

TESTIMONY of Jennifer Davis,  
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American Committee on Africa

Committee on Ways and Means  
House of Representatives  
July 8, 1987.

Mr. Chairman, I want to thank you for the opportunity to testify today in favor of HR 1005 which seeks to deny foreign tax credit for any tax paid or accrued to the Republic of South Africa. Such action would be a significant further step on the road to ending apartheid, a road on which Congress placed its feet firmly with the 1986 passage of the Anti-Apartheid Act. I am executive director of the American Committee on Africa, which has been informing Americans about the struggle for African self-determination and freedom since its founding in 1953.

The struggle for freedom in South Africa faces new challenges today in face of the continued intransigence of the white minority government and its refusal to abandon apartheid. People inside South Africa have faced escalating repression as they have sought to build a democratic movement. I do not need to detail the South African government's actions in this body: the detention and torture of thousands, including children as young as ten and eleven, trade unionists, community activists; "treason trials" and the prohibition of meetings and even public funerals, the banning of publications and organizations.

The people of South Africa have long called on the international community to aid them in their struggle for freedom. The late Dr. Martin Luther King Jr. and the late Albert Lutuli, President of the African National Congress, both men Nobel Peace Laureates, issued a joint appeal for action in 1962 "We...ask men of good will to take action against apartheid in the following manner:...Don't buy South Africa's products; Don't trade or invest in South Africa." Another Nobel Peace Laureate, Archbishop Desmond Tutu, has also called for strong international action.

Under South African law, any person who advocates divestment or disinvestment is guilty of subversion for which the penalty is up to 20 years in prison. Despite this danger, trade unions, the religious community, political organizations, civic groups and others continue to call for divestment and sanctions, and at home, unions have called on employers to stop deducting taxes from employees, demanding an end to taxation without representation.

In December 1985, the then newly formed Congress of South African Trade Unions (COSATU) -- the largest labor federation in South Africa's history with a membership of 650,000 Black trade unionists -- declared its full support for divestment. And the National Union of Mineworkers, in early 1987, passed a resolution reaffirming "its support for all forms of international pressures, including sanctions and disinvestment."

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Last year, the U.S. Congress took an historic step by passing the Anti-Apartheid Act which imposed a series of economic sanctions against South Africa. As part of those sanctions, Congress prohibited most new investment in South Africa and revoked the tax treaty between South Africa and the U.S. However, U.S. companies can still claim credit against their U.S. taxes for those paid in South Africa. Cutting of these tax credits would have a quadruple effect.

1] It would send a clear signal of intent to the apartheid regime that the U.S. Congress is still deeply concerned to find peaceful ways of eliminating apartheid, and provide continuing encouragement to democratic South Africans.

2] It would add to the pressure already being exercised under the Anti-Apartheid Act on U.S. corporations to cut off all business links with South Africa.

3] It would thus help deprive the apartheid regime of a flow of funds, much of which might on average, be devoted directly to police and military repression and the implementation of apartheid.

4] It would have some revenue enhancing effect in the U.S.

As of 1985, total U.S. economic involvement in South Africa, including direct investment, bank loans and shareholdings, totaled some \$8.5 billion. About 250 U.S. companies have direct investment in South Africa of \$1.3 billion and many others conduct business through licensing and franchising agreements. Before I deal more extensively with the general economic and political arguments for cutting all economic links to apartheid South Africa, let me seek to provide some estimate of the financial values involved in the payment of taxes.

Figures for the amount of taxes paid to South Africa and income tax credits claimed are compiled in even years by the Internal Revenue Service's Statistics of Income division - Foreign Returns and Analysis Section. These figures are based on actual tax returns. The 1984 statistics are not yet available and are not expected before the end of the year, but it is possible to compute working estimates of the dollar values involved.

Taxable income of U.S. affiliates from South Africa in 1980 was \$493,551,000 and \$440,780,000 in 1982. Taxes paid or accrued and deemed paid to South Africa, including Namibia, was \$228,927,000 in 1980 and \$211,593,000 in 1982. This would imply an effective tax rate of about 46% in 1980 and 48% in 1982.

Although country specific information is not available, in both 1980 and 1982 about 83% of total foreign taxes paid were claimed as credits against U.S. tax. This would suggest that the tax credits claims for South Africa (and Namibia) was \$190,011,000 in 1980 and \$175,622,000 in 1982.

Figures are also kept by the Department of Commerce's Bureau of Economic Analysis. The BEA figures are based on survey information, and because different definitions are used, are not directly comparable to those of the IRS, but are again useful as confirming the overall parameters within which we appear to be operating. For example, according to figures

published by BEA, South African Nonbank Affiliates of Nonbank U.S. Parents in 1982 had net income of \$509,000,000 and paid income taxes of \$373,000,000.

The BEA figures for 1983, 1984 and 1985 are only available for majority owned (more than 50%) Nonbank Affiliates of Nonbank U.S. Parents.

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South African Income and Taxes Paid  
by  
Majority Owned Nonbank Affiliates  
of Nonbank U.S. Parents  
(Millions of dollars)

|                       | 1982 | 1983 | 1984 | 1985* |
|-----------------------|------|------|------|-------|
| Net Income After Tax  | 283  | 388  | 262  | 148   |
| Income tax paid       | 263  | 272  | 293  | 227   |
| Net Income Before Tax | 546  | 660  | 555  | 375   |

\* preliminary

Source: BEA.

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This would imply an effective tax rate of 41% in 1983, 52.7% in 1984 and 60.5% in 1985. Such estimates are rough approximations. The breakdown of foreign tax paid by type of industry is not available for any year after 1982, but net income by industry for those years is available, allowing some extrapolation to provide estimates of the taxes paid in each category.

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Net Income South African  
Majority Owned Nonbank Affiliates of U.S. Parents  
(millions of dollars)

|       | All Industries | Petroleum | Manu-<br>facturing | Wholesale<br>trade | Finance<br>(except<br>banking),<br>insurance,<br>& real estate | Services | Other<br>Industries |
|-------|----------------|-----------|--------------------|--------------------|--|----------|---------------------|
| 1983  | 388            | 125       | 153                | 197                | 2  | 11       | #                   |
| 1984  | 262            | 94        | 98                 | 59                 | 4  | 4        | 3                   |
| 1985* | 148            | 75        | 43                 | 13                 | 5  | 3        | 8                   |

# less than \$500,000

\* preliminary

Source: BEA

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The last year for which BEA has published a breakdown of taxes paid by types of industry is 1982. These figures include all South African affiliates 10% or more owned by a U.S. parent.

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1982 Taxes of South African Nonbank  
Affiliates of Nonbank U.S. Parents  
(millions of dollars)

|                |           |                    |                    |  |          |                     |
|----------------|-----------|--------------------|--------------------|--|----------|---------------------|
| All Industries | Petroleum | Manu-<br>facturing | Wholesale<br>trade | Finance<br>(except<br>banking),<br>insurance,<br>& real estate | Services | Other<br>Industries |
| 373            | (D)       | 188                | 55                 | 4  | 17       | (D)                 |

(D) = suppressed

Source: BEA

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It should be noted that the BEA figures do not include banks. This means that Citicorp, a major U.S. investor, which recently announced its intention to withdraw from South Africa, does not show up in the figures. It is worth noting that the continuing political crisis in South Africa, coupled with a severe recession and escalating pressure in the U.S. has led to an increasing U.S. corporate exodus from South Africa. More than 70 U.S. companies ended their direct investment in South Africa in 1985 and 1986, and the trend continues. Figures for foreign income and taxes paid in South Africa can also be expected to decrease. Further, because of the drop in the value of the Rand, profits in dollar terms are also lower even if, in Rand terms, profits have remained unchanged. Profits in South Africa have also generally been down in the years since 1982, a period of severe recession. Recent reports indicate that profits may again be on the rise, but the trend is not yet clear.

The figures cited by BEA are incomplete. Thus taxes on the petroleum sector are suppressed as are the figures for "other industries." Thus \$112,000,000 is not apportioned to a category. It seems reasonable to assume that the largest category would be for oil, an indication of the continuing vital role of companies such as Mobil, the largest U.S. investor in South Africa.

To sum up, in the first three years of this decade, U.S. corporations earned estimated incomes of over one billion dollars, paid well over half a billion into Apartheid's treasury, and earned some half billion dollars in credits from the U.S. treasury for making such payments.

It is worth pointing out that many U.S. companies have received investment incentives from South Africa. Again, according to BEA, 116 companies received tax concessions, 56 tariff concessions, 42 received subsidies and 29 received other incentives in 1982. All this is an indication of South Africa's eagerness to have continued U.S. investments flowing into its system.

### The Role of U.S. Investment

There is extensive documentation on the role of U.S. investment in apartheid South Africa, which I will summarize only briefly.

As long ago as January 1978, the Senate Subcommittee on Africa issued a report declaring: "The net effect of American investment has been to strengthen the economic and military self-sufficiency of South Africa's apartheid regime."

U.S. computer companies, including IBM, Unisys and Control Data dominate the computer market. The single largest user of computers in South Africa is the white minority government, which accounts for 25% of all sales. The white controlled economy, from the gold mines to the banks, relies heavily on U.S. computers. "South Africa really needs U.S. companies in certain industries, particularly high tech industries and computers," noted an IBM representative in 1984.

South Africa also relies heavily on foreign corporations to refine and distribute petroleum products. Chevron, Texaco, Mobil and Shell dominate the market -- controlling more than half of all filling stations. They also refine crude oil and are legally required to sell to the police and military. Mobil's investment of over \$400 million makes it the single largest U.S. investor in South Africa.

Under the National Key Points Act, all companies -- including foreign multinationals -- can be forced by the government to provide armed security of their facilities under the supervision of South Africa's defense forces. This legislation effectively makes all corporations extensions of the state. U.S. corporations argue that foreign investment is a positive force for change in South Africa. If this were true, South Africa should have witnessed steadily improving conditions since the commencement of U.S. investment. In reality, neither U.S. presence nor increased involvement has prevented the growth of the repressive apparatus of the apartheid state -- rather, it has actually contributed to its growth.

Between 1960 and 1981, the level of U.S. investment in South Africa increased ninefold. Yet during that same period the South African government expanded and entrenched its repressive apartheid system. In that same period, the government forcibly removed more than 3.5 million Blacks from "white areas" to areas designated for Blacks, and throughout the period Blacks were prevented from acquiring any meaningful political rights.

### Paying Taxes to South Africa

There is something particularly objectionable about providing tax credits for money paid to the South African Treasury.

Even a cursory examination of the South African Budget reveals the extent to which such income would be used to maintain the apartheid system, paying the police and soldiers who are now occupying Black townships or terrorizing Black schoolchildren.

Several points should be stressed when assessing the South African budget. Spending for defense has increased dramatically over the past 15 years and official figures do not begin to reflect the money allocated to maintaining apartheid in South Africa and destabilizing neighboring countries. Many of the costs of defense are deliberately hidden in the budgets of other sectors of the government. Moreover, the South African government consistently underestimates its budget by an average of 7%, and the distribution of this additional 7% is not specified in official statistics. **Even more important, while the government is spending increasing amounts on repression, it still is unable to meet all of its needs.** Until the economy began picking up recently, money allocated to the defense forces went mainly to operating costs, with little left over for modernizing and replacing equipment.

In the period from 1971 to 1981, the defense budget increased by 860%, to a total of R2,465 (\$2,810) million in 1981. In the years following, as shown below, there has been a steady increase in defense spending. The total estimated expenditures for defense for 1987-88 is R6,683 (\$3,007) million. The army, which is largely responsible for controlling the population of South Africa, now receives 39.2% of the defense budget.

|         |       |
|---------|-------|
| 1981-82 | 30%   |
| 1982-83 | 8%    |
| 1983-84 | 15.9% |
| 1984-85 | 21.4% |
| 1985-86 | 13.5% |
| 1986-87 | 19.2% |
| 1987-88 | 31%   |

Expenditures on the police force have also been increasing steadily. As shown below, the police budget has almost doubled in the past four years, from R795.64 (\$541.03) million in the 1984-85 budget to R1,530 (\$688.50) million in the 1987-88 budget. The 1987-88 budget represents the greatest leap, an increase of 42.9% over the previous year's budget.

| <u>Year</u> | <u>Million R</u> | <u>Million \$</u> | <u>R % increase</u> |
|-------------|------------------|-------------------|---------------------|
| 1984-85     | R795.64          | \$541.03          |                     |
| 1985-86     | R954.71          | \$429.62          | 19.99%              |
| 1986-87     | R1,071.00        | \$471.29          | 12.18%              |
| 1987-88     | R1,530.00        | \$688.50          | 42.9% .uj on        |

Note: \$ to Rand conversions are approximate as the rates have varied extensively in parts of the period referred to.

There are a number of other government departments which also contribute directly to the apartheid system. Custody and administration of justice, including the prison and court systems, has increased 29.6% in the last year to R917 (\$412.65) million. The category of "protection services" listed as "other" has increased 74% to R288.4 (\$129.78) million. The Ministry of Cooperation and Development has also experienced budget increases, from

R1,924.43 (\$865.99) million in 1984-85 to R2,348.37 (\$1,056.77) million in 1985-86. Statistics on the budget of the Ministry of Cooperation and Development for 1986-87 and 1987-88 are not listed separately. Adding the budgets for these departments to that listed under defense brings the total from R6,683 (\$3,007) million to R11,766.4 (\$5,294.88) million.

More importantly, the South African government hides much of its defense expenditures in other budgets. For example, official statements have pointed to substantial increases in expenditures on education as proof that the government is committed to reform. Indeed, expenditures on education rose 19.3% in 1986, and most of the increases were allocated to black primary and secondary schools. Another 19.6% increase in the budget for education was introduced in the 1987-88 budget, bringing educational costs to R9,100 (\$4,095) million. 40% of the budget increase was allocated to black education. **What is not mentioned is that the expenses of the troops occupying black schools are paid from the education budget.**

Similarly, there have been reports that a large chunk of military expenditure was also concealed in Namibia's budget allocation. The expenses of the troops which patrol the borders of South Africa, and which are largely responsible for the raids on neighboring states, are paid from the budget of the Department of the Interior. The purchase and maintenance of any buildings or structures used by the military, which in 1985-86 cost R133 (\$59.85) million, comes under the budget of the Department of Public Works and Land Affairs. The Atomic Energy Board, responsible for both military and non-military uses of nuclear technology, had a budget of R776 (\$349.2) million in 1986-87, up 47.5% from the previous year's budget.

Mr. Chairman, I would like to be able to prove incontrovertibly to the members of this committee that if you took this action today, apartheid would collapse tomorrow.

We all know that is not true. But there is increasing evidence that the international pressures being exerted on apartheid are having a significant impact on critical sectors of the white community. In December 1986 Finance Minister Chris Stals went so far as to say that "if the world banking community should effectively exclude South Africa from international trade and payments systems...It would put us on the barter system overnight. That is the muscle they have on their side."

U.S. action last year triggered or accelerated extensive international action against apartheid. Twenty-five industrialized democracies have now imposed various economic sanctions against South Africa, according to the U.S. State Department. Common sanctions imposed by South Africa's trading partners included: a ban on new investments in South Africa by 20 countries; a ban on imports of gold coins (Krugerrands) by 18 countries; a ban on imports of South African iron and steel by 17 countries and a ban on new loans to South Africa by nine countries. New action by Congress could have an important impact, in South Africa and internationally -- carrying the message that this House will not rest until Apartheid is overthrown.

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### Sources:

Financial Mail, (Johannesburg), various dates.

Quarterly Bulletin, South African Reserve Bank, June 1987

Survey of Current Business, U.S. Department of Commerce, Bureau of Economic Analysis (various dates)

U.S. Direct Investment Abroad: 1982 Benchmark Survey Data, U.S. Department of Commerce, Bureau of Economic Analysis, December 1985.

Phone conversations with Internal Revenue Service and the Department of Commerce, Bureau of Economic Analysis (June, July 1987)

### Notes and explanations

Exchange rates used are:

|             |                  |        |           |        |
|-------------|------------------|--------|-----------|--------|
| <u>R1</u> = | 1987.[estimate]. | \$0.45 | 1984..... | \$0.68 |
|             | 1986.....        | \$0.44 | 1981..... | \$1.14 |
|             | 1985.....        | \$0.45 |           |        |

The Bureau of Economic Analysis collects information on the following categories. 1) All Affiliates of All U.S. Parents; 2) Nonbank Affiliates of Nonbank U.S. Parents and 3) Majority Owned Nonbank Affiliates of Nonbank U.S. Parents. The amount and type of information varies according to the category. The first category includes all affiliates 10% or more owned by a U.S. parent. The second is the same as the first but it excludes banks, both if the U.S. parent is a bank or if the South African affiliate is a bank. The third category is the same as the second, but it includes only those that are majority (more than 50%) owned.

There are numerous differences in how the BEA and the IRS compute their figures, which is why the two sets of figures are not directly comparable. The IRS data are based on figures from actual tax returns, while BEA reports use generally accepted accounting principles, the standard used in stockholder reports. The two methods of accounting result in significantly different figures for both revenue and expenses. For example, BEA and IRS calculate the rate of depreciation differently and they come up with different income figures. BEA and the IRS also have different definitions of income. Because BEA looks at income from the point of view of the U.S. parent, it includes interest from intercompany debt in calculating income and subtracts foreign withholding taxes and dividends on remittances to the U.S. parent. How the change in the exchange rate affects the value of assets is also handled differently. When the exchange rate goes down, as it has in the past few years, BEA treats the decline in the dollar value of the foreign assets as a capital loss, but the IRS does not. All the above items have a significant effect on the foreign income figure.

The BEA and the IRS have different definitions of income and income tax paid. BEA's figures are larger because they include the total income and income tax paid by foreign affiliate (as long as that affiliate is 10% or more owned by a U.S. parent). The IRS figure for "taxable income of foreign affiliates" and "income tax paid" only includes the amount attributable to the U.S. parent, or essentially the U.S. parents share.