments, is not met in South Africa.

Next there will be a review of countries that have attempted and abandoned wealth taxes in recent years. The same reasons for abandoning wealth taxes – cost of implementation, corruption exposure, capital flight – apply to South Africa, only, typically, more so.

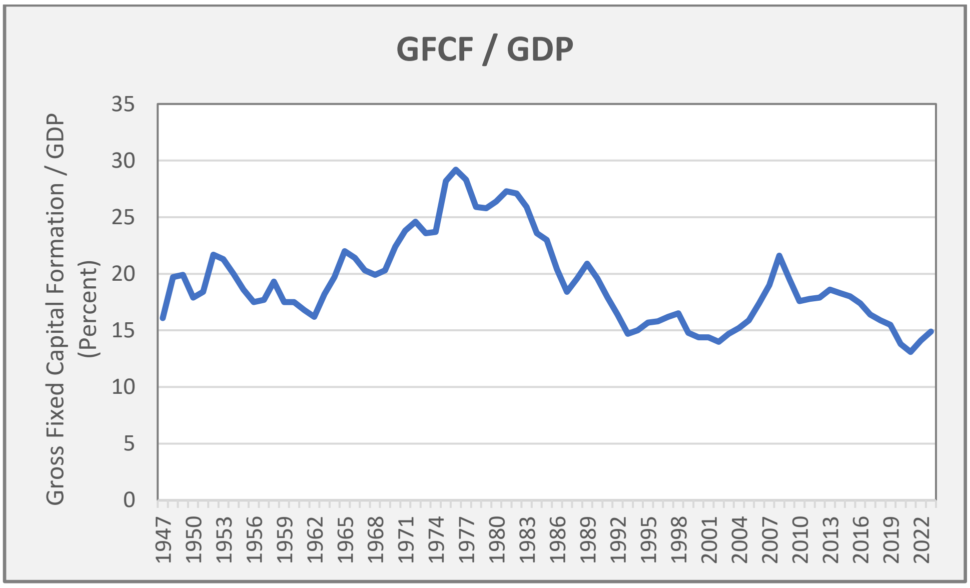
Next there will be a review of the Davis Tax Committee report, in the historical context of post-apartheid South Africa, echoing the Committee's call for more data, particularly on the racial composition of wealth ownership in South Africa, before a new wealth tax can be seriously contemplated.

Finally, there will be a review of the State Capture report regarding the state's relative inability to manage wealth. This will reveal a further inadequacy of any proposed wealth tax. Whereas states that impose defensible wealth taxes effectively reallocate private investment into public investment for the public benefit, the South African state is currently ill-equipped, unfortunately, for the task, and is more likely to liquidate assets for the short-term benefit of a few.

Gross Fixed Capital Formation

The two most important drivers of long-term growth are human skills and fixed capital formation. Education is set aside as a core issue until the end of this report since Treasury is not equipped to address the problem of poor public schooling.

However, the second major source of long-term development – fixed capital formation – can be impacted by Treasury directly.



Source: SARB, KPB6282J, retrieved November 2024.

Gross Fixed Capital Formation GFCF as a portion of Gross Domestic Product measures the proportion of annual produced value that is turned, so to speak, into wealth-growing wealth of an immovable sort. This is addition to the stock of wealth that a new wealth tax would most likely draw down directly.

The increase in the GFCF-GDP ratio in the 2000s, from 14% to 21.6%, contributed significantly to the greatest jobs boom in the rainbow republic's history over that same period, with roughly 2 million jobs created from 2003 to 2008. There were multiple other contributing factors, including dramatic rises in private debt, and a commodity (super) cycle. However, the positive impact of adding to the sum of fixed capital on labour opportunities is beyond serious doubt.

Since that period, however, the ratio of new (fixed) investment to total product has declined, as have the job prospects of work seekers. In 2008 the official unemployment rate was 22.9%, at the latest count it was 32.9%.

Treasury has a strong record of drawing attention to the lack of employment, and GFCF, and the relation between the two. The relevant question is whether a wealth tax will impact GFCF? There are two primary reasons to indicate that the answer is yes.

- South Africa is a relatively open market for (domestic and international) investors to enter, or exit. SARB records a net capital outflow of R163.6 billion in 2020 and R162.3 billion in 2021, as one indicator of ease of exit. The easier the market is to exist, the greater the risk of capital flight.
- "South Africa's sovereign credit risk premium remains elevated" according to the 2024 Treasury Budget Review. A wealth tax is disproportionately damaging to (relatively) higher risk

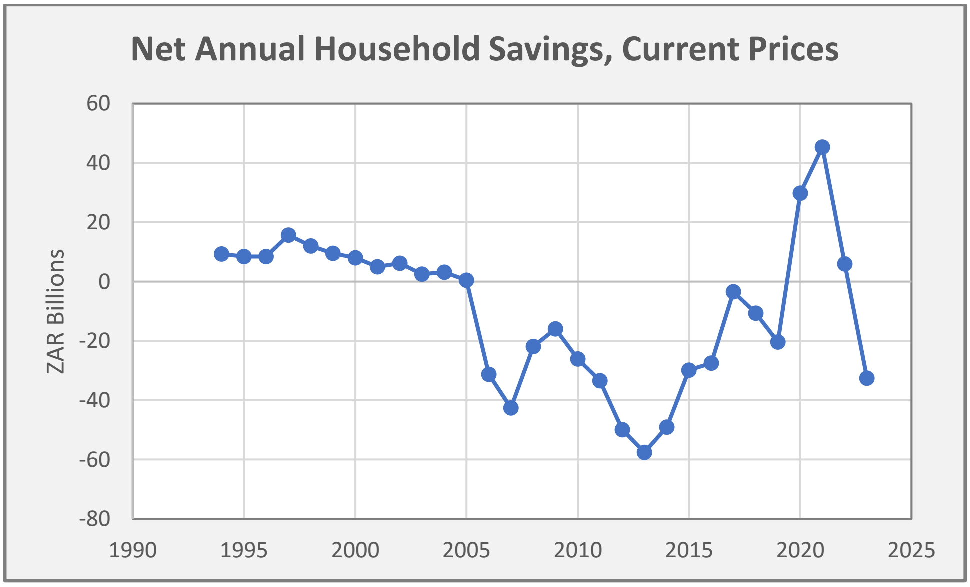
assets, since the tax event is certain, even in the case of a capital loss, while a capital gain (in real terms) on an asset is uncertain.

Both reasons point to the elevated risk of disinvestment, i.e. reduction of GFCF. That in turn exacerbates the risk of ongoing unacceptable levels of unemployment. That risk presents a decisive reason to reject any new form of wealth tax at this time.

Wealth-Income Ratios

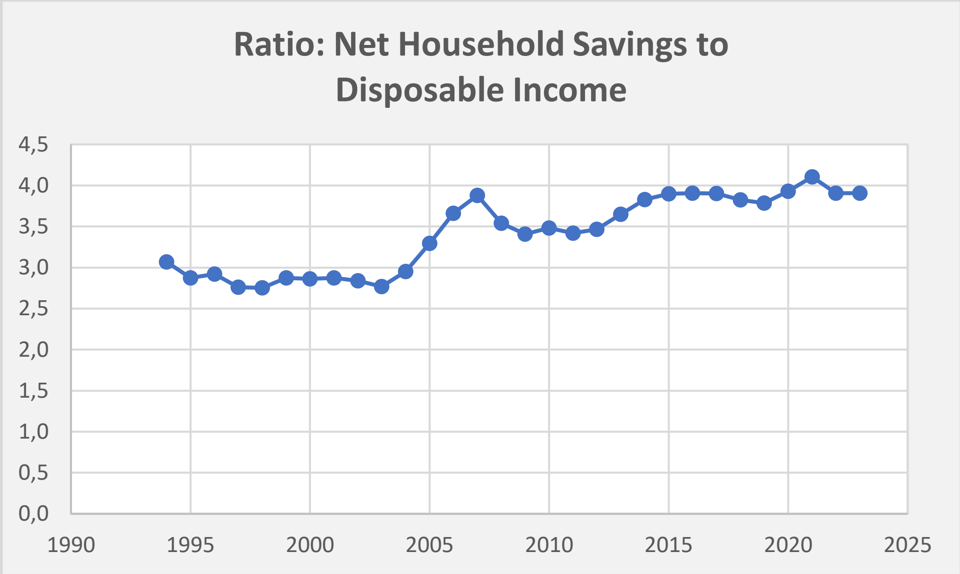
In some countries that argue for a wealth tax, or that have introduced a wealth tax, unemployment levels are so low that there is political will to implement policies that will knowingly increase unemployment for the sake of achieving other policy goals, for example a reduction in wealth inequality. However, every opinion poll conducted by the South African Institute of Race Relations (IRR) from 2013 to 2024 has indicated that unemployment is a top priority to a plurality of respondents, far outweighing conflicting concerns with distribution. This makes sense, since South Africa has one of the worst unemployment rates on record, as is well known. In this context, increasing unemployment through a wealth tax's inhibition of GFCF for the sake of a reduction in wealth inequality is not in the public interest.

However, wealth tax proponents sometimes make an alternative claim that denies such a trade-off: reducing wealth inequality through a wealth tax will (despite potential negative effects on GFCF) have a net positive impact on employment. To evaluate this argument, it is first necessary to know whether South Africans have (overall) been able to save a swelling nest-egg of surplus wealth that can readily be taxed.



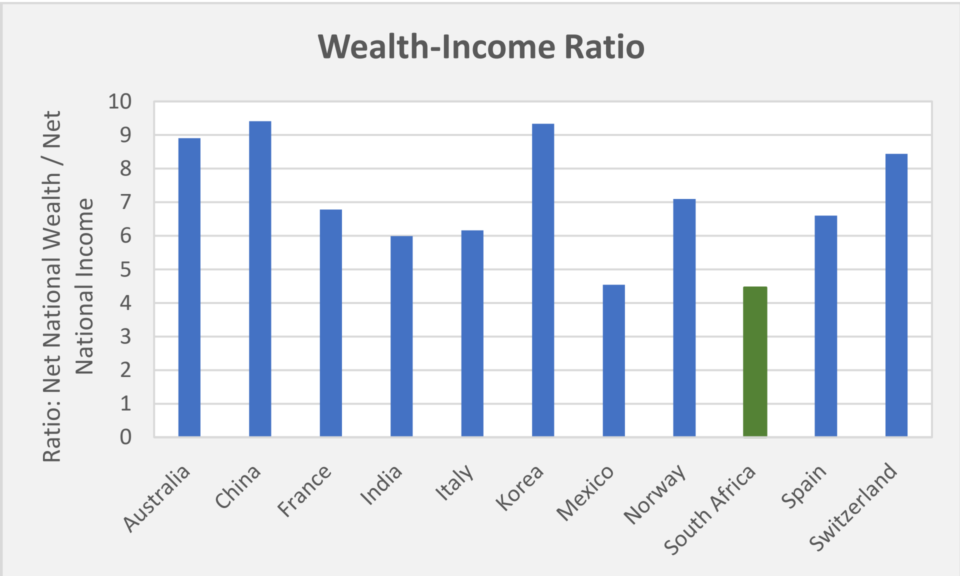
Source: SARB KPB6200J, retrieved November 2024.

South African households have overall notoriously struggled to save year to year. This raises a red flag against the notion that Piketty's concern about capital accumulation dominating market activity applies domestically. However, some households are extremely wealth and overall household savings (including non-profit organizations that serve households) are roughly four times greater than annual disposable income.



Source: SARB KPB6288J, retrieved November 2024.

The question that the above graph raises is to what extent a household savings-disposable income ratio of 4:1 represents what Piketty calls the "domination of capital"? Does the ratio provide evidence to support his kind of call for a wealth tax even if the wealth tax costs more to administer than it generates in revenue, since the purpose of the wealth tax is to "liberate" the economy from the oppression of "excessive" wealth stocks relative to annual wealth flows (income)? Or, is the savings-income ratio too low to justify that argument?



Source: World Inequality Database, Retrieved November 2024.

The above graph indicates the ratio of net national wealth to net national income. This ratio is the only term common to Piketty's two "fundamental laws of capitalism", and his argument for reducing wealth inequality to increase productivity is quantitatively indexed by his laws to the wealth-income ratio as follows: the greater the wealth-income ratio the more relevant Piketty's redistributive argument for efficiency gains becomes; the less the ratio the less relevant that redistributive argument for efficiency gains becomes.

Put in another, perhaps more familiar way, the key concern in a Pikettian analysis of "capital dominated" economies is that the ratio of the savings rate over the growth rate is high, so that new production is disproportionately accumulated into further savings, entrenching wealth (and income) inequality over time in a vicious cycle. However, South Africa's savings rate is so low, and its wealth-income ratio is so mediocre, that this concern is foreign.

The only three countries in Europe with a wealth tax of the relevant kind are Switzerland, Norway, and Spain. These are also countries that have (or in Spain's case recently had) some of the highest wealth-income ratios in the world. While South Africa's wealth-income ratio is currently 4.46:1 Spain's is 6.6:1 and Norway's is 7.01:1. Switzerland's wealth-income ratio is 8.44, roughly twice that of South Africa.

To conclude, South Africa is not only a middling country in terms of GDP and wealth, it is also a middling country in terms of the relevant ratios between new production and existing wealth. While there is great inequality in South Africa between high earners and the unemployed, as well as great inequality between high owners and the penniless; it is *the wealth-income ratio* that is fundamental to the 21st century economic international analysis of accumulated wealth as an obstacle to productivity as propounded by the world's most influential wealth tax proponents. Careful attention to the data, however, reveals that South Africa is simply too poor, relative to its income, for such analysis to recommend a wealth tax here as it might in a country like Switzerland, or China, or Korea, or even France or Spain.

Abandoned Wealth Taxes

According to the OECD: "While 12 countries had net wealth taxes in 1990, there were only four OECD countries that still levied recurrent taxes on individuals' net wealth in 2017. Decisions to repeal net wealth taxes have often been justified by efficiency and administrative concerns and by the observation that net wealth taxes have frequently failed to meet their redistributive goals. The revenues collected from net wealth taxes have also, with a few exceptions, been very low." (OECD, *The Role and Design of Net Wealth Taxes in OECD,* OECD Tax Policy Studies, No. 26, OECD Publishing, April 2018).

Administrative costs and compliance challenges faced by OECD countries that abandoned a net wealth tax are likely to be worse in South Africa, given the shocking findings of the Nugent Commission Report, the slow pace in dealing with State Capture, and South Africa's grey-listing by the Financial Action Task Force.

"The revenues collected from net wealth taxes have also, with a few exceptions, been very low", according to the OECD, covering much wealthier countries (OECD, *Ibid*). While low revenues were a problem in OECD countries that are significantly wealthier per capita than South Africa, they are only more likely to be a problem in poorer South Africa.

In terms of capital flight risk, it is true that South Africa's market is not as well integrated with its neighbours as countries are that belong to the EU. However, the risk of capital flight is not only determined by the ease of transferring capital across jurisdictions, but also the risk of the relevant market relative to alternatives. Since South Africa's risk premium is far higher than the OECD average, it faces considerable additional risk of flight from even the safest domestic assets, namely sovereign bonds, towards foreign investment opportunities that do not involve a certain tax on wealth even if the asset value declines.

Treasury's Budget Review flags data published by the World Bank on perceived state performance, which includes the World Bank's corruption perception index. South Africa was in the top 20% (best performers) of countries worldwide in the 1990's, and is now roughly in the 50% percentile. This drop in the rankings is one of the top fastest declines in perceived ability to combat over the last two and a half decades in the world. This decline further augments the challenge in a new wealth tax insofar as enforcement requires any new opportunities for corrupt activity.

Davis Tax Committee

The Davis Tax Committee urged a *think first act later* attitude to any new net wealth tax. "As a first step, the DTC proposes that all personal income taxpayers above the filing threshold be <u>required to submit a statement of all assets and liabilities from the 2020 tax year onwards</u>. This will not be used (at this stage) to calculate a liability for a wealth tax but will <u>provide much needed information to inform a future decision about a wealth tax</u> and allow SARS and National Treasury the opportunity to iron out definitional issues with regard to the proposed tax base [emphasis added]." (DTC Final Report, *Wealth Tax*, 2018).

If this recommendation is further pursued it is crucial that Treasury publish the (anonymized) results of ownership distribution patterns in terms of race. This is why.

Black South Africans were deliberately, violently, unconscionably oppressed for decades since the Union. As a result only a minority of household wealth was owned by black South Africans in 1994. Once it became clear however, that black South Africans have become the predominant wealth owners in South Africa various interest groups have stepped in with the (counterproductive) aim to introduce a wealth tax. As such it is important to evaluate the racial composition of the top 10%, top 5%, top 1%, and top 0.5% of South Africans by wealth, so that the public can consider whether it is just to introduce a wealth tax at this time of what has been reported as a dramatic demographic shift in the upper echelons of the economy.

Value-for-money – State Capture Report

The State Capture Report issued the advice to "maximize value-for-money" in the public interest. (Regarding education the lack of "value-for-money" service delivery is evinced by the fact that South African grade 4's have the worst recorded PIRLS literacy rates, at 81% unable to read, despite education spending being high relative to GDP relative to peer states). A SARB working paper indicated that the fiscal multiplier of state spending was recently near 0 or even negative (van Rensberg et al, *Fiscal Multipliers in South Africa after the Global Financial Crisis*, May 2021). This result is shocking.

Furthermore, there is no doubt, given the audit records and business performance of State-Owned Enterprises, that the South African state is not currently in a position to manage general wealth with greater productive impact than occurs generally in the private sector. From a "value-for-money" perspective, therefore, it makes more sense to serve the public interest by leaving wealth where it stands a chance to generate the greatest multiplier of value addition, i.e. in private hands – while taxing income flows on personal income, corporate income, trade (VAT and tariffs) etc.

Conclusion

While the debate in countries like Switzerland and France about whether to remove or return a wealth tax are interesting, South Africa is another country that is poorer in absolute terms, poorer per person, poorer in terms of wealth relative to income, poorer in terms of risk, poorer in terms of administration, and poorer in terms of ability to remain attractive as an investment destination. Most importantly, South Africa is poorest in terms of employment. As such, here any new wealth tax must be rejected.