

# Taxation and governance in complex contexts

## Prospects for a fiscal social contract in South Africa

Sansia Blackmore and Odd-Helge Fjeldstad

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# Talking points

1. Background and motivation
2. Methodology and data
3. The case of democratic South African
4. Fiscal position 2024
5. Prospects for tax bargaining and a fiscal social contract
6. Conclusion

# 1. Background and motivation

# Historical evidence of a positive tax-governance link

- State-building in Western countries: ‘governance dividend’ from taxation (Levi 1988; Tilly 1992)
- Three main channels (Moore 2008):
  - 1) Governments dependent on taxes, will be inclined to pursue policies to expand the economy and thus the tax base
  - 2) Tax collection requires capable bureaucracy
  - 3) Bargaining over taxes is central to building relations of accountability between state and citizens based on mutual rights and obligations
    - *Fiscal Social Contract*
    - “No taxation without representation” (American Revolution 1776)
    - Taxation → Participation → Accountability

# Can we expect similar positive tax-governance links in the contemporary developing world?

- Research finds evidence of a *positive association between taxation and good governance*, but also of its *high context dependency* (Braütigam et al. 2008; Prichard 2015; Meagher 2018; Moore et al. 2018)
- Conditions that would work in favour of a fiscal social contract include:
  - When taxes contribute significantly to state revenue this may strengthen the bargaining power of taxpayers
  - Taxes that are salient (like income tax), heighten taxpayers' awareness of the contributions they make and are more likely to encourage demands for accountable spending of revenue
  - Salience in public expenditure also influences taxpayers' perception of reciprocity; expenditure that visibly violates reciprocity is more likely to invite taxpayer contestation
  - Taxation that is broad-based
  - Taxpayers' capacity to mobilise collectively

# The case of democratic South Africa

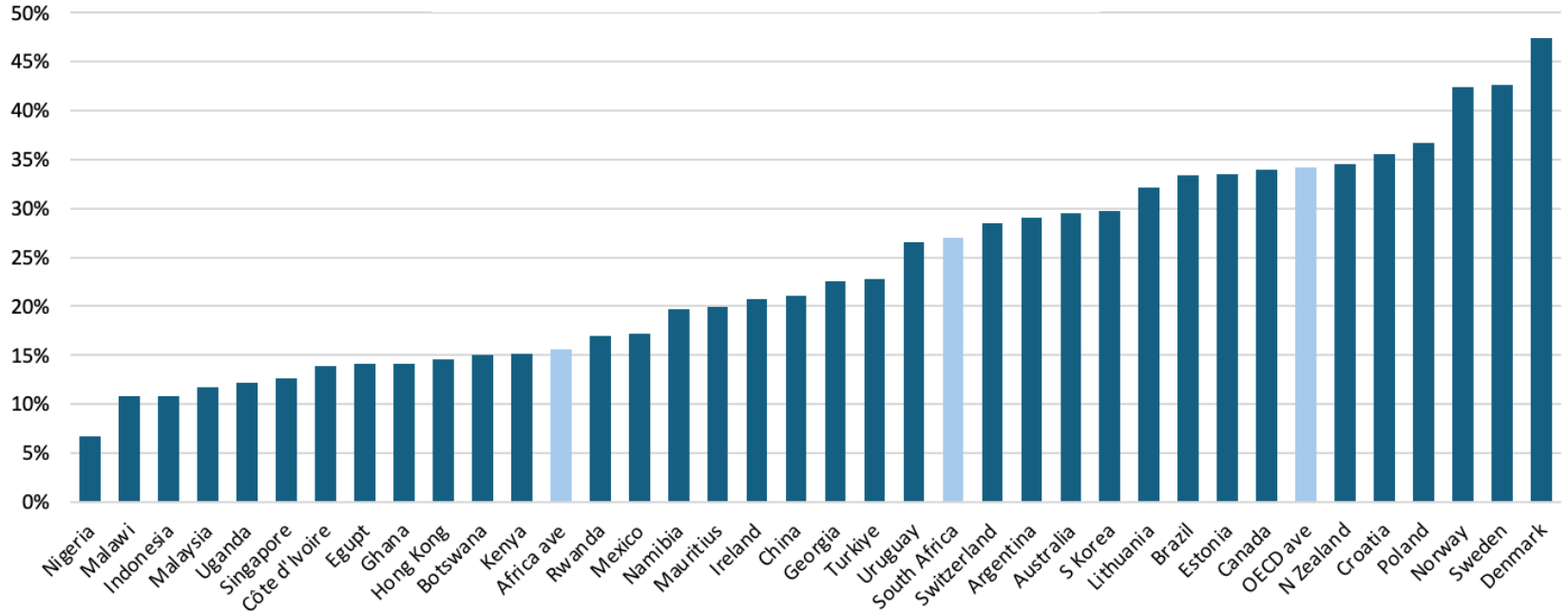
- South Africa remains - and has for decades been - a tax-dominant (or fiscal) state (tax revenue constitutes more than 98% of state revenue)
- With a tax-to-GDP ratio of 25-28%, South Africa outperforms its African and developing country peers in terms of tax collection [see graph next slide]
- The single largest contribution comes from personal income tax (38%)
- Yet - and against theoretical predictions based on Western historical experiences - the country ranks comparatively poorly on governance metrics

*Why is that?*

And: *What are the prospects for tax bargaining and a fiscal social contract?*

These questions are the focus of our study.

## Tax-to-GDP ratio, 2021



Source: OECD Global Revenue Statistics Database

## 2. Methodology and data



# Methodology and data

- Descriptive analysis
- Mixed methods
- Main sources of data:
  - Revenue and expenditure data from the SARB, National Treasury, SASSA, OECD, Afrobarometer and World Values Survey
  - Reports from public commissions on state capture, taxation and public expenditure
  - Scholarly literature on economic and political development in SA during the last three decades
  - Newspapers articles and media reports

### 3. The case of democratic South Africa

# Democratic SA:

## A political settlement with three sub-bargains

- SA democratised in 1994
- Opportunity to renegotiate the social contract, rewrite institutional framework
- Transition underpinned by political settlement containing *three sub-bargains* (Levy et al. 2021):
  - 1) Explicit terms governing the handover of political power  
→ Protection of private property rights; rule of law
  - 2) Implicit bargain ruling the distribution of power and benefits among the ideologically diverse incoming elite → the Triparty Alliance
  - 3) Promises to non-elites of economic inclusion and upward mobilisation  
→ Economic transformation and empowerment; pro-poor fiscal restructuring
- Constitutional backing gave credence to the promises

# Democratic SA in 1994: Constitutionalism and strong economy, but unequal

- Constitution with defined mutual rights and obligations of state and society
- Powerful set of checking institutions to prevent a repeat of exploitative history
- Also unusual among middle-income peers: effective government and high-quality judicial institutions
- Diversified economy, largest and most industrialised in Africa
- Highly unequal
- Society-wide *fiscal commitment* to a progressive tax and transfer system towards economic inclusion and upward mobilisation (*the third sub-bargain*)

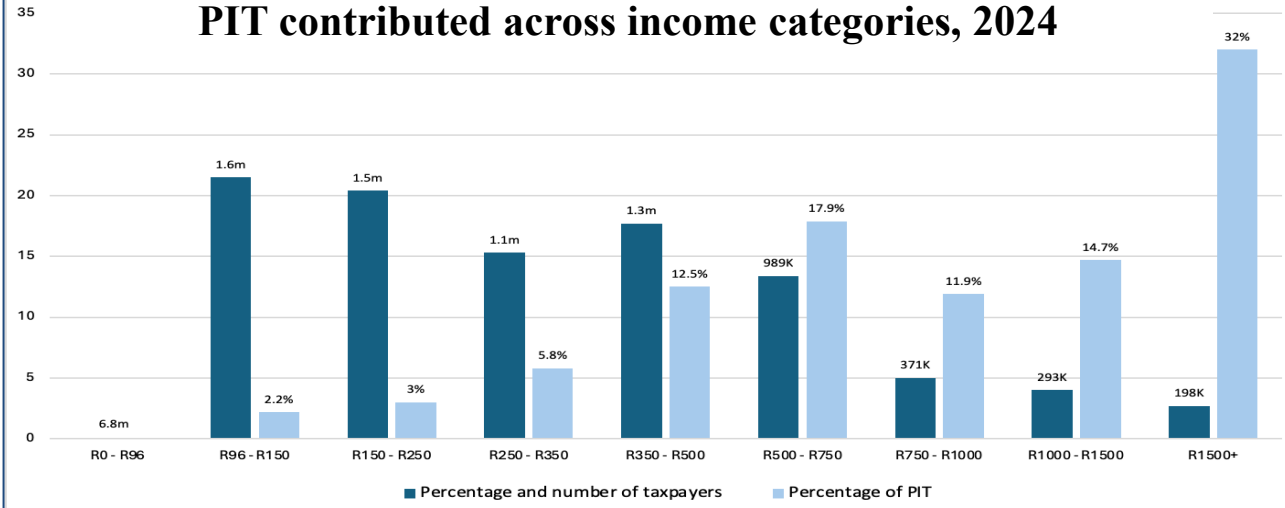
# Democratic SA in 2024:

## Two of the three sub-bargains broken

- *Second sub-bargain* - “distribution of power and benefits among the ideologically diverse incoming elite” - went wrong:
  - Politicised bureaucracy, cadre deployment, preferential procurement, state capture
  - Despite checking institutions, decline in accountability and governance (“executive aggrandisement”)
- *Third sub-bargain* - “promises to non-elites of economic inclusion and accelerated upward mobilisation” - failed:
  - Service delivery failures as municipalities collapse
  - SOE failure (ESKOM, Transnet) – deindustrialisation, declining economic potential
  - Cost of government dysfunction: *Globally among the highest unemployment and inequality rates; 62% poverty*

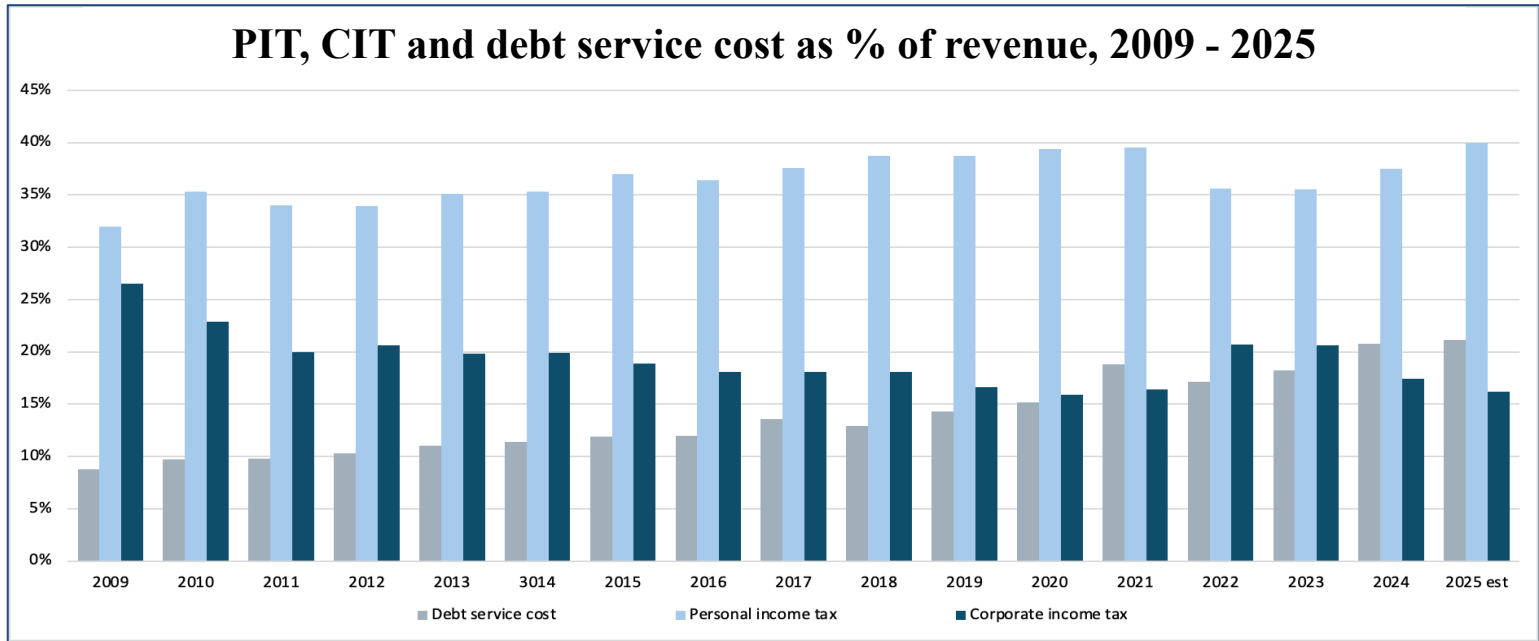
## 4. Fiscal position in 2024

## PIT progressive and concentrated: Share of taxpayers and % PIT contributed across income categories, 2024



### Personal Income Tax

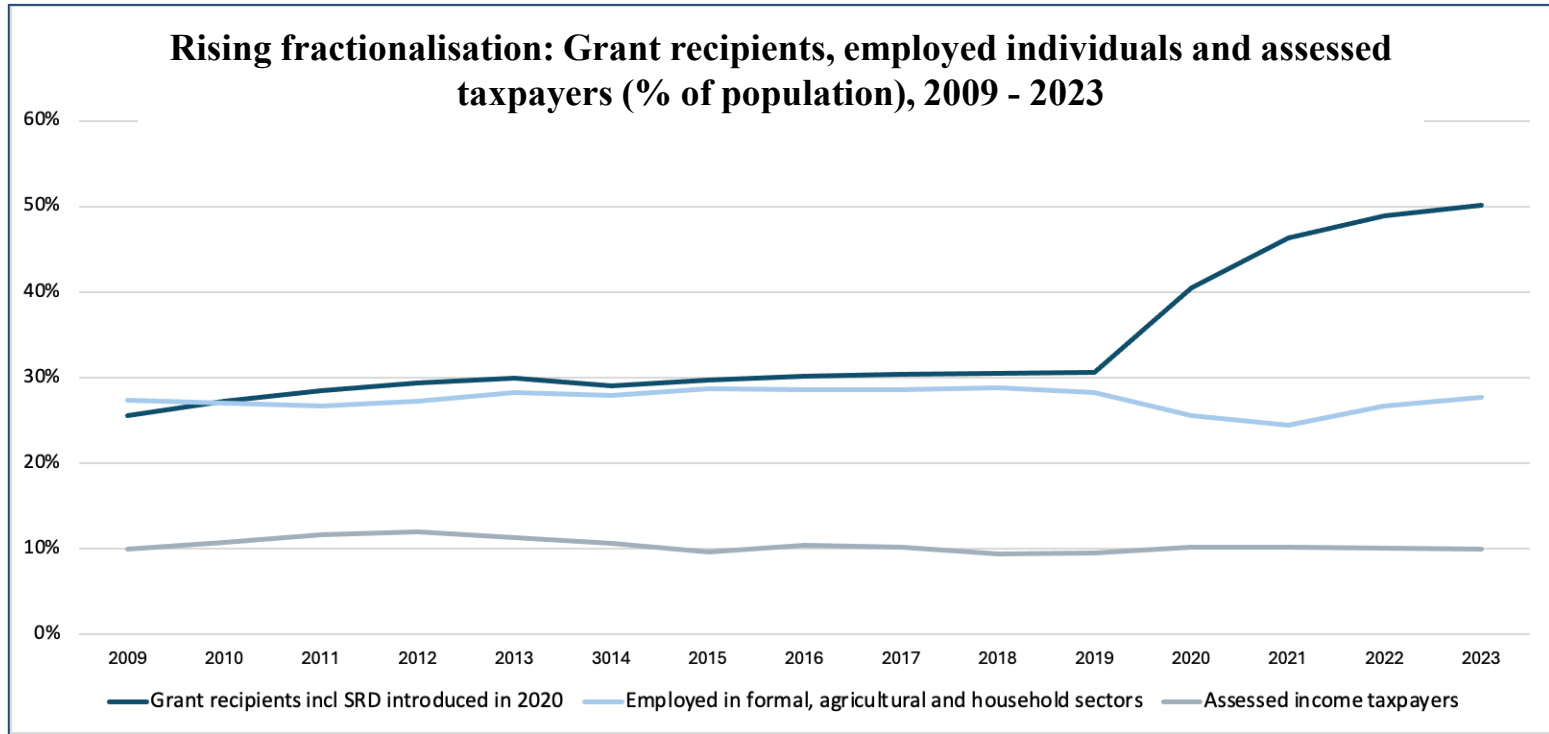
- 38% of total revenue (VAT 25%)
- 3.1 million individuals pay 90% of PIT (total population in SA: 62 million)
- 280 000 PIT payers at the top = social grant expenditures
- Tax Adm. Act (2011): limited taxpayer rights; drafted for enforcement



## Corporate Income Tax

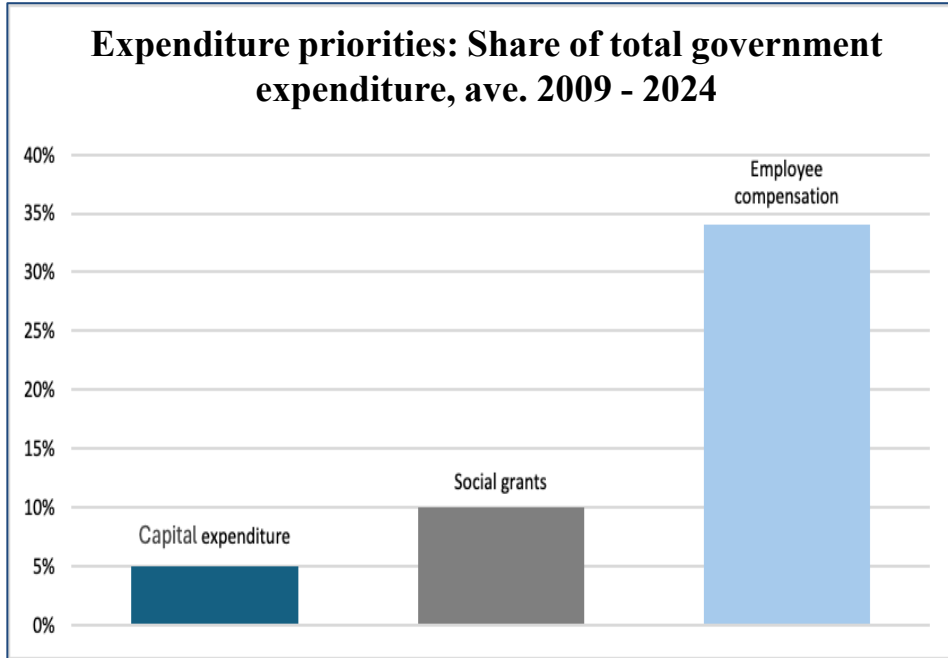
- 20% of revenue → declining
- Reflects stagnating economy → base narrowing
- From 2024, CIT < Debt service cost





Sources: SA Reserve Bank (2024), National Treasury (misc) and SA Social Security Agency (2023)

# Public Expenditure



Sources: National Treasury (misc.) and SA Social Security Agency (misc.)

**Composition of expenditure reflects crowding-out pressures:**

- Pro-poor, pro-growth or pro-elite?
- Context:
  - Politicised and unionised bureaucracy, cadre deployment
  - Preferential procurement, failing SOEs and municipalities
  - Failing service delivery (energy, logistics, water, health, education)
- Rising state debt and cost to service debt; fiscal cliff
- Tax and transfer system diverted from common to elite interest (World Inequality Lab; Hausmann 2023)
- SA a special case (?) - ***negative tax-governance link***
- Back to our question: Prospects for tax bargaining and fiscal social contract in SA?

## 5. Prospects for tax bargaining and a fiscal social contract

# Prospects for tax bargaining and fiscal social contract in SA?

Supportive conditions according to the literature:

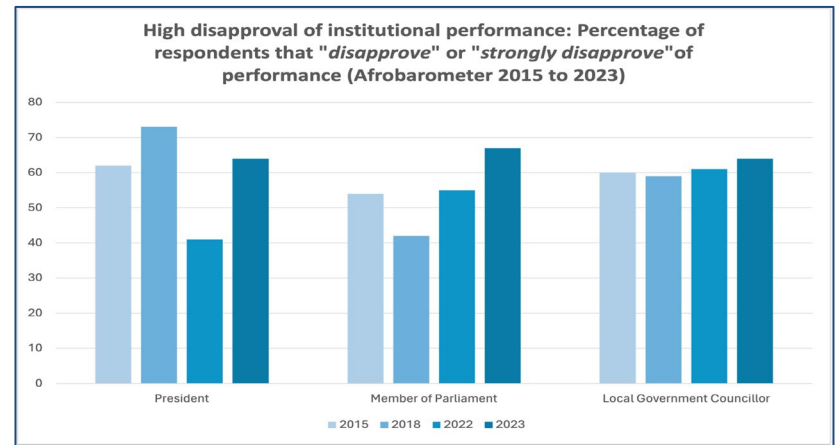
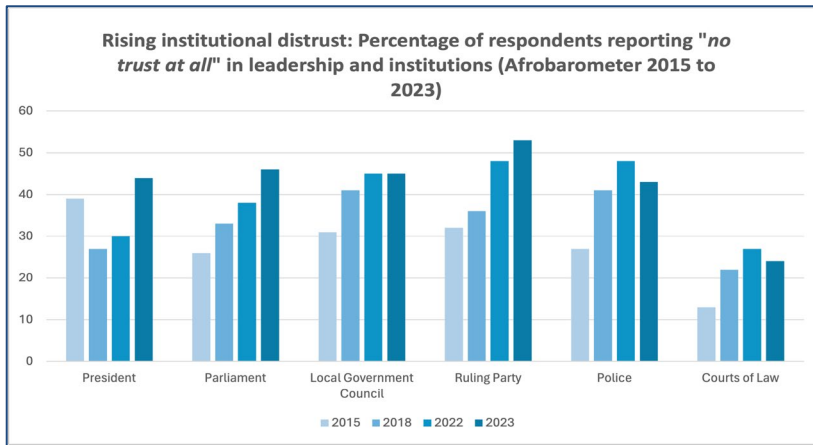
- Tax dominance in state revenue
- Salient taxes with PIT as the major single revenue base
- Salient uses of tax
- Constitution commanding - in principle - executive constraint and accountability
- Conducive institutional environment - in principle - protecting taxpayer rights and rules of enforcement
  
- However: Executive accountability has been systematically eroded and institutional checking mechanisms have been dismantled since 1994
  - Horizontal enforcement of accountability difficult/impossible
  - Vertical, electoral channels have not managed to ‘punish’ unaccountable governance

## **Nature of state-society relations and the social contract:**

- *Transactional social contract*: Conditional compliance
  - Tax reciprocity demanded
  - Mutual responsibilities between the state and taxpayers
  - Taxes in return for public services
- *Norms-based social contract*: Unconditional compliance
  - Based on social values about what one *ought* to do
- SA: Transactional or norms-based social contract?
  - Indicative of people's attitudes: World Value Surveys and Afrobarometer

# State-society relations and the social contract in SA: WVS (2013) and Afrobarometer (2022, 2023) responses

- Rising distrust in and disapproval of leaders, government and institutions



Rise in % of respondents with “no trust at all”. In 2023, distrust in ruling party greater than distrust in opposition parties, raising questions about legitimacy. Ethnic affiliation remains the main determinant of electoral behaviors (Gethin 2020).

High dissatisfaction with performance of leaders and institutions, especially of municipal councillors, reflecting service failures that leave the poor without sanitation, water and electricity.

## **State-society relations and the social contract in SA: WVS (2013) and Afrobarometer (2022, 2023) responses (cont.)**

- >80% of the AB (2023) respondents believe that the President, MPs, civil servants, judges, police, SARS are corrupt and go unpunished
- Low political interest and engagement (< 50% of SAns of voting age voted in 2019 election)
- Low appetite for contestation or collective mobilisation
- Majority of respondents prefer non-elected leader that would provide law and order, jobs and houses over democracy
- Responses indicative of a social contract that is *not transactional*

# Why do South African taxpayers seemingly accept an ‘exploitative’ social contract? Why not tax revolts?

- Effects of social norms
- Internalised commitment to the ‘new’ South Africa
- Coercive rules of tax enforcement
- Limited exit strategies/voting with their feet
  - Though in 2022: Exodus of 6000 taxpayers (Edward Kieswetter 2023)
- Political resistance against tax bargaining
  - Public engagement for the purpose of responsive government and accountability not welcome
  - Will ‘disturb’ entrenched networks of rent seeking and patronage



# Fragmented state-society dynamics: split social contract

Taxes



State → elite transformation, horizontal checking disabled



Grants

## Taxpayers → Transactional social contract

- 7 million taxpayers provide 38% of total tax revenue
- Electorally unimportant
- Salient tax
- Salience in expenditure: awareness of state capture (Zondo 2022)
- Reciprocity: tax and transfer → transformation and inclusion (no engagement and accountability)
- No institutional space for tax bargaining; more coercive enforcement
- Accused of being anti-poor when attempting to engage
- Suits leadership that would not want tax bargaining to disrupt patronage networks

## Grant recipients → Norms-based social contract

- 30 million
- Electorally important
- But low political interest, participation and appetite for contestation
- Yet high expectations from state
- Fiscal system used for elite transformation, maintains exclusion
- Grants are compensation for exclusion (Hausman 2023)
- Grant dependence electorally leveraged, dominates recipient behaviour
- Clientelistic accountability; the poor made complicit in maintaining a system that excludes them

# 6. Conclusion

# Tax-governance links in contemporary South Africa

- 1) The government is dependent on taxes (98% of state revenue), yet government policies over the past two decades have contributed to contract the economy and narrow the tax base
- 2) The bureaucracy is politicised reflected in cadre deployment, extensive corruption, mismanagement and state capture
- 3) Limited institutional space for fiscal bargaining
  - Despite checking institutions, there is a decline in accountability and governance
  - “Taxation without representation” → coercive tax enforcement
  - “Clientelistic accountability”

→ *These features contribute to explain why a positive tax-governance link has not materialised in democratic South Africa*

# Prospects for a fiscal social contract in South Africa?

- Positive:
  - Constitutionalism
  - Salient taxes and salient use of taxes
- Negative:
  - Tax not broad-based and is narrowing, esp. the PIT
  - Institutional environment is not supportive to engage in tax bargaining
    - Edward Kieswetter (7 Feb 2023): “*The risk of a tax revolt in South Africa is always present*”
  - Non-transactional nature of state-society relations and the social contract
    - Edward Kieswetter (7 Feb 2023): “*While it is not sustainable to have 29 million people on social grants, it is a safety net that protects people from destitution and even demise*”

Thank you for your  
attention!



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