IRR

The IRR's Blueprint for Growth:
Slash waste, cut taxes

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Headline Findings

This report summarises a longer report on Fiscal Policy. The headline findings are as follows:

- Since 2018 South Africa has had the most negative average response rate to international pollster Ipsos's question, 'Would you say things in this country are heading in the right direction, or are they off on the wrong track?'
- The operating hypothesis is that the most acute direct cause of this negative outlook is unemployment, particularly black unemployment, which has roughly doubled in the BEE era since 2008. To address this economic growth must be restored.
- Two key trends are identified: increasing corruption, caused by declining regulatory effectiveness, caused by a 'problem in the legislative design' called BEE; and, on the other hand, a dramatic increase in the size of the decreasingly effective state. Evidence of these trends is provided is provided and a proposal to produce better outcomes is then evaluated.
  Evidence:
- According to World Bank data the South African state appeared to improve corruption busting in the mid-2000s, but overall, between 1996 and 2022, it suffered the worst relative decline in corruption control of any major sovereign constitution democracy, with the worst single year of decline being between 2021 and 2022.
- According to World Bank data South Africa suffered the 7th worst relative decline in regulatory effectiveness between 1996 and 2022. This matters to 'systemic analysis' of procurement, which means analysing policy rather than the personalities in charge.
- The most prominent global socio-political analyst to visit South Africa in the last five years, Francis Fukuyama, recommended that left-right ideological gridlock can be broken by thinking about quality and quantity of government together, a multidimensional approach. We attempt to do this through a Tax Increase Effectiveness Decrease (TIED) score and show that of all the countries where the required statistics are available, South Africa is behind only Lesotho in terms of a growing state that is dropping in effectiveness from 1996 to 2019.
- The Zondo Report connects corruption, 'state capture', to a 'problem in the legislative design', specifically confusion of the 'inevitable tension' between 'preferential procurement', elsewhere known as BEE premiums, and 'maximum value-for-money', a confusion which subverts accountability.
- Treasury does not provide 'transparency' or 'cost control' on BEE premiums.
  Proposal:
- Cut BEE premiums, which are estimated to be around R17 billion per annum, to simplify procurement to improve transparency. This in turn will improve corruption control to the value of an estimated R150 billion Zondo Dividend.
- Use the first R100 billion of the Zondo Dividend to pay for a VAT tax cut, by reducing rates from 15% to 11.5%, with either a further VAT cut to follow or else a General Fuel Levy cut of about R2.20 per liter. The initial VAT cut is estimated to leave R31 billion in the pockets of the 70% poorest South Africans, where it is likely to be much better spent than by the government.
- International experience shows that cutting VAT stimulates economic growth.
- Black business is expected to benefit directly from a share of roughly R30 billion of the VAT cut that is not passed through to consumers, and from improved governance, and from improved consumer demand in pertinent nodes of the heterogenous market. This benefit outweighs losses by reducing BEE premiums.

- The upshot is that cutting BEE to cut VAT will stimulate growth in the economy, and revitalise the Rainbow Republic for the benefit of all, but especially poor, black, unemployed people whose ranks have swollen in the BEE era.

Biggest Problem

Since the election of President Cyril Ramaphosa South Africa has had the highest average negative response rate in the world to international pollster IPSOS's question, 'would you say things in this country are heading in the right direction, or are they off on the wrong track'?

On average 80.0% of respondents in South Africa have said this country is on the wrong track since March 2018. Argentina comes out second worst in the same period, at an average of 77.6%.[1]
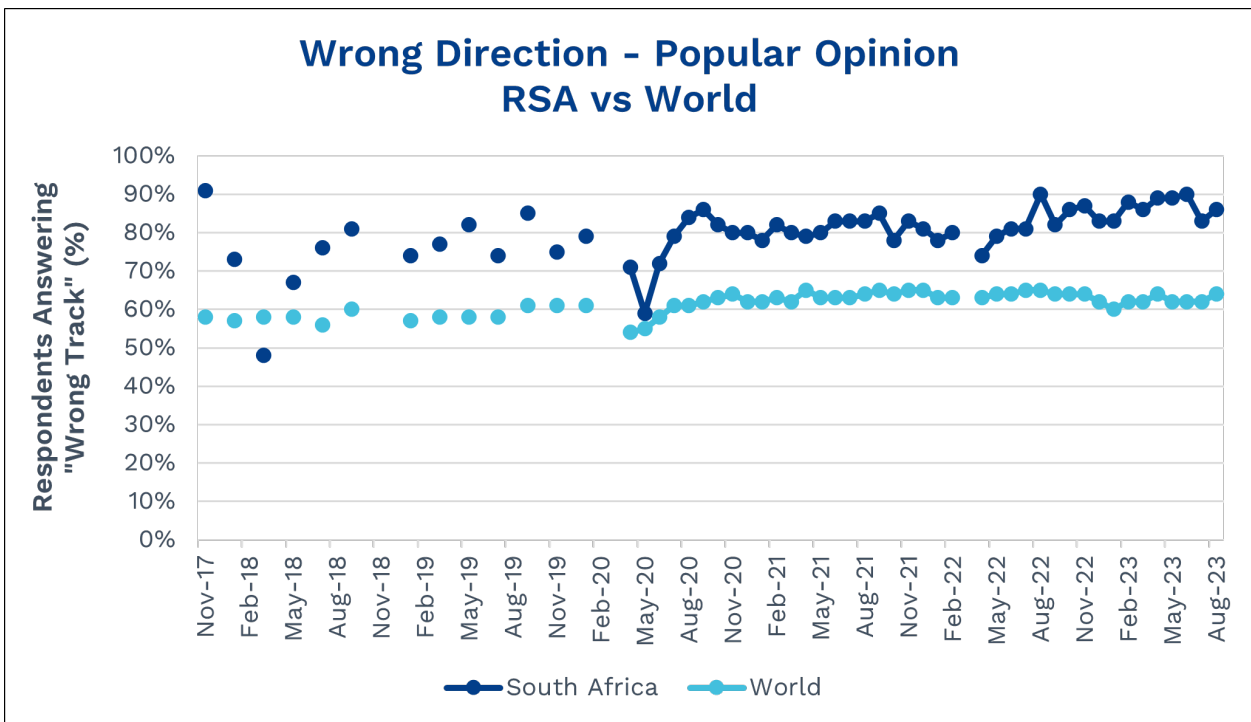
Source: Ipsos What Worries the World, each entry pulled from a separate page on Ipsos.com

Surveys commissioned by the Institute of Race Relations (IRR) and independently conducted have consistently shown, since 2013, that the biggest identified problem is unemployment. The question is not asked in these terms, but I believe that black unemployment, which is higher than the national unemployment rate, is the most acute source of distress to the Rainbow Republic.

Black Unemployment in RSA
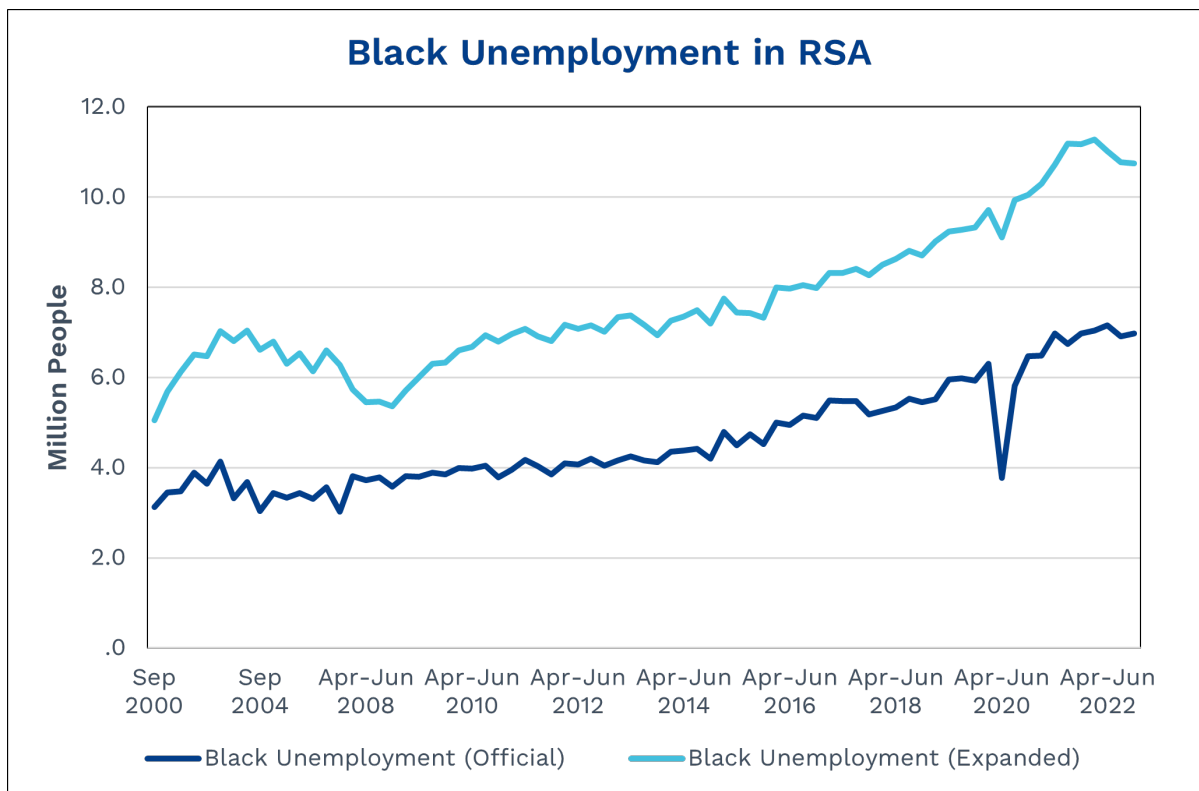
Source: Stats SA, via email

Consider the period starting in 2009. Black unemployment almost doubled on the official definition from roughly 3.6 million to 7 million. On the expanded definition, which includes discouraged work seekers, black unemployed almost doubled from 5.4 million to 10.7 million.

This period of doubling black unemployment is the main BEE era, where public procurement was used as the main incentive to drive BEE by paying premiums to companies that had higher BEE points. At this stage of the analysis it is too soon to say whether BEE has made black unemployment worse, or whether it would have been even worse were it not for BEE.

Black Unemployment

One hypothesis to explain the increase in black unemployment since the end of 2008 is that white supremacy, sometimes referred to as 'white monopoly capital', is to blame. How have white supremacists managed to increase black unemployment decades after the first all-race government elections and decades after the adoption of a liberal, non-racial, protective constitution? The means is a form of oligopsony, where white incomes and expenses form such a dominant part of the total market that they are able to exert direct market manipulation,

as well as political manipulation (e.g. through media preferences that producers aim to cater for by distorting discourse with political consequences), to the detriment of black people, which is felt most acutely by the worst off in that group, namely the unemployed. This purpose is carried out either inadvertently through implicit bias or deliberately by evil white racists, or both.

Without getting into the mental states and motives of 'whiteness', or of all individuals that are white, it is possible to dispel this hypothesis merely by reference to facts on national income distributions.
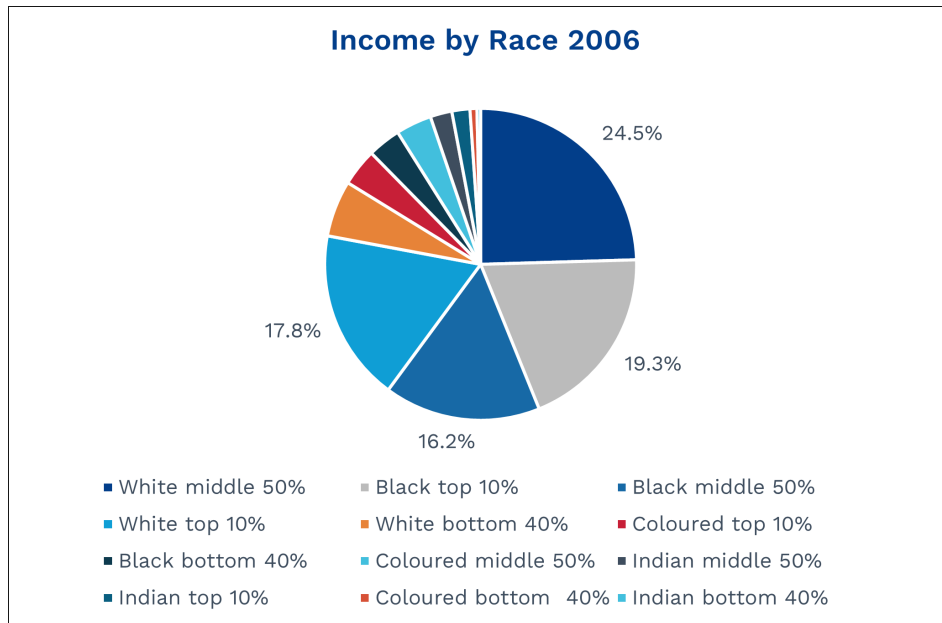
Source: Stats SA Inequality Trend Report & own calculations

In 2006 the white middle 50% earned the greatest single share of any demarcated group. Overall, white people earned an estimated 48.2% of income in 2006.
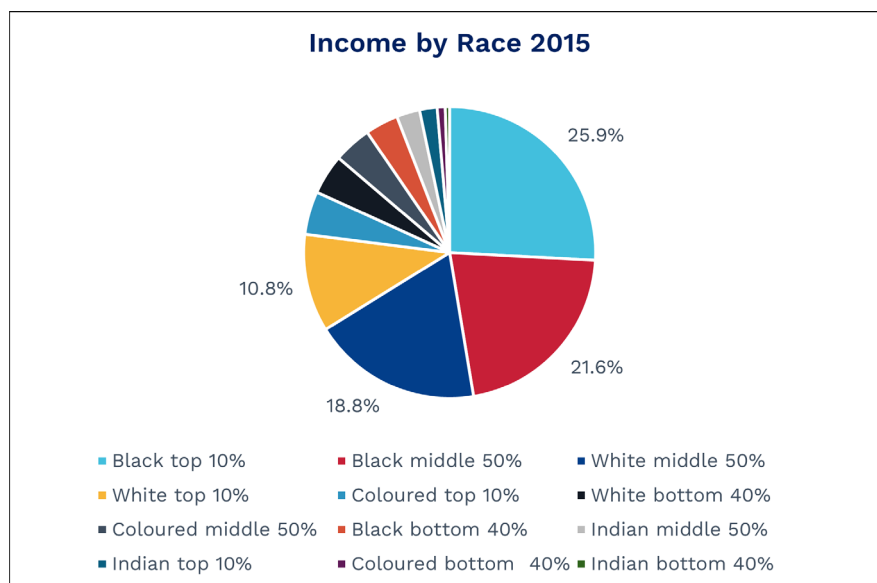
Source: Stats SA Inequality Report & own calculations

By 2015, however, the black top 10% had moved into pole position. Both the black top 10% and the black middle 50% had overtaken the white middle 50%. The white share of national income was 34.1%, roughly a third, while the black top 10% was roughly a quarter, and the black middle 50% was roughly a fifth.

There are roughly 9 times more people in the black top 10% than in the white top 10%. So, the fact that the black top 10% earns 2.5 times more suggests that the per capita income of the white top 10% is higher than the per capita income of the black top 10%. What matters though is that anyone in any of the relevant top 10% groups not only has considerable buying power, but also has the capacity to redirect purchases both physically and digitally. Companies that cater to a nefarious white oligopsony by, for example, refusing to hire black staff, will dissatisfy the largest demarcated group, commanding a quarter of national income, with the means to redirect purchases to avoid supporting such craven companies. This weighs against the white oligopsony hypothesis for explaining black unemployment.

Still, some might think that the top 10% is an insufficiently elite group to locate the source of white oligopsony. The top 0.1% of South Africans, roughly speaking, are dollar millionaires. In 2015 New World Wealth found that the number of white dollar millionaires and black dollar millionaires was roughly equal, with the latter fast overtaking the former.

Since 2015 Stats SA and New World Wealth have not provided new matching race-income data. I am confident that the black top 10% has continued to grow in income since that time, predominantly by growing even more skillful and productive, delivering great public benefit. The same holds for the ultra-rich black top 0.1%.

As of 2015 at least the white oligopsony hypothesis was disqualified simply by the insufficient aggregate market power of white individuals.

Finally, it is worth noting the following.

Specified Procurement by BEE Level 2017

■ Level 1	■ Level 2	■ Level 3
■ Level 4	■ Level 5	■ Level 6
■ Level 7	■ Level 8	■ Non Contributors

Pie chart values: 40.6%, 22.6%, 9.8%, 15.0%
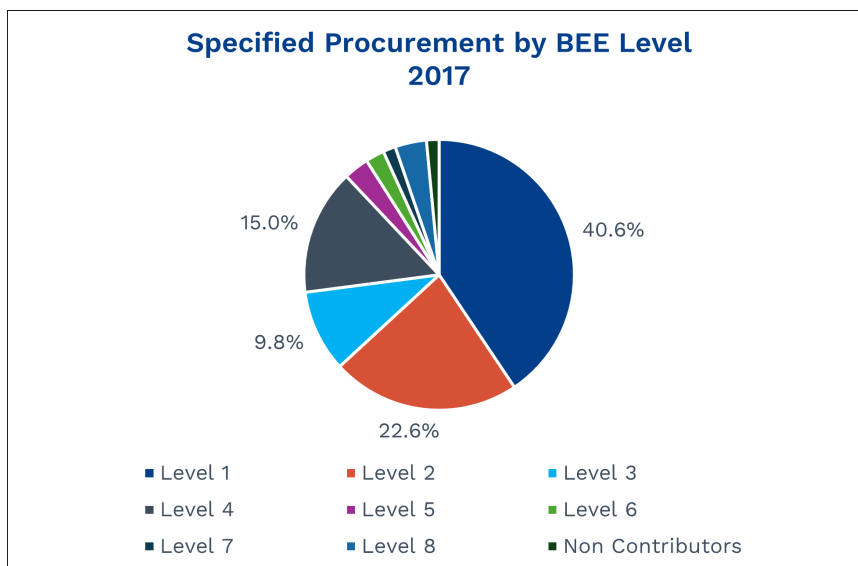
Source: State of Procurement Spent in National and Provincial Departments, Report, Office of the Chief Procurement Officer, Treasury,http://ocpo.treasury.gov.za/Resource_Centre/Publications /2018%20State%20of%20procurement%20spent.pdf & own calculations

According to a Treasury study of a 'representative' sample the bulk of procurement contracts where BEE points were specified in 2017 were BEE Level 1, 2, and 3 companies. This is 75% of 'specified' contracts by value. Unspecified contracts occur predominantly through deviations and contract extensions, and it is certainly not the case that such contracts exclusively go to companies with low BEE scores. But even including unspecified contracts, BEE Levels 1, 2, and 3 were paid 55% of total procurement by value. This indicates that for at least the last seven years businesses with high black ownership and management have been in extremely successful, and fruitful, positions.

BEE -> State Capture Hypothesis

Whatever the cause of rising black unemployment, policy makers who want to improve the situation had better look at the basics. Everyone can agree that corruption is bad. Corruption has increased in South Africa because regulatory effectiveness has decreased. At the core of that decrease lies a problem in the legislative design identified by the Zondo Report, which is known to laypersons as part of BEE. Specifically, the problem in the legislative design is confusion caused by conflicting imperatives, one of which demands that value-for-money be maximised, while the other allows deviations from value-for-money to pay what the late UKZN professor Stephen Oseko Migiro called a 'premium' on the 'contract value' whose 'cost [is] paid by departments for effecting preferential procurement'[2]. In short, these are BEE premiums.

It is worth emphasising that the quantum of BEE premiums is not in itself the problem identified in the legislative design in the Zondo Report. That would have been beyond the scope of the Zondo Report and highly inappropriate. Rather, it is the confusion created by the way that these BEE premiums are provided for in law that was identified as a problem in the legislative design relevant to state capture.

The failure to identify priorities regarding BEE premiums is ongoing. Treasury provides no account in any budget of how much public money is spent every year on paying for BEE premiums. The only Treasury evidence I could find regarding BEE premiums was mentioned in passing at the end of a 2010 survey study by Migiro that analyzed procurement in a few departments in Mmabatho, North West. Below is a reproduction of the table, with an added total at the bottom.

	Contract Value	Premium Paid	Premium Paid %
Transport (NW 052/05)	13 504 402	3 611 003	26.74%
Agriculture (DPW/05)	284 943	80 259	28.16
Education (EDU/06)	11 700 000	1 093 150	9.34%
Public Works (DPW/05)	274 885	77 243	28.10%
Sports Arts & Culture (SAC1/06)	665 567	411 273	61.79%
Total	**26 429 797**	**5 272 928**	**19.95%**

Source: SO Migiro, Public Sector Procurement and Black Economic Empowerment, p. 185, https://www.ajol.info/index.php/jsda/article/view/65061

The BEE premium is calculated to be 20% in total.

The City of Cape Town published a 'value-for-money' report in 2023 which showed that BEE premiums are still being paid. For example, due to BEE, traffic signal controllers were bought for R80 273.45 even though they were available at R74 750.00 due to BEE. That is a 7.4% BEE premium[3].

Treasury is obliged by Section 216 of the Constitution to implement transparent cost control. Its failure to account for BEE premiums is a dereliction of that duty.

The Zondo Report found that confusing measures that simultaneously demand the maximisation of 'value-for-money' while also requiring procurement activities that do not maximise value-for-money created a situation ripe for exploitation by corrupt actors It expressed a clear recommendation.

This uncoordinated approach...leaves a critical question unanswered: is it the primary intention of the Constitution to procure goods at least cost or is the procurement system to prioritise the transformative potential identified in section 217(2)? There is an inevitable tension when a single process is simultaneously to achieve different aspirational objectives.

There are of course many cases, one hopes the vast majority, in which the award of the tender satisfies both objectives of the Constitution but undoubtedly there are other cases some of which may well be high-value tenders in which one or other of these two objectives must be preferred, and it is in such cases that the legislation fails to give guidance.

In the view of the Commission the failure to identify the primary intention of the Constitution is unhelpful and it has negative repercussions when this delicate and complex choice has to be made, by default, by the procuring official.

Ultimately in the view of the Commission the primary national interest is best served when the government derives the maximum value-for-money in the procurement process and procurement officials should be so advised.

The same problem is encountered when a choice must be made between the competing virtues of localisation and lower cost. Again, the view of the Commission is that the legislation should make it clear that in such a case the critical consideration is value-for-money.[4]

So, step one is to recognise the key role the BEE premiums play in the public procurement system – implemented under a framework that is so confusing that it facilitates corruption across the board, by people of all races. It is trite to observe that public procurement corruption inculpates both private and public actors. It is also worth making explicit, for the sake of readers unaccustomed to non-racialism, that nothing in the Zondo Report analysis depends on any race group having any unusual propensity for, or aversion to, corruption, and most black businesses are obviously highly productive, excellent, successful contributors to productivity, as are most white businesses and most coloured businesses, and most Indian businesses, and most businesses without racial identification, just as most people of all races are decent, law-abiding, and conscientious.

Step two is to evaluate the extent of the problem. There is corruption everywhere, including in countries with very low, and improving, unemployment rates. Is it really possible that corruption has become so bad that curing the relevant 'problem in the legislative design' identified in the Zondo Report could have any major impact on black unemployment? Recall that black unemployment has roughly doubled from 5.4 million to 10.7 million. There is no way that can be reversed overnight by one policy change. But is corruption a big enough problem that reducing it to some significant extent could reduce black unemployment to some significant extent?

Corruption
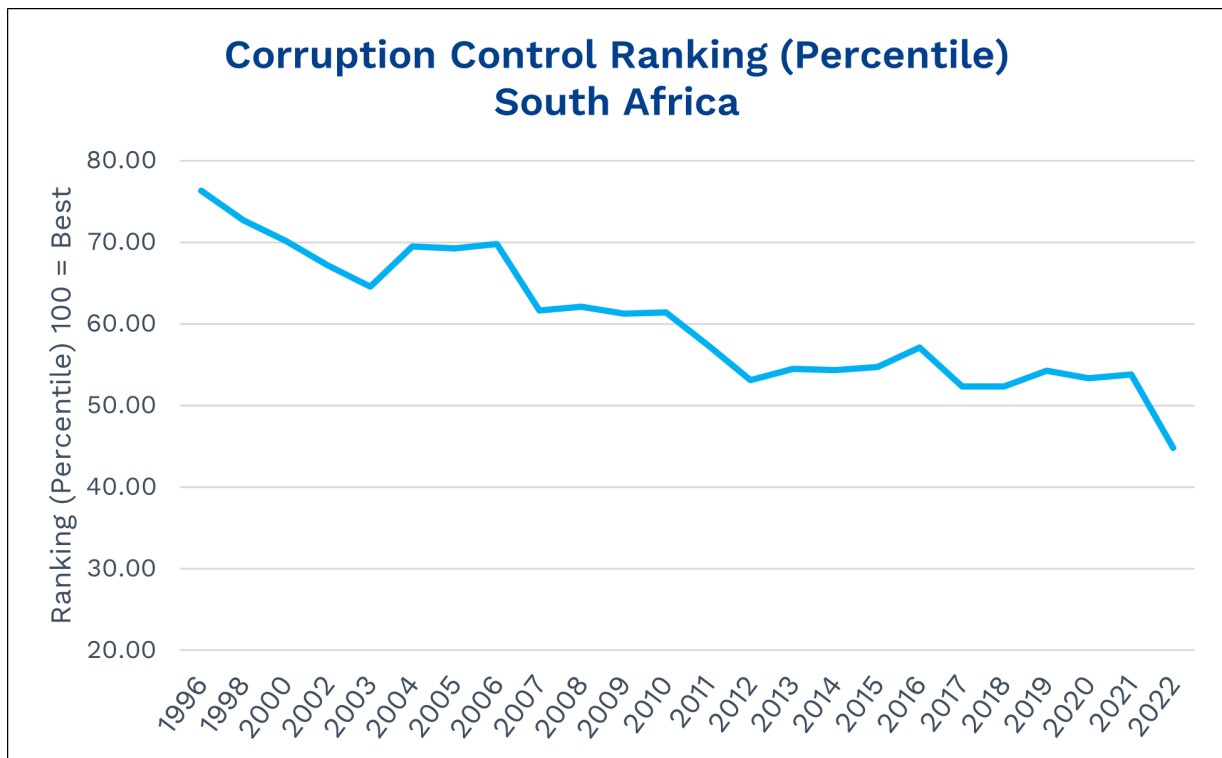
Source: World Bank Control of corruption https://databank.worldbank.org/databases/control-of-corruption

The ability to combat corruption was perceived to improve in the mid-2000s, and there was another hopeful uptick in 2016. But the overwhelming trend has been negative. The following table shows which countries have dropped furthest in the rankings.

Corruption Index Rank (percentile)			
Country Name	1996	2022	DELTA
Eritrea	72.0	8.0	64.0
Trinidad and Tobago	80.6	40.6	40.1
Zimbabwe	47.8	8.5	39.4
West Bank and Gaza	59.1	25.0	34.1
Eswatini	58.6	26.9	31.7
South Africa	**76.3**	**44.8**	**31.5**
Mongolia	60.8	33.0	27.7
Burundi	30.6	4.2	26.4
Nicaragua	33.9	7.5	26.3
Madagascar	44.1	17.9	26.2

Source: World Bank, Control of Corruption,
https://databank.worldbank.org/databases/control-of-corruption

The South African state has suffered the worst decline in ability to combat corruption of any major sovereign constitutional democracy. This is a world record. This is, on its face, the kind of change that might be able to explain economic conditions that could hamper employment terrifically.

But first, it is worth returning to the question of whether this is just a few 'bad apples'. President Cyril Ramaphosa, for example, used his 2024 State of the Nation Address to blame a few 'individuals at the highest level of the state' and a few 'private individuals' for conspiring 'to take over' and take 'billions of rands'.

As such it is worth asking whether regulatory effectiveness has generally been of a high quality, but on the one hand there was a tiny 'problem in the legislative design', starting with unaccounted BEE premiums, and a very large problem emanating from a few 'individuals', so that only the latter bear the main blame for the scale of corruption?

This 'bad apples' hypothesis can be dismissed almost out of hand. Again, it is worth noting that corruption is everywhere. If the 'bad apples' are to explain the greatest decrease in control of corruption in any major sovereign democracy on the planet over decades, they would have to be shown to be the most genius corrupt actors, in this respect, in recent history. To be sure, extremely intelligent people perpetrated 'state capture', but are they of such a calibre that they could do it absent some glaring flaw in the design?

Alternatively, it is worth asking if there a connection between the particular problem in the legislative design identified in the Zondo Report and regulatory effectiveness more broadly? In other words, has there been a broader regulatory decline of a sufficient magnitude to explain the corruption increase without resort to a 'hyper-genius bad apples' hypothesis.

Regulatory Effectiveness

Regulatory Quality Rank (Percentile) South Africa

Source: World Bank, Regulatory Quality, https://databank.worldbank.org/source/worldwide-governance-indicators
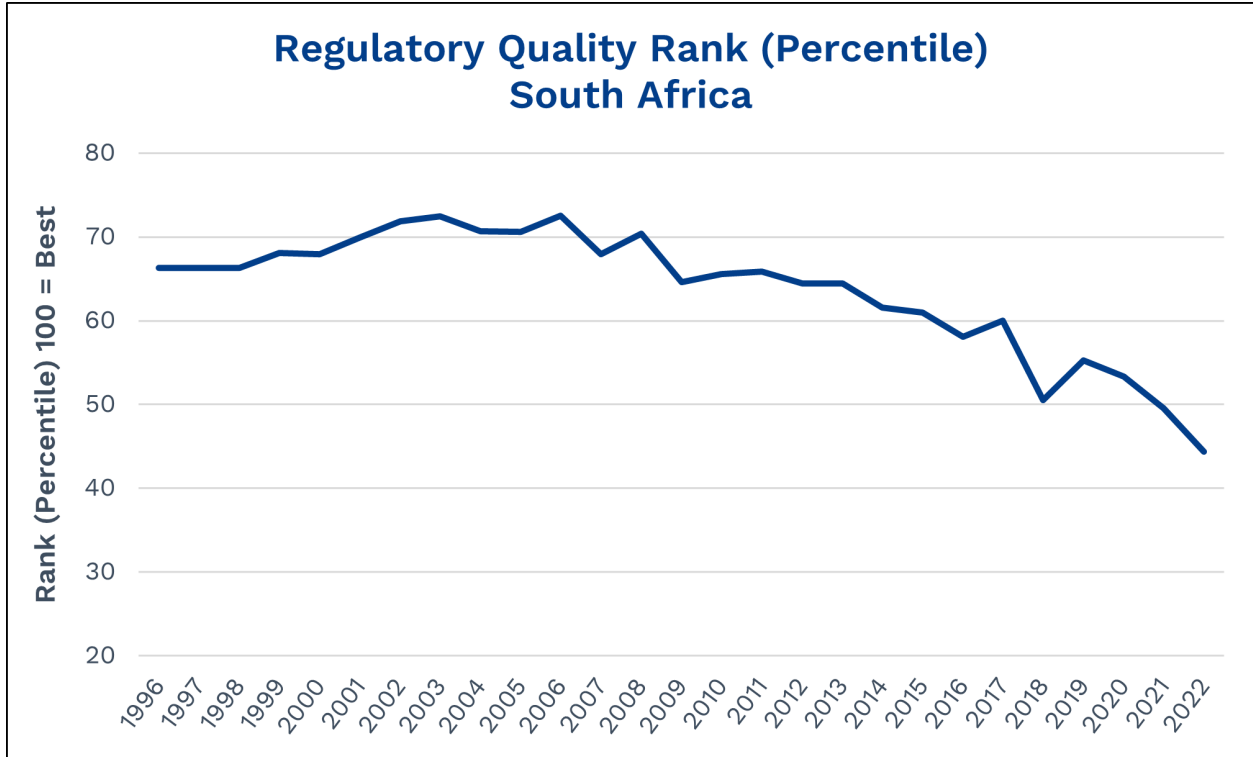
There is a notable improvement in regulatory effectiveness in the early years of the Rainbow Republic. But since 2008 the decline has been dramatic.

	Regulatory Quality Percentile (Worst global declines)			
Country Name	1996	2022	DELTA	Rank
Maldives	81.0	26.9	54.1	1
Bolivia	54.3	10.4	44.0	2
Argentina	66.8	25.9	40.9	3
Venezuela, RB	40.2	2.4	37.9	4
Gabon	60.3	25.5	34.9	5
Bahamas, The	78.3	47.2	31.1	6
Sri Lanka	58.2	27.4	30.8	7
Yemen, Rep.	32.1	2.8	29.2	8
Egypt, Arab Rep.	53.3	24.5	28.7	9
Belize	61.4	35.8	25.6	10
Tunisia	60.9	37.3	23.6	11
South Africa	**66.3**	**44.3**	**22.0**	**12**
Mauritania	35.9	14.6	21.2	13
Cambodia	46.2	25.0	21.2	14
Lebanon	34.8	13.7	21.1	15

Source: World Bank, Regulatory Quality, https://databank.worldbank.org/source/worldwide-governance-indicators

South Africa has had the 12th worst apparent drop in regulatory effectiveness rankings, and the 7th worst of major sovereign democracies. This is sufficient to dispel any 'hyper-genius bad apples' explanation for corruption decline. The rules of the system play a decisive role.

Fukuyama

However, the skeptical reader might wonder if it is possible for state capture to have such a dramatic impact on the whole economy that reducing it by making public procurement more transparent could improve economic conditions in general, and to such an extent as to reduce black unemployment in particular. The state, after all, is only a fraction of the whole economy. And the domestic economy is, after all, just a cork floating in the world's proverbial ocean. To answer this question, it will be important to see changes in the size of the state relative to everything else in South Africa.

Francis Fukuyama gave a speech at the University of the Witwatersrand in 2019 in which – roughly speaking – the following observation was made. While it is bad for government effectiveness to decline, it is even worse for the size of the state to grow as well, in such a situation.

Fukuyama's speech was primarily directed at an effort to transcend one-dimensional tax universalist preferences that appear to be a hangover from the First Cold War. Some experts think taxes should always go up, others think taxes should always be cut, and yet others think that the status quo should always be respected. Alternatively, one could draw an X-axis with all the possible tax rates from 0% to 100% and have experts locate their universalist positions somewhere on the line. Fukuyama advised fiscal decision makers to get past this one-dimensional ideological trench by looking at state *quality* as well as *quantity.*
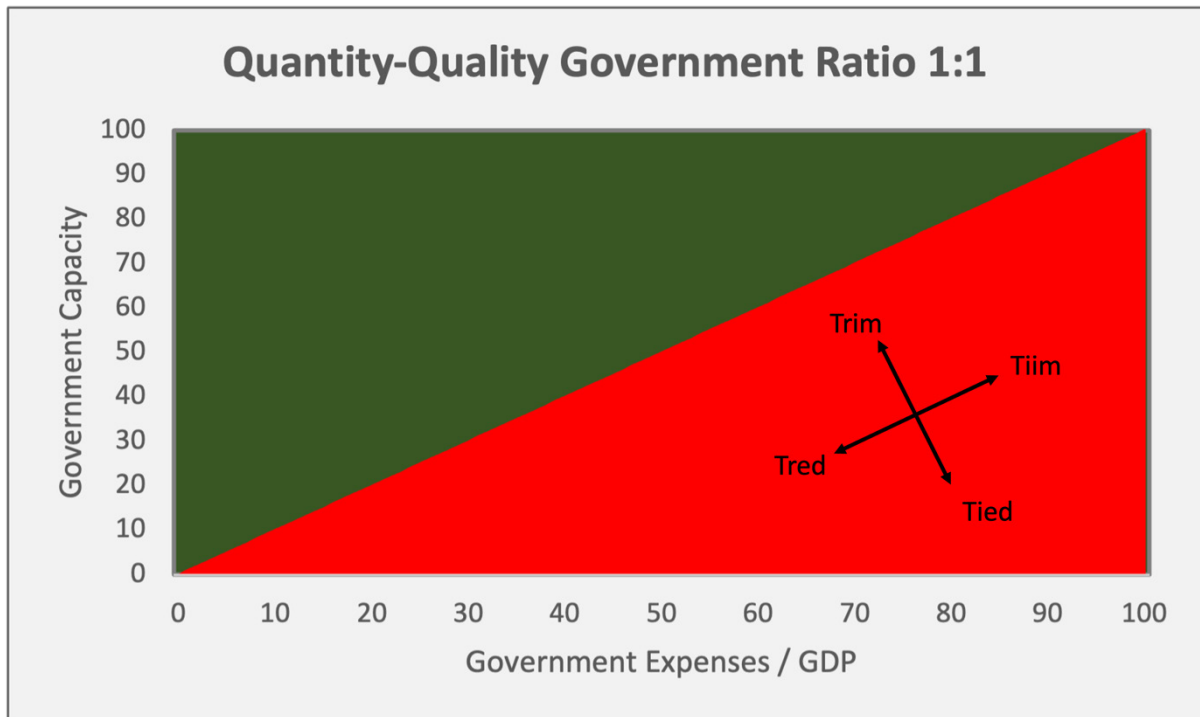
Illustration

Here is a hypothetical picture of how that would look. On the X-axis is government expenses as a portion of GDP. On the Y-axis is government capacity. This could be measured in many ways.

In the green zone the tax question is open-ended. Maybe it should go up, down, or stay the same. But once a state is in the red zone its government is misallocating resources at the margins. It should exit the red zone. In theory it could do so by improving effectiveness, or decreasing taxation, or both. If it cannot improve effectiveness then it must, in order to allocate resources productively, cut tax.

Technical note: why is the dividing line between the red and green zone 1:1? This is an arbitrary number that has been chosen merely for illustrative purposes. Once the fiscal multiplier is evaluated further down this point will be revisited.

The identified cardinal directions are Tax Reduction Improved Manageability (TRIM); Tax Reduction Effectiveness Decreased (TRED); Tax Increase Effectiveness Decrease (TIED); Tax Increase Improved Manageability (TIIM). As a basic geometric observation TRIM is the most efficient direction of travel to exit the red zone.

South Africa, however, has been moving in a TIED direction for decades. A TIED score formula was developed (see details in the longer report) that scales movement in the TIED direction. Only Lesotho has a higher TIED score between 1996 and 2019 than South Africa. That means to the second worst degree globally, South Africa's state bloated as its effectiveness declined.

That in turn answers the question of whether South African state corruption could possibly be sufficient in extent for it to be the case that changing the effectiveness and size of the state could impact labour participation rates and employment. Here is a breakdown of the quantity and TIED trends.

Growth in Size of Government
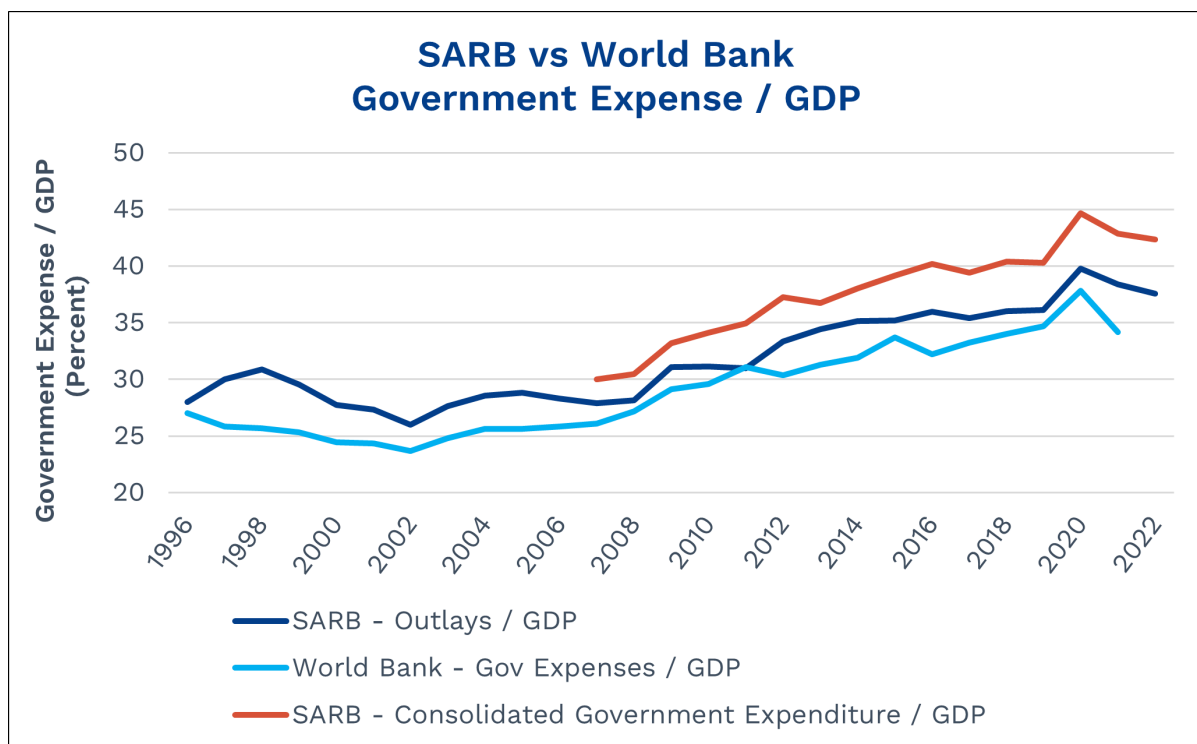
Source: SARB and World Bank, https://data.worldbank.org/indicator/GC.XPN. TOTL.GD.ZS

This graph shows the dramatic growth of the South African state relative to GDP by three different measures. It is important to note that while the World Bank measure could indicate a watershed turn to smaller government, more recent SARB data caution against that view. It is primarily for that purpose that the SARB data are included.

Quarterly Government Expenditure / GDP
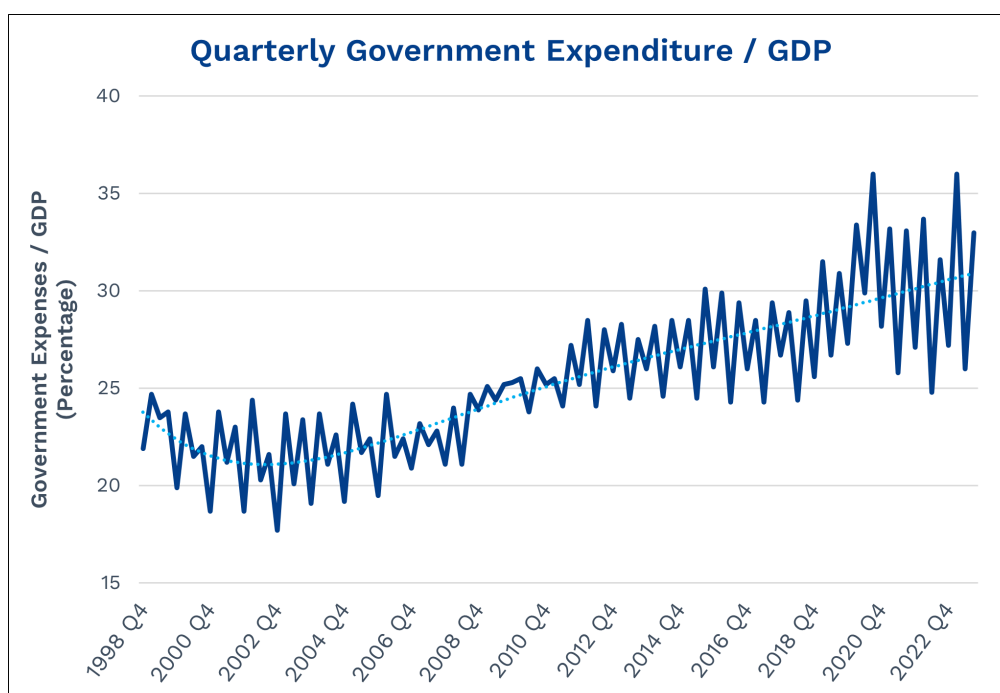
Source: SARB

The above graph shows national government expenses as a portion of GDP on a quarterly basis. This further cautions against any notion of the overall trend being reversed.

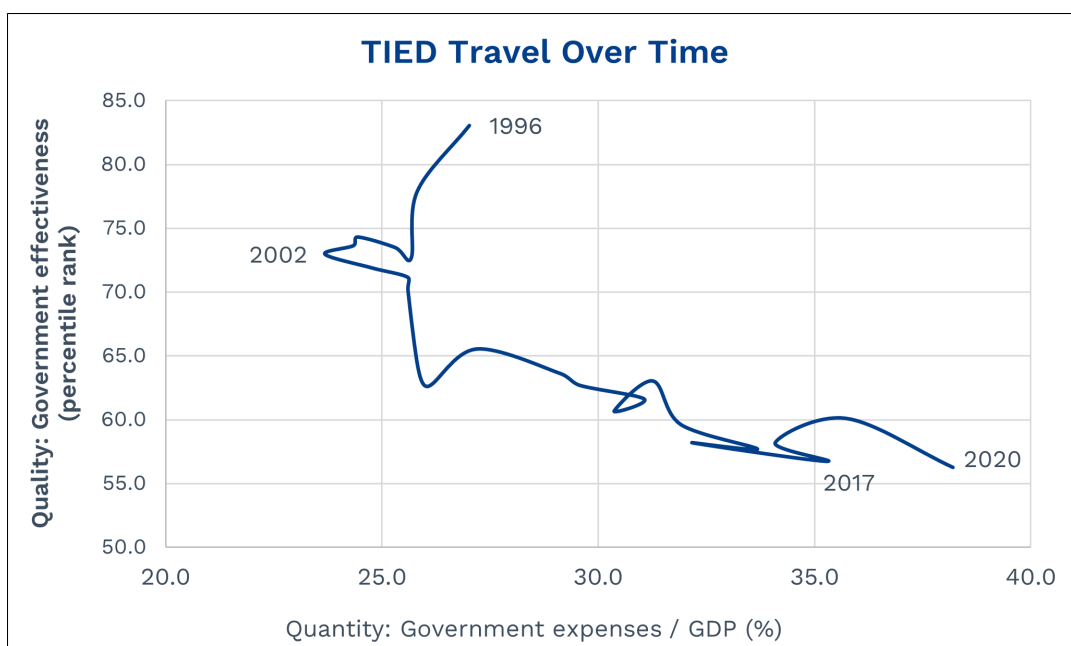| Country Name	Expense (% of GDP)				Country Name	Expense (% of GDP)			
	1996	2019	DELTA	Rank		1996	2019	DELTA	Rank
South Korea	13.3	27.5	14.3	1	Greece	42.4	47.1	4.7	18
Mongolia	13.3	25.6	12.3	2	Uruguay	27.8	32.2	4.4	19
Turkiye	25.2	35.6	10.4	3	Indonesia	10.4	14.5	4.1	20
Lesotho	30.0	39.7	9.8	4	Mauritius	18.8	22.8	4.1	21
Mexico	11.1	19.8	8.7	5	Peru	17.0	20.7	3.6	22
Azerbaijan	15.8	24.3	8.5	6	United States	20.0	22.7	2.7	23
Dominican Rep.	8.1	15.9	7.8	7	Norway	36.0	38.6	2.6	24
South Africa	**27.0**	**34.7**	**7.6**	**8**	Jamaica	23.4	25.8	2.4	25
Chile	15.7	23.3	7.6	9	Albania	21.1	23.2	2.1	26
Georgia	17.4	24.6	7.2	10	Luxembourg	37.7	39.5	1.8	27
Costa Rica	22.5	29.6	7.1	11	Portugal	36.8	38.5	1.7	28
Argentina	15.2	22.0	6.9	12	Australia	24.6	26.1	1.6	29
Thailand	11.2	17.9	6.7	13	Japan	14.9	16.4	1.5	30
Romania	26.9	33.5	6.6	14	Iceland	29.9	31.1	1.2	31
Nicaragua	10.8	16.5	5.6	15	Belarus	27.7	28.6	0.9	32
Vanuatu	22.2	27.8	5.6	16	United Kingdom	36.1	36.7	0.5	33
Guatemala	8.0	13.0	5.0	17	Bahamas	18.3	18.8	0.5	34
					Estonia	35.9	36.1	0.2	35

Source: World Bank and own calculations https://data.worldbank.org/indicator/ GC.XPN.TOTL.GD.ZS

One thing to be considered when looking at this table is how awkwardly it fits with tax universalist preferences. Those on the left who think it is always better to grow the state to combat private exploitation have to reckon with the fact that many of the fastest growing states are also the most exploitative. On the other hand, those on the right who think it is always better to shrink the state to combat state exploitation have to reckon with the fact that some of the fastest growing states occur in countries with some of the fastest growing markets, and high freedom values, in the world.
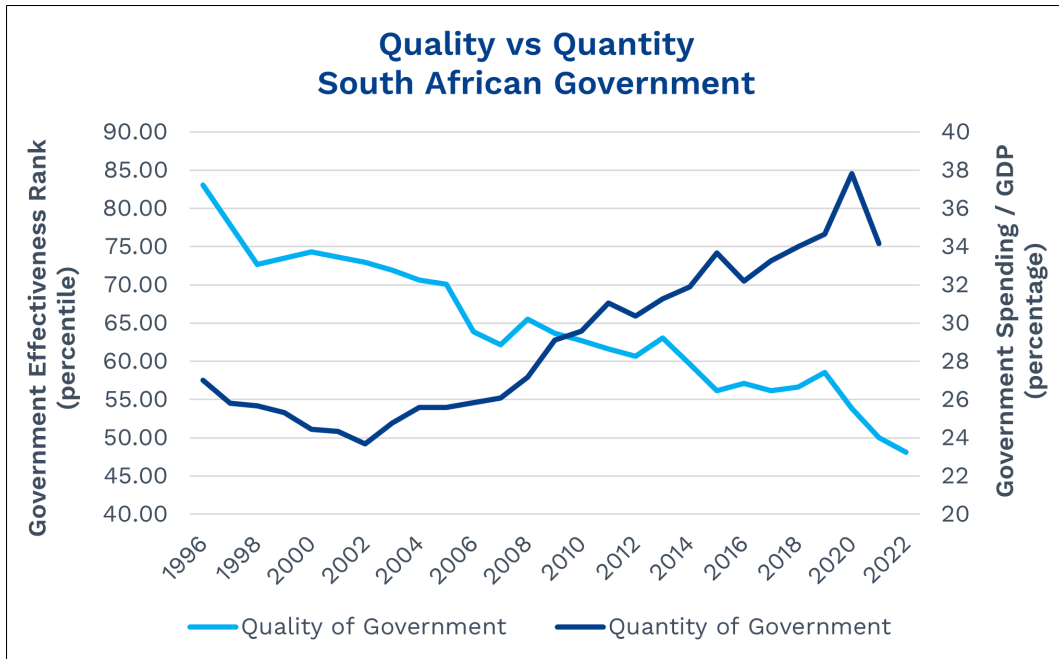
Source: World Bank

The basic Fukuyama insight was to compare quality with quantity of government. The picture above is stark. As quality declined quantity increased. That means more of a bad thing.
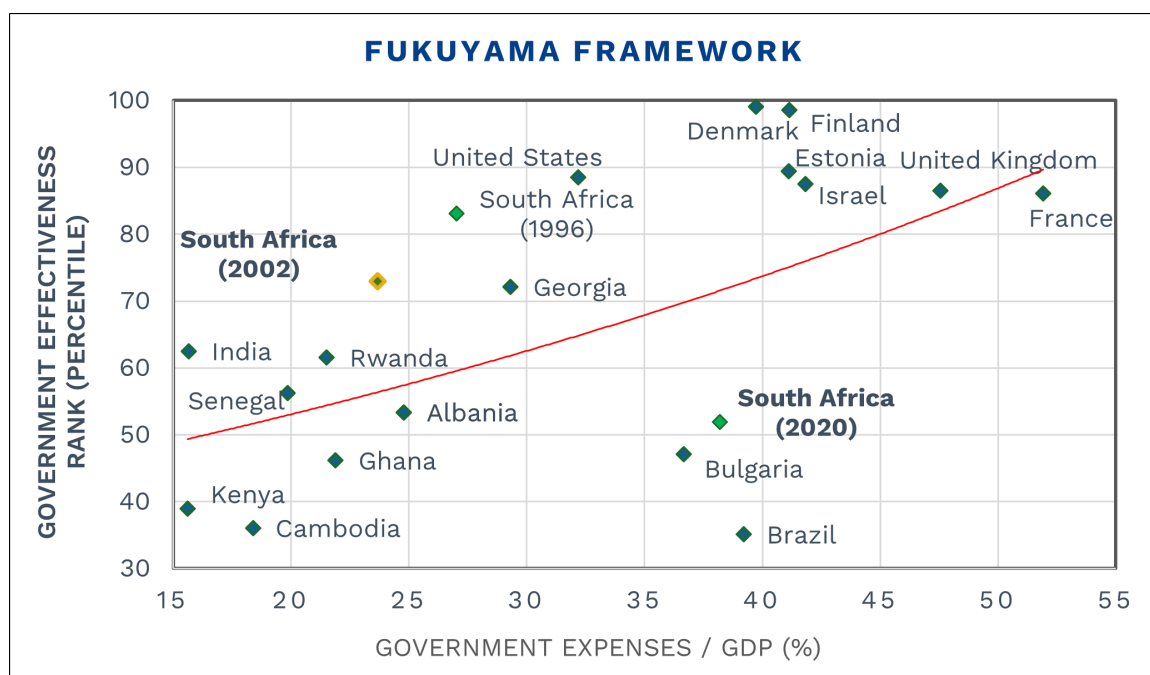

Source: World Bank and own calculations

This is South Africa's TIED signature, showing direction of travel by year, with some variations. Only the brief period leading to 2002 shows travel in a TRIM direction.

| Country Name	Expense (% of GDP)			Government Effectiveness: Percentile Rank			QUALITY-QUANTITY Combined	
	1996	2019	DELTA	1996	2019	DELTA	TIED	RANK
Lesotho	30	38.2	8.3	53	17.3	35.7	22.0	**1**
South Africa	27	35.7	8.7	83.1	60.1	23	15.9	**2**
Mexico	11.7	20.4	8.7	62.3	39.9	22.4	15.6	**3**
Argentina	15.2	22	6.9	60.1	48.6	11.6	9.3	**4**
Chile	15.7	23.3	7.5	86.9	77.9	9	8.3	**5**
Greece	42.4	47.1	4.7	77.6	65.9	11.7	8.2	**6**
Dominican Rep.	8.1	15.9	7.8	47	38.9	8.1	8.0	**7**
Guatemala	8	13	5	37.2	26.4	10.7	7.9	**8**
Nicaragua	10.8	16.6	5.8	33.9	24.5	9.4	7.6	**9**
Peru	17	20.7	3.6	57.4	47.6	9.8	6.7	**10**
Turkiye	25.2	35.6	10.4	55.7	53.8	1.9	6.2	**11**
Romania	26.9	33.5	6.6	45.9	43.8	2.2	4.4	**12**
UK	36.1	36.6	0.5	96.7	90.9	5.9	3.2	**13**
Norway	36	38.9	2.9	98.9	97.6	1.3	2.1	**14**
Australia	24.6	26.2	1.6	95.6	93.3	2.4	2.0	**15**
Portugal	36.8	38.5	1.7	86.3	84.1	2.2	2.0	**16**

Source: World Bank and own calculations

Here South Africa's position in the global TIED stakes is shown to be the second worst globally, between 1996 and 2019.

Source: World Bank and own calculations

A note of caution on the picture above. The red line is fairly arbitrary. It divides France and the UK, but it might be that the red line should be a bit lower, so that France and the UK are both above it, in the green zone. Or it might be that the red line should be a bit higher, so that France and the UK are both to the right of it, in the red zone. It would be highly desirable for more research to be done to better understand where to draw the line. For now, it is clear, for example by reference to the South African fiscal multiplier (see below), that South Africa is deep in the red zone.


Fiscal Multiplier South Africa
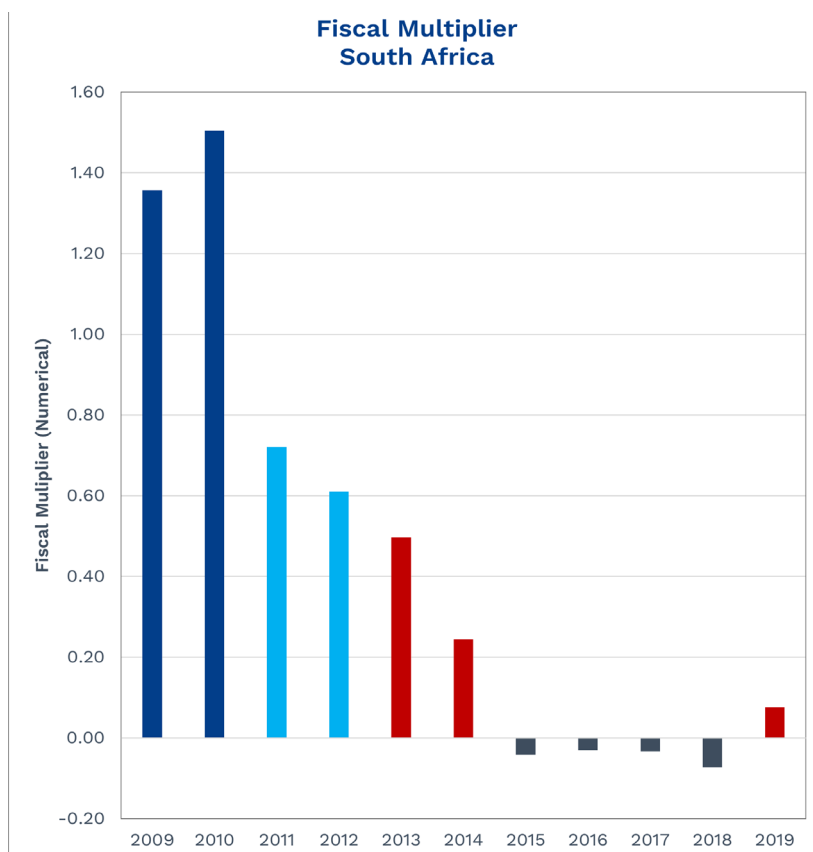
Source: Theo Janse van Rensburg, Shaun de Jager, and Konstantin Makrelov, https://sajems.org/index.php/sajems/article/view/4191

The fiscal multiplier is a measure of impact of government fiscal expenditure. Typically, a fiscal multiplier above 1 is desired, since it means that for every R1 spent by the government on the margins more than R1 of GDP is added. If, instead, that R1 had been spent privately with even greater positive GDP impact then purely from a productivity perspective it would be preferable for that R1 to be spent privately. But still, a multiplier above 1 indicates some form of government productivity.

When the fiscal multiplier is below one that means spending R1 produces a GDP impact of below R1. The fiscal multiplier is not usually thought of as being able to enter the negative range. However, the South African state is breaking new ground, conceptually and practically. A SARB working paper shows negative fiscal multipliers in recent years.

This is shocking domestic evidence that South Africa is in the red zone, where resources are being badly misallocated by the state. The recommended fiscal decision is to move in a TRIM direction. This is achieved by heeding the Zondo Report advice on maximising value-for-money in procurement, totaling over R1.1 trillion per annum, to improve corruption control and regulatory effectiveness, and, in turn, government effectiveness, while also imposing a VAT tax cut.

Reaping the Zondo Dividend
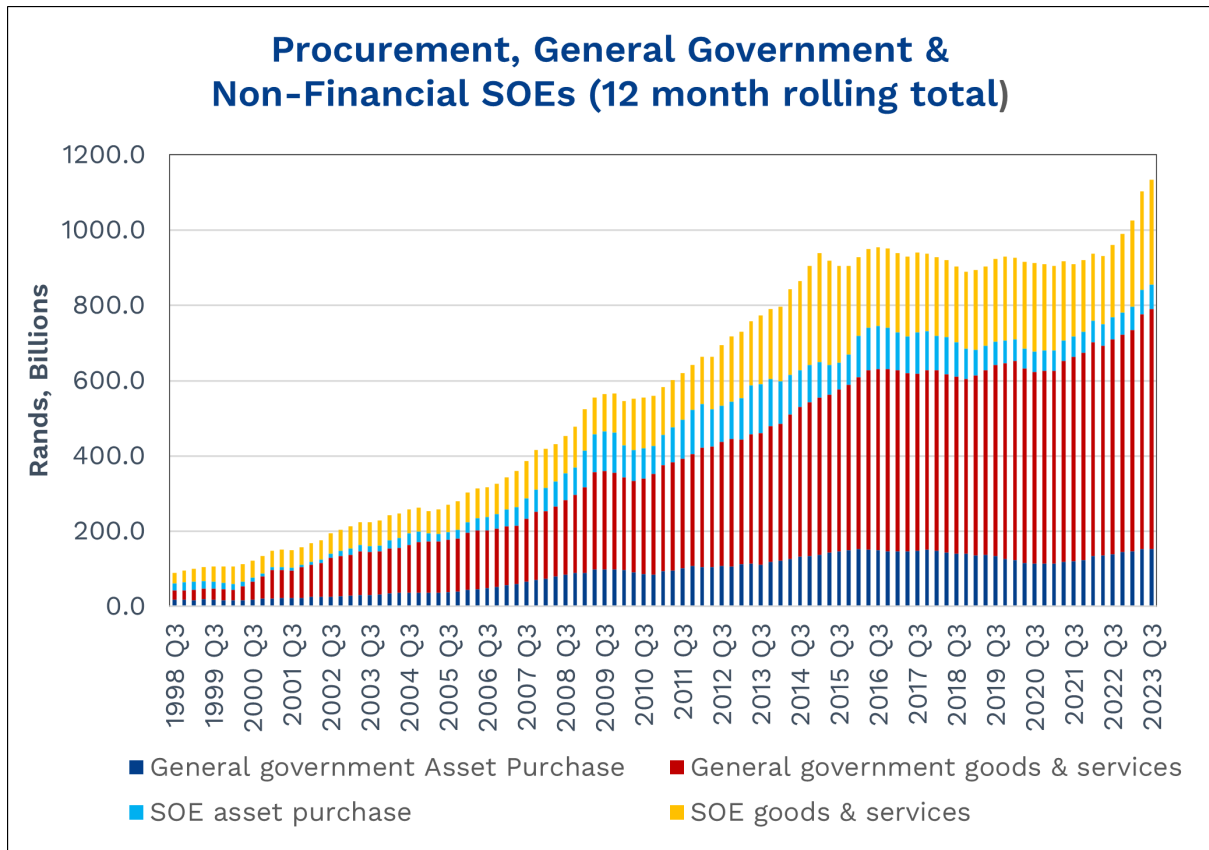
Source: SARB, including data shared directly via email

The 12-month rolling total cost of procurement is over R1.1 trillion at the latest count by SARB. Here is where an estimated R150 billion is expected to be found in savings.

	Official	Estimate		
		% Total Procurement	% Real Procurement	Nominal (R billion)
Number of Contracts with Recorded BEE Premiums	?	10%	-	-
Recorded BEE Premium Per Contract	?	5%	5.8%	-
Total Recorded BEE Premiums	?	0.5%	0.6%	5.7
Number of Contracts with Unrecorded BEE Premiums	?	20%	-	-
Recorded BEE Premium Per Contract	?	5%	5.8%	-
Total Unrecorded BEE Premiums	?	1%	1.2%	11.3
Total BEE Procurement Premiums	?	**1.5%**	**1.7%**	**17.0**
Present Cost of Corruption in Public Procurement	?	21.2%	24.4%	240.6
Corruption Cost after Zondo value-for-money advice	?	9.5%	11%	108.3
Zondo Difference	?	**11.7%**	**13.4%**	**132.3**
Pre-Zondo Procurement (R Billion, Q3 2023)	1134.8	100%	115.2%	-
Post Zondo (Real) Procurement	?	86.8%	100%	985.4
Zondo Dividend	?	**13.2%**	**15.2%**	**149.3**

Source: SARB and Long Report, own calculations

Technical note: 'total procurement' is the total amount paid, as per SARB data. By contrast 'real procurement' is total procurement minus BEE premiums and the 'Zondo Difference'. The 'Zondo Difference' is the expected saving from implementing the relevant value-for-money advice in the Zondo Report. This is estimated to be 55% of readily preventable corruption, in other words roughly half of the updated Brown waste estimate.

Further technical note: recorded BEE premiums are paid whenever a tender is awarded demonstrably not on the basis of value-for-money. Unrecorded BEE premiums are paid when deviation from value-for-money is not on the tender record.

This can occur when the business that wins would have won without BEE but monetised its BEE advantage; or when the business that wins would not have won without BEE, but the business that would have won did not compete either because it anticipated its loss or because it suffered pre-disqualification.

Limits to estimate: Treasury does not publish data on BEE premiums that it pays. This is highly unfortunate. It also violates Section 216 of the Constitution of the Republic of South Africa. In the absence of direct evidence, circumstantial evidence has regrettably had to be relied on to estimate BEE premiums.

In addition, Treasury has failed to do a thorough cost analysis after the Zondo Report of what the potential gains would be from implementing a maximum value-for-money procurement system. However, the former Chief Procurement Officer, Kenneth Brown, did provide an estimate of the cost of waste from readily preventable corruption in 2016. That estimate is conservatively scaled and updated to 21.2% of total procurement.

Workings and substantiations are provided in the longer report.

Cutting VAT by R100 billion

VAT is a regressive tax, meaning it falls disproportionately heavily on the poor compared to the rich. Some people make the mistake of thinking that zero-rating makes VAT overall progressive. Reliable up to date data is, unfortunately, not available. However, a 2007 study by Treasury that breaks down VAT savings by expenditure quintile undermines the assumption. Although inflation will have changed the numbers today, as would the doubling of black unemployment, the relative proportions in VAT savings may be comparable.

Zero-rated products	Savings, Rands (Millions)					
	1st Quintile	2nd Quintile	3rd Quintile	4th Quintile	5th Quintile	Total
Mealie meal	383.6	414.7	607.6	347.6	206.9	**1 960.4**
Bread flour #	62.1	72	101.8	57.1	31.5	**324.5**
Rice	91.5	128.3	253	220.1	180	**872.9**
Mealie rice	36	44.7	72.5	52.1	39.8	**245.1**
Brown bread	162.7	239.2	515.2	435.5	308.8	**1 661.4**
Cooking oils	77.7	104.1	286.6	404.2	516.5	**1 389.1**
Fresh milk	48.1	72.2	192.3	251.7	385.9	**950.2**
Sour milk	16.4	22	46.1	42.3	31.7	**158.5**
Milk powder	24.4	36.9	79.8	66.6	47.4	**255.1**
UHT milk	13.9	17	32.5	39.4	68.7	**171.5**
Eggs	50.1	73.4	169.7	165.7	178.2	**637.1**
Potatoes	103	109.8	197.7	183.2	148.1	**741.8**
Mealies	10.2	9	9.4	6.1	14.3	**49**
Tomatoes	49.9	62.7	125	112.6	108	**458.2**
Lettuce	0.4	1	4.4	13.3	43.8	**62.9**
Apples	0	0.1	0.4	1.1	2.9	**4.5**
Bananas	0	0.1	0.2	0.4	1	**1.7**
Oranges	0.9	1.9	9.4	26.1	53.9	**92.2**
Paraffin	2.1	3.4	9.5	12.1	18.9	**46**
Total	**1 133**	**1 412.5**	**2 713.1**	**2 437.2**	**2 386.3**	**10 082.1**

Source: p. 114, https://www.treasury.gov.za/publications/other/vat%20 merit%20goods%20final%20report%20%20-%2015%20oct%202007.pdf. Note: the expenditure quintiles are approximate and range from 'very low' expenditure (1st quintile) to 'very high' expenditure (5th quintile).

The top and second-highest quintile by expenditure gain most benefit from zero-rating. As the Treasury study puts it: '[VAT zero-ratings and exemptions] make the VAT system more regressive by transferring substantially more benefits from preferential product treatment to higher expenditure groups than to lower expenditure groups.'[5]

The following is a calculation of the estimated benefit of a R100 billion VAT cut, achieved by dropping the VAT rate from 15% to 11.5%, based on an estimated 70% pass through and Treasury data on VAT payment by decile.

Decile	Savings, Rand (Billion)
1 (poorest)	1.4
2	2.1
3	2.6
4	3.1
5	3.5
6	4.1
7	5.1
8	7.3
9	12.4
10 (richest)	27.6
Total	69.0

Source: Long Report, own calculations from
https://www.sars.gov.za/wp-content/uploads/
Docs/TaxStats/2022/TStats-2022-Highlights-booklet-A5.pdf

This VAT cut is expected to leave R12.6 billion in the pockets of the poorest 50% and R29.1 billion in the pockets of the poorest 80%.

This is the most desirable way to spend the Zondo Dividend, by cutting a tax that disproportionately burdens the poorest.

However, it is noteworthy that the richest 20% would be spared roughly R40 billion in taxation. In absolute terms, that means that higher income people would save more than lower income people. But this forms a lower portion of total income for those in higher groups.

Furthermore, a cut of the General Fuel Levy from R3.96 (2023 rate) to R1.73 would save buyers R50 billion.

This is necessary to offset the reduction in consumption demand that occurs when the state procures the same output while spending R150 billion less by reaping the Zondo Dividend. Absent a VAT cut, or something like it, this mid-term beneficial move will certainly have short-term negative consequences on economic activity. One of the benefits of the General Fuel Levy is that it can be adjusted promptly. Should the Zondo Dividend be reaped more quickly than expected, quick fuel price cuts can be implemented to save aggregate consumer demand. This has positive expected benefits for all South Africans, but especially the poorest. Insofar as fuel tax cuts are not passed through to final consumers, they are expected to be absorbed by the taxi industry, a crucial employer.

Unlocking Black Business Growth

If firms with high BEE scores are paid R17 billion in BEE premiums per annum there must be a deep concern about the cost of BEE premiums being brought down to R0. However, it is worth noting that R31 billion of the VAT cut is expected to be kept by businesses, including black businesses. Just in case black businesses keep roughly half of that amount, 55%, the offset will be complete.

However, even if that offset is not complete it is worth noting that most procurement already goes to businesses with very high BEE scores and most of these companies would be the best even without BEE. In other words, in most cases, black businesses will not go from winning contracts to losing contracts, but instead will go from winning contracts at super-economic profits to winning contracts at normal, which is to say sustainable, positively incentivising, non-distortionary profits.

Black businesses have been inhibited by maladministration and a shrinking economy, in real per capita terms, since 2010. However, moving South Africa in TRIM direction by cutting BEE premiums to pay for a pro-poor VAT cut is expected to attract domestic and foreign investment. This in turn grows the market into which black businesses sell goods, and from which black businesses buy goods, while reducing sovereign risk, which lowers the price of credit. All of this, in turn, stimulates black business growth.

Unlocking Rainbow Republic Growth

The Constitution requires the implementation of a procurement framework that provides 'for (a) categories of preference in the allocation of contracts; and (b) the protection or advancement of persons, or categories of persons, disadvantaged by unfair discrimination'.

It may be best to consider the primary category in (b) to be unemployed persons. However, if fiscal decision makers are committed to racial categorisation it must be considered that black unemployed persons are materially disadvantaged in a way that all employed persons are not. To boost employment it is necessary to improve the manageability of the state and keep more cash in the pockets of the poor. If this has the expected effects of stimulating economic growth that would ncrease employment opportunities, which is the best hope for the pertinent category of disadvantaged persons.

Endnotes

1   https://www.ipsos.com/en/what-worries-world
2   https://obituarykenya.co.ke/professor-stephen-oseko-migiro/
3   Procurement Transparency Report, Cape Town, p. 73 https://resource.capetown.gov.za/documentcentre/Documents/City%20research%20reports%20and%20review/SCM_Procurement_Transparency_Report.pdf
4   Judicial Commission of Inquiry into State Capture Report: Part 1, Vol. 1: South African Airways and its Associated Companies, Sections 529-533, pp. 796-797, https://www.statecapture.org.za/site/files/announcements/673/OCR_version_-_State_Capture_Commission_Report_Part_1_Vol_I.pdf
5   Source: p. 116, https://www.treasury.gov.za/publications/other/vat%20merit%20goods%20final%20report%20%20-%2015%20oct%202007.pdf.

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