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UNIVERSAL BASIC INCOME GUARANTEE FACTSHEET SERIES

"BUT HOW WILL WE PAY FOR IT"?

Financing a UBIG

An important question in the discussion of a UBIG in South Africa is how much it will cost and how the government will pay for it. In general, governments have three ways they can finance new programmes like this: (1) they can raise taxes, (2) they can borrow (that is take on more debt), or (3) they can reallocate public spending from one item to another. Governments have the choice of focusing on one, or a combination of these options. Further, when assessing the cost of any budgetary item, it is important to take into account both the gross and the net cost. The gross cost is the actual amount of money that government budgets for the programme. The net cost, however, is this gross cost minus the money that flows back to the government as a result of the programme, in this case the UBIG.

What is the gross cost of a UBIG?

A UBIG paid to all adults between the ages of 18 and 59 at the level of the Food Poverty Line (FPL) of R624 per month would have a gross cost of R255 billion per year.[1] However, this number assumes that everyone who qualifies will take the grant up. Contrary to this, research shows that a significant portion of the population is likely to opt to not receive the UBIG, usually because they have alternative income sources.[2] We can assume, based on historical uptake of other grants, that only 60% of those eligible will opt in to receiving the grant initially, improving to 80% over time. If the UBIG is taken up by 60% of adults it would cost about R153-billion per year (or around 7% of the 2022/23 government budget) and at 80% uptake it would cost about R204-billion per year (or around 8% of the projected 2025/26 budget).

THE FOUR ELEMENTS OF A UBIG

- **UNIVERSAL** – applies to all adults.
- **BASIC** – covers basic necessities.
- **INCOME** – a regular cash benefit.
- **GUARANTEE** – provided as a right.

What are the benefits that offset the cost of a UBIG?

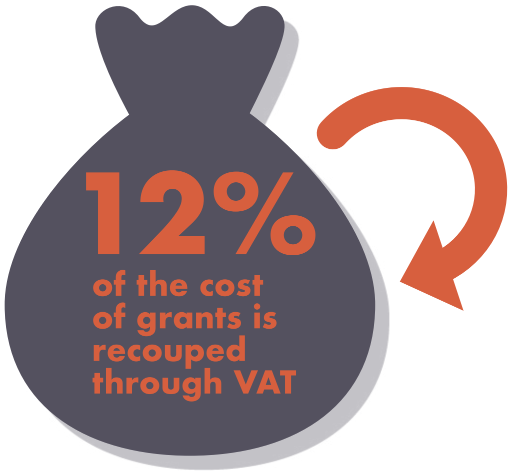
This upfront cost still tends to give an exaggerated picture of the financing requirement for a UBIG. A significant amount of money is directly returned via VAT, and other taxes set aside as a direct 'clawback' for the UBIG. Further, the UBIG should be understood as a form of investment or "stimulus" that promotes economic activity and creates new government revenue.

Put simply, the government makes some of the money back, as a result of the economic activity that putting large amounts of money into poor communities generates (the "multiplier" effect). If we consider the benefits of a UBIG to government as a deduction from the gross cost, we see that a UBIG has a much lower fiscal impact overall.

The latest research on the use of the COVID-19 Social Relief of Distress (SRD) grant shows that people use it to purchase food and basic necessities.[3] That means they spend a significant portion within their local economies. Research from StatsSA shows that the bottom 70% of spenders, spend 81% of their disposable income on items which carry VAT, the tax paid to government on goods and services. This means that about 12% of the money spent on grants is recouped through VAT. As a result, if there is an 80% uptake of a grant set at R624 a month, government would recoup about R24-billion from VAT alone.

In addition to being partially recouped through VAT, government spending on UBIG flows back into government revenue in other ways through increased local economic activity. People with lower incomes spend more of their income on goods produced in South Africa than people with higher incomes, and they also spend more near where they live. When people spend more money in their local economies, local businesses grow. That means that the incomes of small business owners and entrepreneurs goes up, and businesses employ more people.

This added business, income and employment all contributes tax to the government, helping to offset the gross cost of the UBIG. This is often referred to as the "multiplier effect". This positive ripple effect through the economy is well supported by international evidence.



How can we pay for the net cost of a UBIG?

Even taking into account the above, the government would need to finance the net cost of the UBIG, which would still be significant.

Ideally, the government would pay for most of the UBIG with tax revenue, and would limit the amount of extra debt it takes on for this purpose. Further, while financing could draw on a degree of reallocation of expenditure, and reduction of wasteful spending, this should not be done in a manner which undermines provision of public services — which need to be expanded, and not cut.

Not all forms of taxation are the same. Some taxes eat up a large share of the income of poor people (called regressive taxation). An example of this is VAT. If a UBIG was paid for by increasing regressive taxes, this would cancel much of its poverty alleviating benefits. On the other hand, taxes that target the wealthiest people and companies, or that require wealthy people to pay proportionately more than poor people (called progressive taxation[4]) can be effective at redistributing income to poor households — as long as they can be sustained and administered. Studies also find that regressive taxation such as VAT have negative growth, equity and employment effects.[5]

Progressive taxation is the best option for funding a UBIG in South Africa to achieve poverty alleviation and inclusive economic growth which uplifts the poorest. While some critics claim that this will overburden a shrinking number of taxpayers in South Africa, it would actually help to grow the tax base by giving millions more people the means to participate in consumption, business and work. In addition, a recent study by economists found that while higher earners are paying more income tax in absolute terms, their income has increased more than their income tax payments.[6] Therefore, despite claims that South African taxpayers are overburdened, there is scope to increase tax for the wealthy and high-income earners.

There are many options for introducing progressive taxes in South Africa. One important funding mechanism is a *social security tax* (SST). This functions as a "clawback" mechanism to cross-subsidise the UBIG, which means that although everybody pays the tax, people pay it at different rates depending on their income. High income earners pay more in SST than they receive in UBIG benefits, and lower- or middle-income earners, while contributing something, would receive a benefit from the UBIG. The social security tax would cover around 25% of the cost of a UBIG.[7]

Taken together, the revenue directly generated by a UBIG, combined with a progressive clawback from higher-income earners through an SST, and an anticipated lag in uptake in the short- to medium-term overall, will result in a net cost of as low as 50% of the gross cost. Studies have shown that this cost could be covered by progressive taxation. International evidence shows that progressive income tax, corporate taxes and taxes on wealth are better at redistributing and improving incomes for poor households than regressive forms of tax such as VAT. They are also better at promoting increased employment and economic growth.

What other taxes can we use?

Additional sources of revenue would still be needed to finance a UBIG beyond a social security tax. Introducing a UBIG would require a careful rebalancing of the taxation system that is phased in over time, including the removal of measures that currently disproportionately benefit the wealthy.

In South Africa, a large amount of wealth is tied up in things like assets, savings and land, which are currently undertaxed especially amongst the extremely wealthy. In addition, tax breaks and credits related to medical insurance and retirement fund contributions subsidise wealthy people with little to no policy benefit. This all has the effect of syphoning money upwards, and increasing inequality.

Options which could target runaway inequality to fund a UBIG include:

- **A wealth tax:** Researchers have shown that a wealth tax on the wealthiest 1% of the population — just 340,000 people — could raise up to R143-billion a year, but this could take several years to implement.[8]
- **A VAT on luxury goods:** The IEJ has shown that a higher rate of VAT on luxury goods of 25% would raise an average of R9-billion annually.[9]
- **A reduction in government subsidies on pension fund and retirement fund assets:** Research estimates subsidies on pension fund contributions to be R87 billion, while subsidies on the return on investments of retirement fund assets are estimated to be R46 billion. This is a total subsidy of R133-billion on retirement fund benefits alone, much of which is to wealthier South Africans. A significant portion of this could instead be used to benefit poor households.[10] The same holds true with medical aid subsidies, although the amounts are generally lower.
- **A Financial Transactions Tax (FTT) and Resource Rent Tax (RRT):** A FFT set at 0,1% of financial transactions could achieve R41 billion annually, and a RRT could raise over R38 billion per year.
- There are **various other** financing options that have been proposed for consideration.

Collectively, these and other sources of revenue, including a reduction in wasteful and irregular expenditure, could be used to finance the UBIG. The IEJ financing policy brief offers 18 financing options — see full details here[11] — which if appropriately selected and sequenced, could finance a variety of UBIG models.

What does affordability really mean?

The question of "affordability" in the context of government finances is not just technical, it is also political. It requires the government to make decisions about what should be prioritised — whether it is realising everyone's right to live with dignity now, or reducing public expenditure and debt as fast as possible.

While a UBIG does present a significant fiscal cost, there is also a heavy price tag that comes with not doing anything. That cost is borne by the poorest, in the form of trauma, malnutrition and the theft of their agency and opportunities, but it is also borne by the government in the form of a shrinking tax base, a stagnating economy and inevitable social instability. We saw this danger in the July 2021 looting and continue to see it in the ongoing low intensity destruction of infrastructure in communities.[12]

Without taking bold action now, the country will find itself in a position we are even less able to afford in the long run. A UBIG is feasible and affordable without compromising South Africa's fiscal position, and without cutting spending on public services or on existing grants.

The IEJ is currently working on modelling alternative pathways and scenarios to transition to a UBIG over the short to medium term. This work will be the subject of a forthcoming factsheet.

Endnotes

1. Note: calculations and data in this factsheet are from the IEJ July 2021 Financing policy brief, unless otherwise stated.
2. Institute for Economic Justice. 2021. Financing options for a Universal Basic Income Guarantee in South Africa. *Social Protection Series Policy Brief #2*
3. Department of Social Development. July 2021. The Rapid Assessment Of The Implementation And Utilisation Of The Special Covid-19 SRD Grant.
4. For more on progressive taxation see: ActionAid. October 2018. Progressive Taxation Series.
5. ITUC. 2021. Investments in Social Protection and their Impacts on Economic Growth: Tax Financing Options.
6. Goldman, M. and Woolard, I. 22 June 2022. How effective is income tax in reducing inequality in SA? Econ 3x3.
7. For more details on this see: IEJ. July 2021. Financing Options for a Universal Basic Income Guarantee in South Africa. Social Protection Series Policy Brief #2
8. Chatterjee, A. Gethin, A. and Czajka, L. 28 April 2020. Coronavirus: why South Africa needs a wealth tax now. The Conversation.
9. IEJ. July 2021. Financing Options for a Universal Basic Income Guarantee in South Africa. *Social Protection Series Policy Brief #2*
10. Van den Heever, A. 30 January 2022. Is opposition to basic income support for vulnerable adults informed by evidence or ideology? Daily Maverick.
11. www.iej.org.za/wp-content/uploads/2022/09/FINAL-IEJ-policy-brief-UBIG-july2021.pdf
12. See Coleman, N. 29 September 2022. Basic income grant is needed to avert social upheaval. Institute for Economic Justice.

Visit our special UBIG portal by scanning the QR code

Read more in the IEJ's Policy Brief: Financing Options for a Universal Basic Income Guarantee in South Africa, and the IEJ's Working Paper: Can a Universal Basic Income Contribute to Breaking Structural Poverty in South Africa?, and accompanying Annotated Bibliography.

This factsheet is part of our series on the universal basic income guarantee (UBIG) in South Africa.

Factsheets in this series are:

1. **Why does South Africa need a Universal Basic Income Guarantee?**
2. **No one left behind: Why universal basic income makes more sense than targeted grants**
3. **Jobs versus Grants: Are employment and basic income a policy trade off?**
4. **How a UBIG can support healthier kids, happier adults, and lifelong learning**
5. **How a UBIG can advance gender justice and social cohesion**
6. **Not just a handout: How a UBIG gives people the power to prosper**
7. **"But how will we pay for it?" Financing a UBIG**

Forthcoming factsheets in this series will focus on:

- **Modelling pathways to a UBIG**
- **UBIG and the rising cost of living**
- **UBIG and the just transition**

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