Response to public hearings on the 2019 Budget fiscal framework and revenue proposals

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

National Treasury officials

- Ian Stuart – Acting DDG Budget Office
- Duncan Pieterse – Acting DDG Economic Policy
- Debra Makwiramiti – Senior Policy Analyst
- Chris Axelson – CD Economic Tax Analysis

List of organisations that made submissions for public hearings on the 2019 Budget

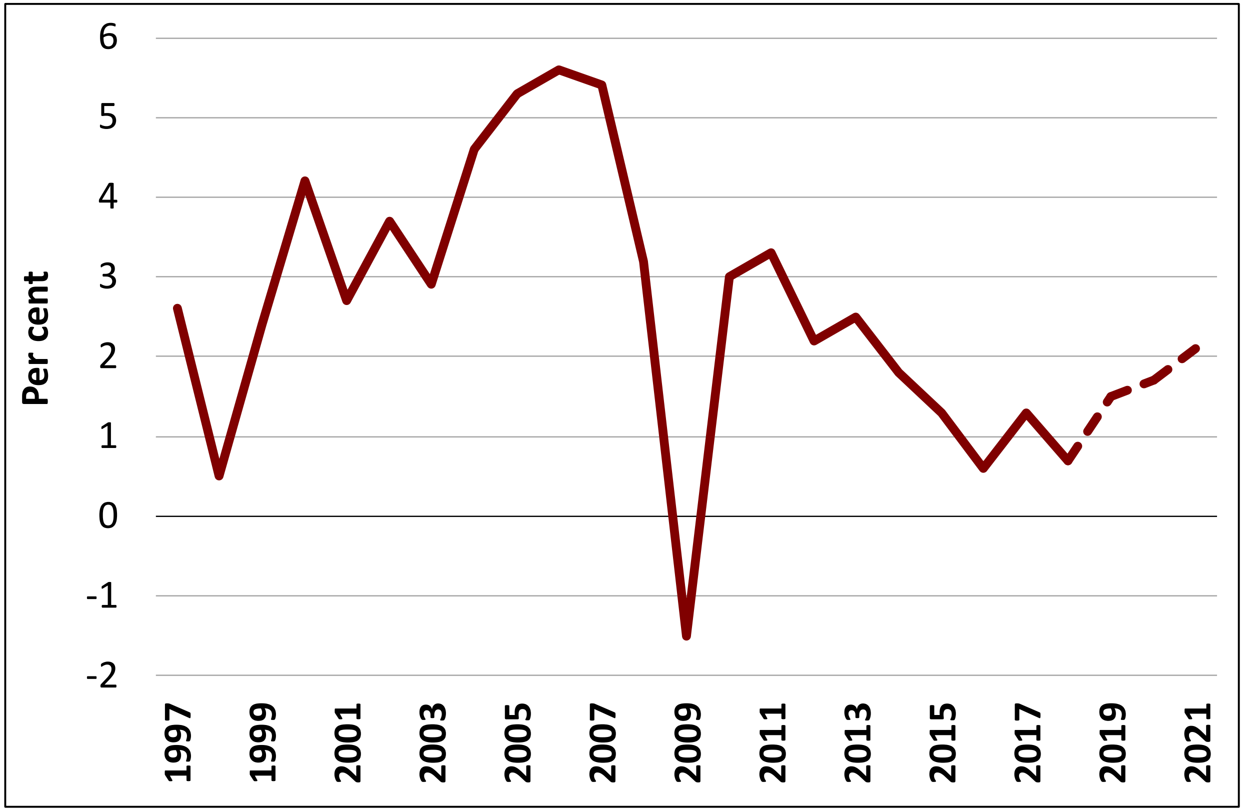
- Budget Justice Coalition
- Civil Society submission on combating gender-based violence
- Congress of South African Trade Unions (COSATU)
- Fiscal Cliff Study Group
- Parliamentary Budget Office
- Pietermaritzburg Pensioners Forum
- PricewaterhouseCoopers (PwC) Tax Services (Pty) Ltd
- Priority Cost Effective Lessons for Systems Strengthening South Africa (PRICELESS SA)
- South African Institute of Tax Professionals (SAIT)
- The South African Insurance Association (SAIA)
- The South African Institute of Chartered Accountants (SAICA)

Main comments from public hearings

1. Fiscal policy stance
   - Spending limits: too austere, or too lax?
   - Tax mix for growth and progressivity
   - Limits of higher taxation (e.g. Laffer Curve; declining tax-to-GDP ratio)
2. Economic growth and revenue forecasts
   - Medium-term GDP forecasts, and interventions to raise growth
   - Tax buoyancy
3. Specific tax matters
   - Carbon tax implementation date
   - Impact of fuel levy on paraffin, LPS and biofuels;
   - Clarity on VAT refund figures
   - Policy of retrospective amendments
4. Specific budget matters
   - Early retirement intervention and service delivery
   - Financial support for Eskom
   - Doubling of the December old-age grant
   - Subsidisation of insurance premiums for emerging farmers

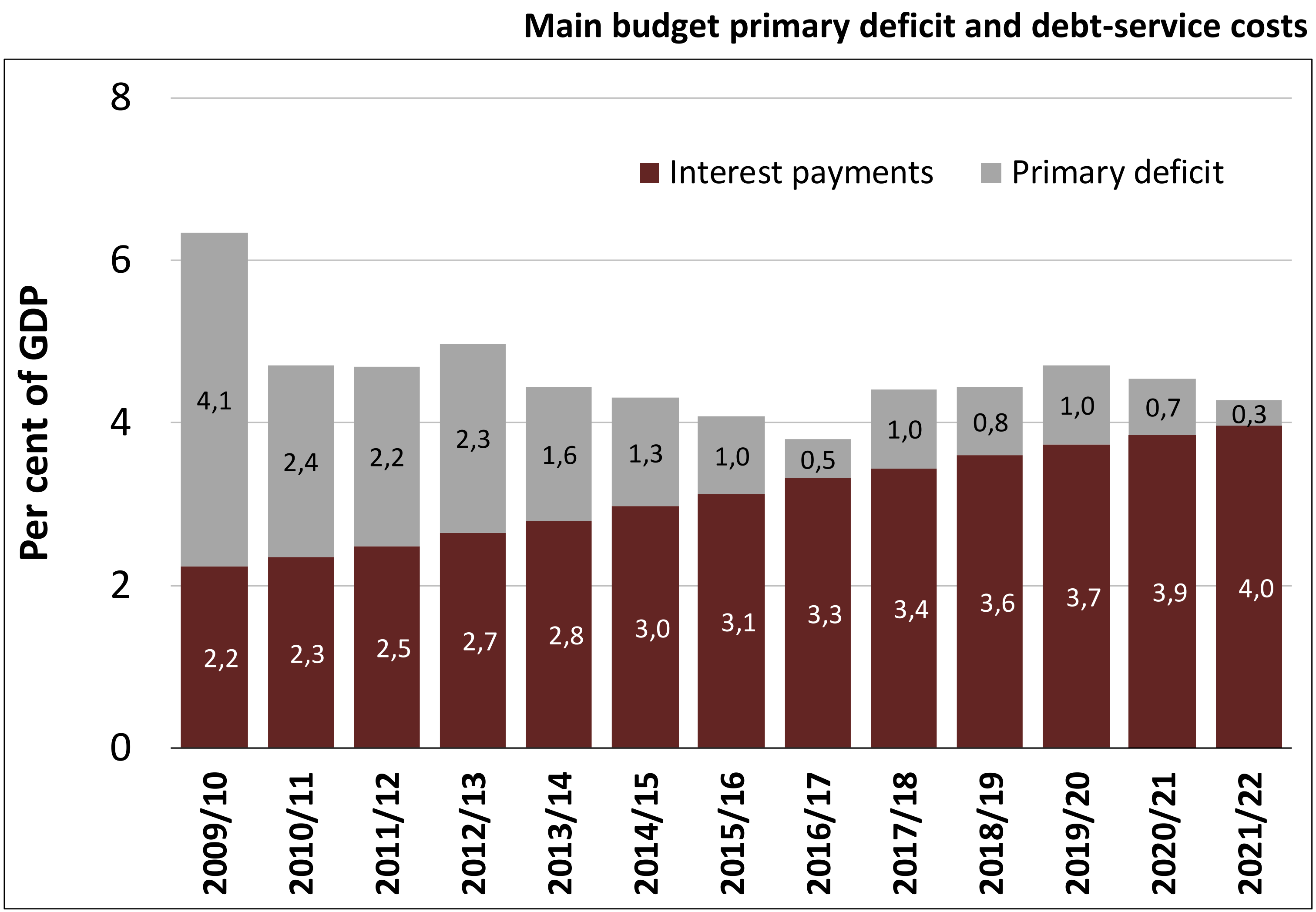
Economic growth has been subdued over the past decade

Real GDP growth, 1997 – 2021

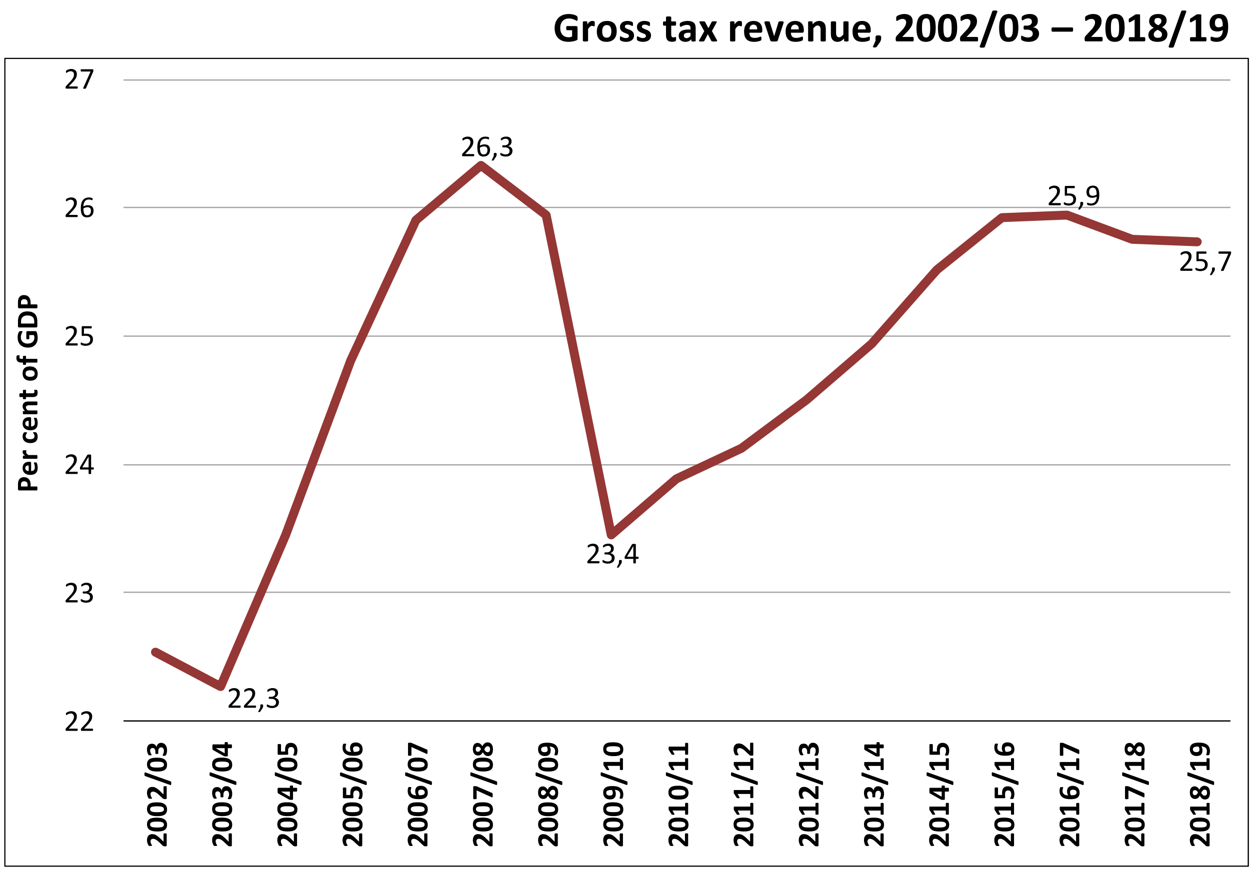


- Real GDP growth estimated at 1.5 per cent in 2019, down from 1.7 per cent in the 2018 MTBPS
- Growth in our major trading partners (e.g. China and Europe) have been revised down, and uncertainty has increased (e.g. Brexit, trade tensions)

Debt-service costs account for an increasing share of the main budget deficit



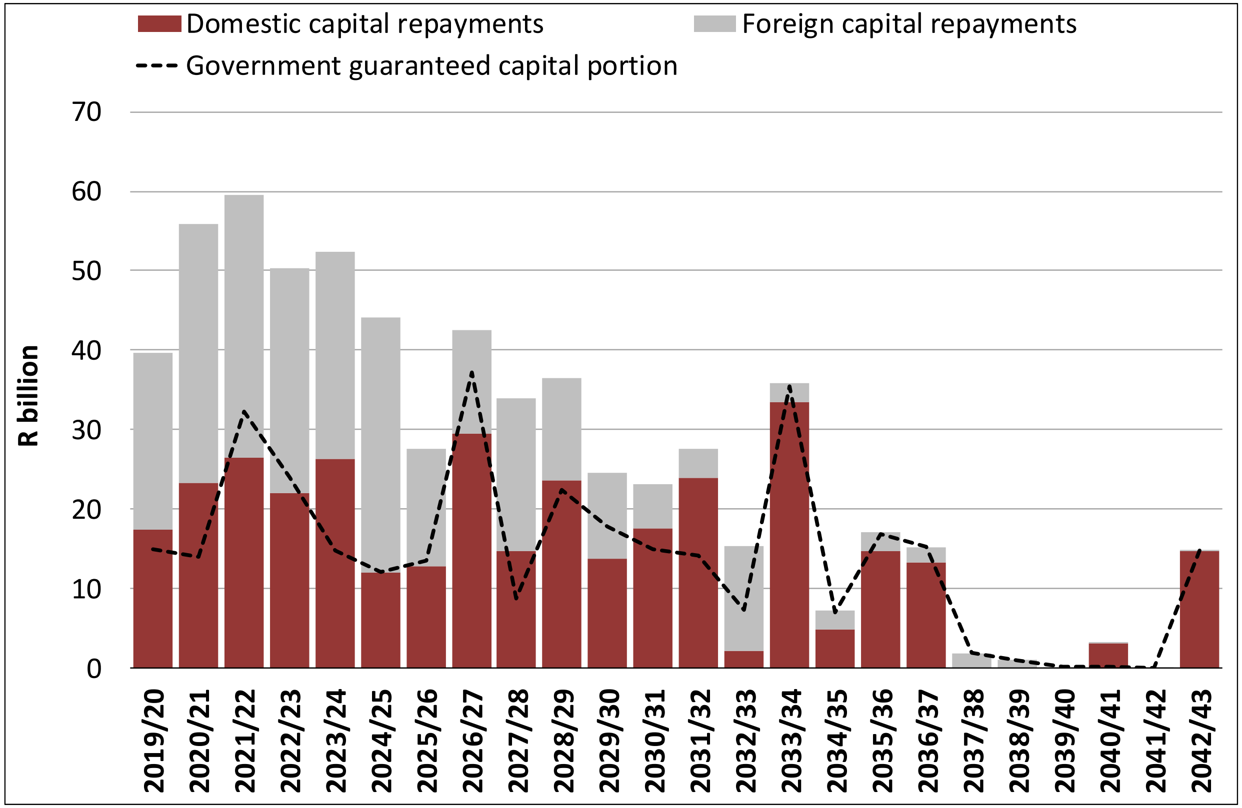
Tax revenue is under increasing pressure



- Tax-to-GDP ratio has fallen in recent years, despite substantial tax increases
- Revenue is expected to underperform by R42.8 billion in 2018/19 compared with 2018 Budget estimates
- This reflects both the economic slowdown and administrative weaknesses in SARS

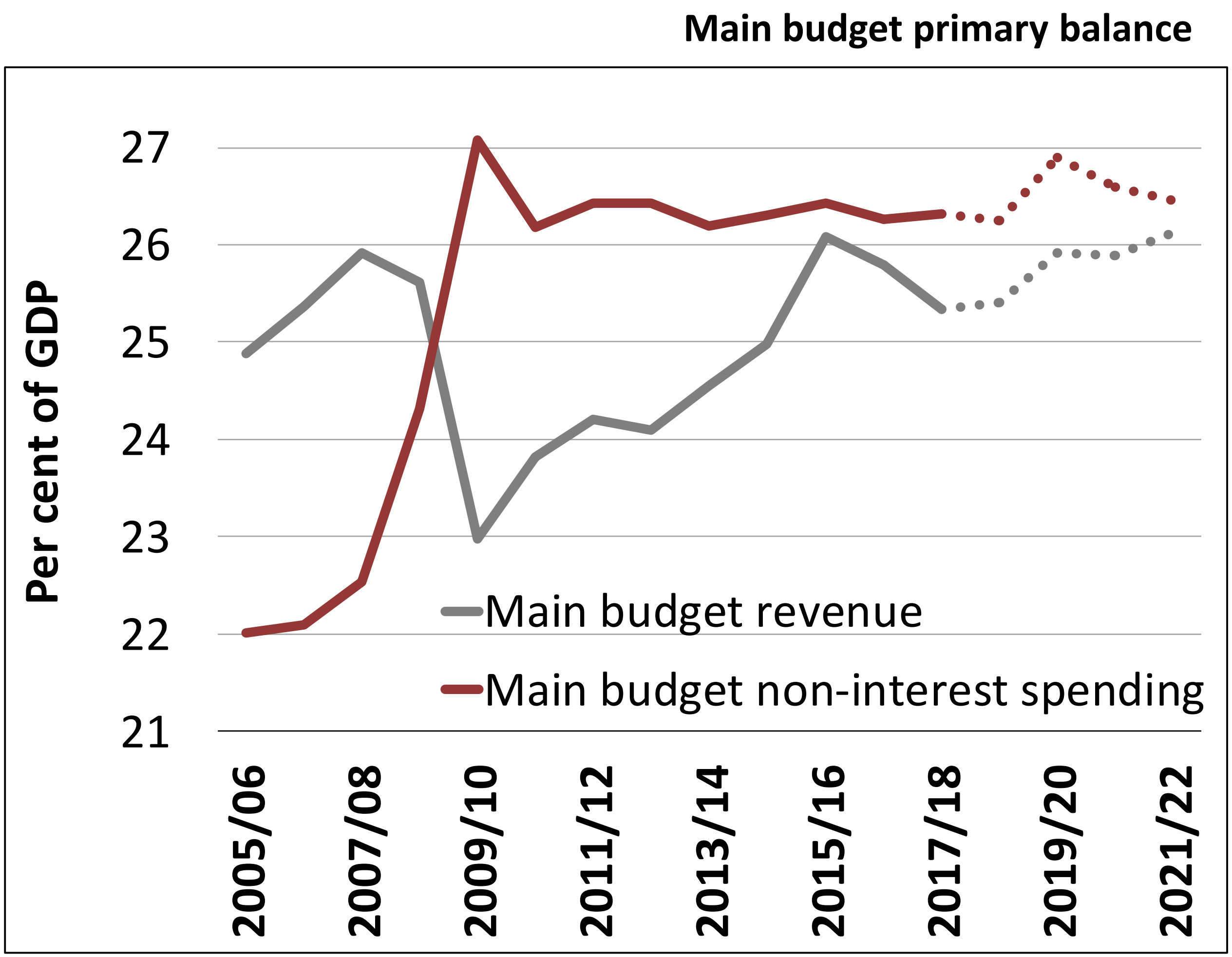
Spending pressures from state-owned companies have increased

Debt maturity profile of major state-owned companies



- The largest SOCs have debt redemptions of around R40 billion in 2019/20 and R55 billion in 2020/21
- Several entities are struggling to meet these obligations, with return on equity deteriorating to -0.3 per cent in 2017/18. This reflects weak revenue growth and high cost structures.
- After capital investment and debt servicing, most institutions show negative cash flows

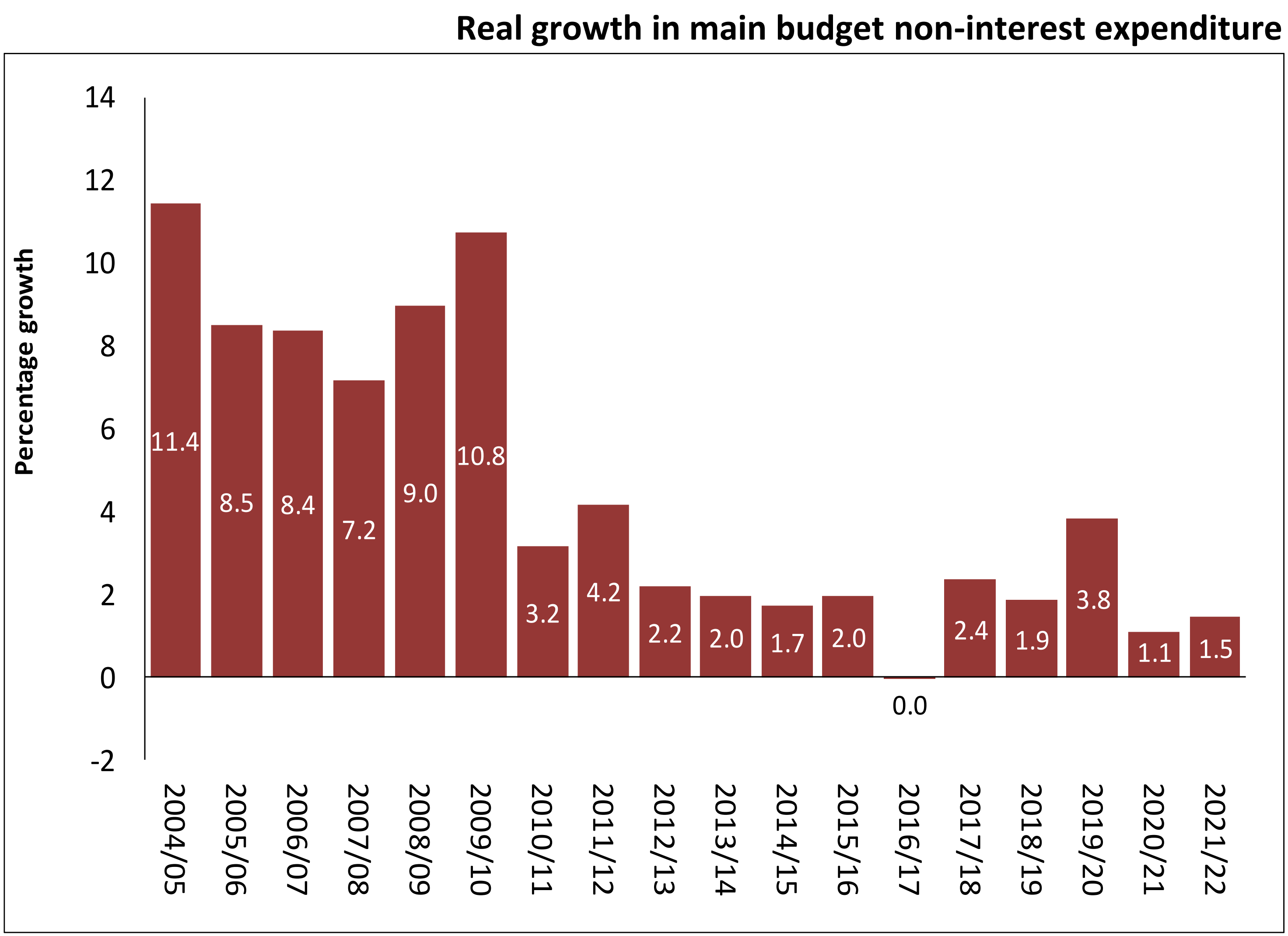
Fiscal measures narrow the primary deficit over the next three years



Fiscal policy balances competing pressures to ensure sustainability

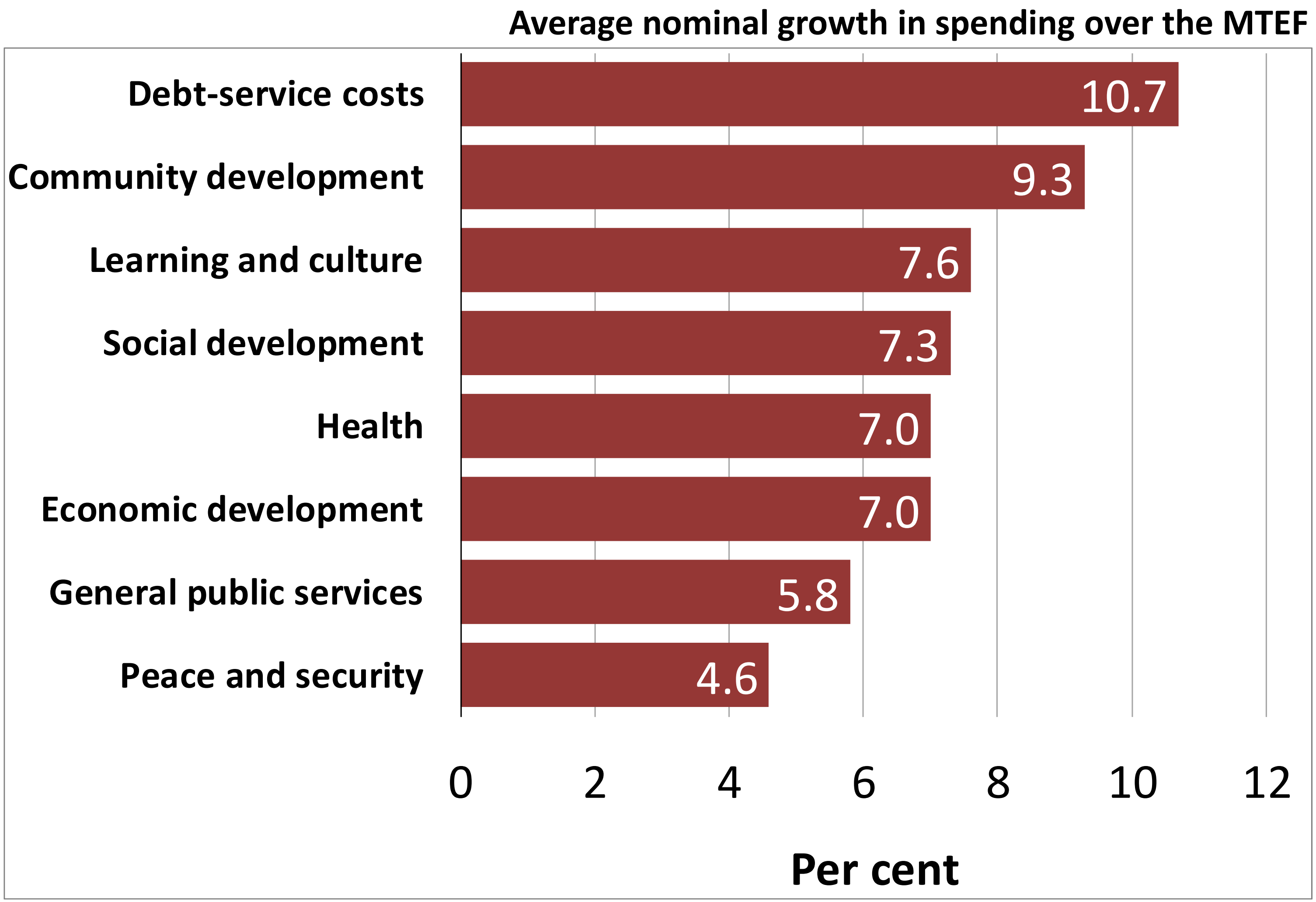
- **Expenditure reprioritisation (total amounts over the next three years)**
  - Baseline reductions of R50.3 billion, with about half of this amount relating to compensation
  - These reductions are offset by provisional allocations of R75.3 billion, of which the vast majority goes towards supporting reconfiguration of Eskom (R69 billion)
  - Contingency reserve is increased by R6 billion in 2019/20 (to respond to possible requests for financial support by SOCs), and is lowered by R8 billion in the two outer years of the framework
  - As a result of these measures, the expenditure ceiling is revised up by R16 billion over the medium term, compared with 2018 Budget estimates
- **Tax measures amounting to R15 billion in 2019/20 and R10 billion in 2020/21**
  - The majority of the R15 billion increase results from limited fiscal drag relief
  - Other elements include inflation-related increases in the fuel levy and a new carbon tax

Main budget non-interest spending grows in real terms



** Excluding financial transactions*

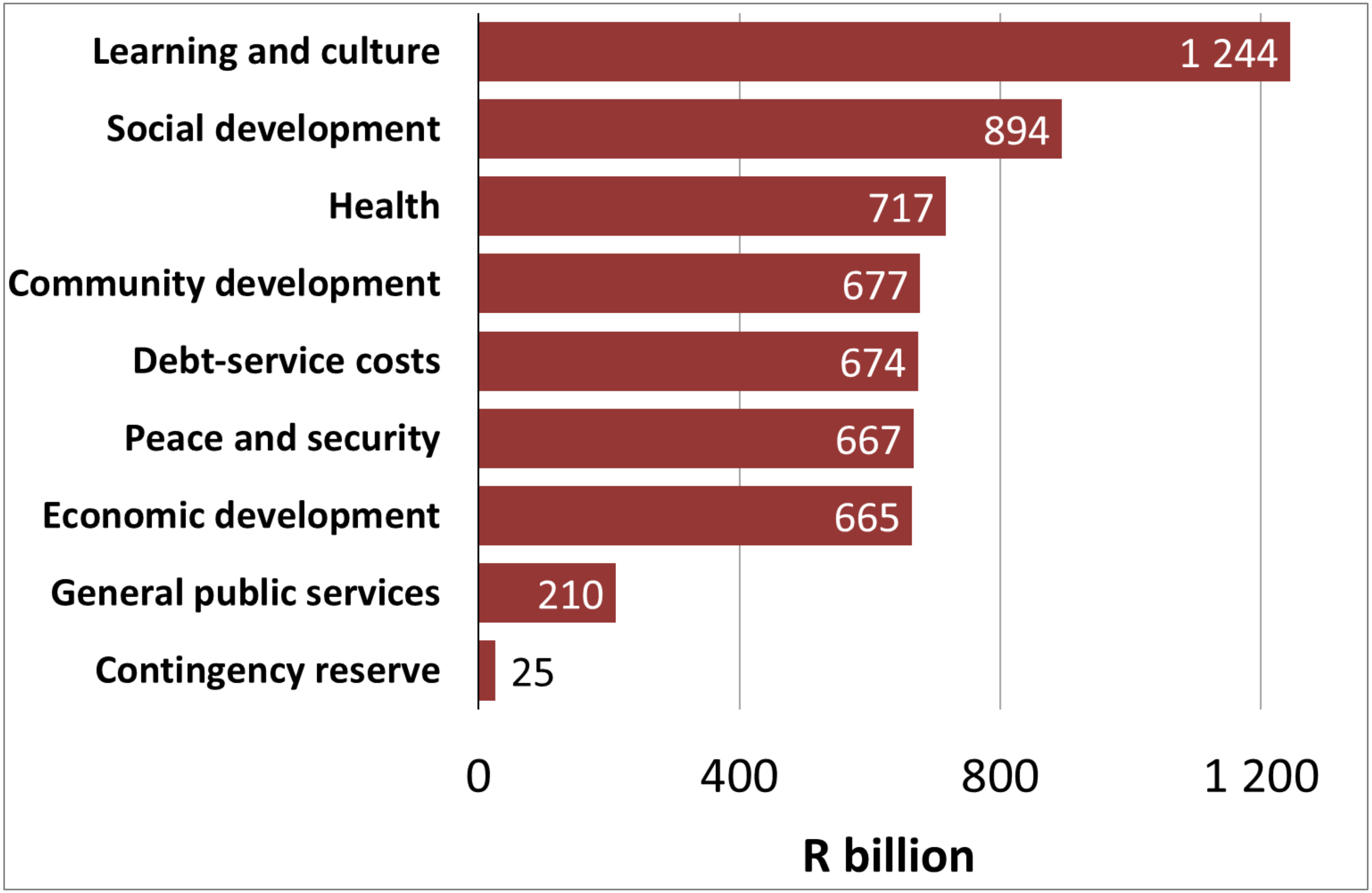
Social spending areas continue to grow above inflation



- Community development includes funding for free basic services and human settlements

Learning and culture remains the largest function, followed by social development and health

Consolidated government expenditure by function, 2019/20 — 2021/22



Credible forecasts are balanced, not optimistic or conservative

Problems with optimistic forecasts

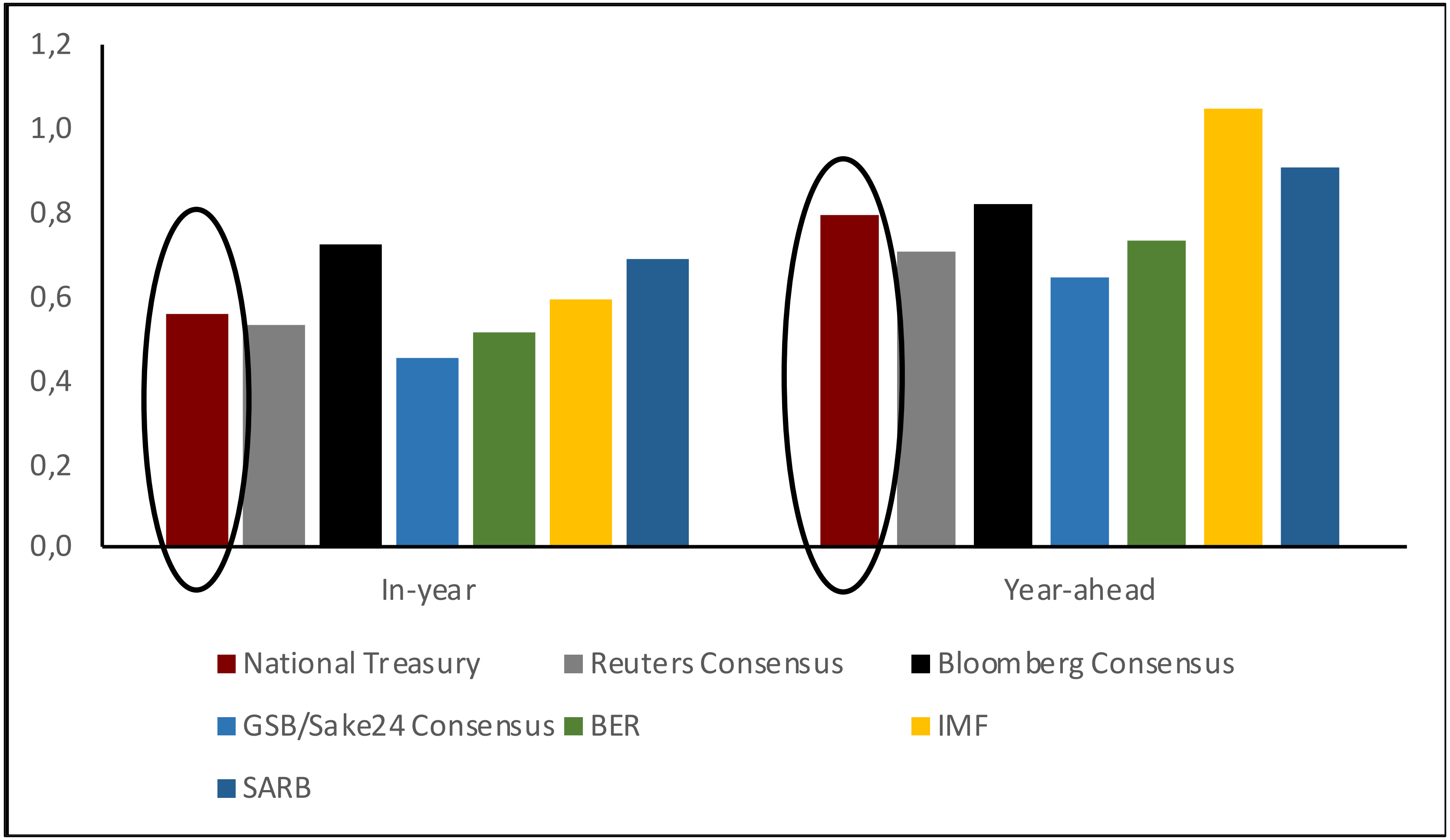
- Government plans for higher spending
- But revenue collections can be weaker than expected, as growth disappoints
- In response, government may have to **increase taxes or borrowing** to meet the pledged spending

Problems with conservative forecasts

- Government plans for weak growth, leading to **lower allocations** or unnecessarily **higher taxes**
  - Lower allocations can harm service delivery
  - Higher taxes can harm economic activity
- If government signals lower growth, it can **reduce confidence**

National Treasury forecast is balanced: not overly optimistic or conservative relative to other forecasters

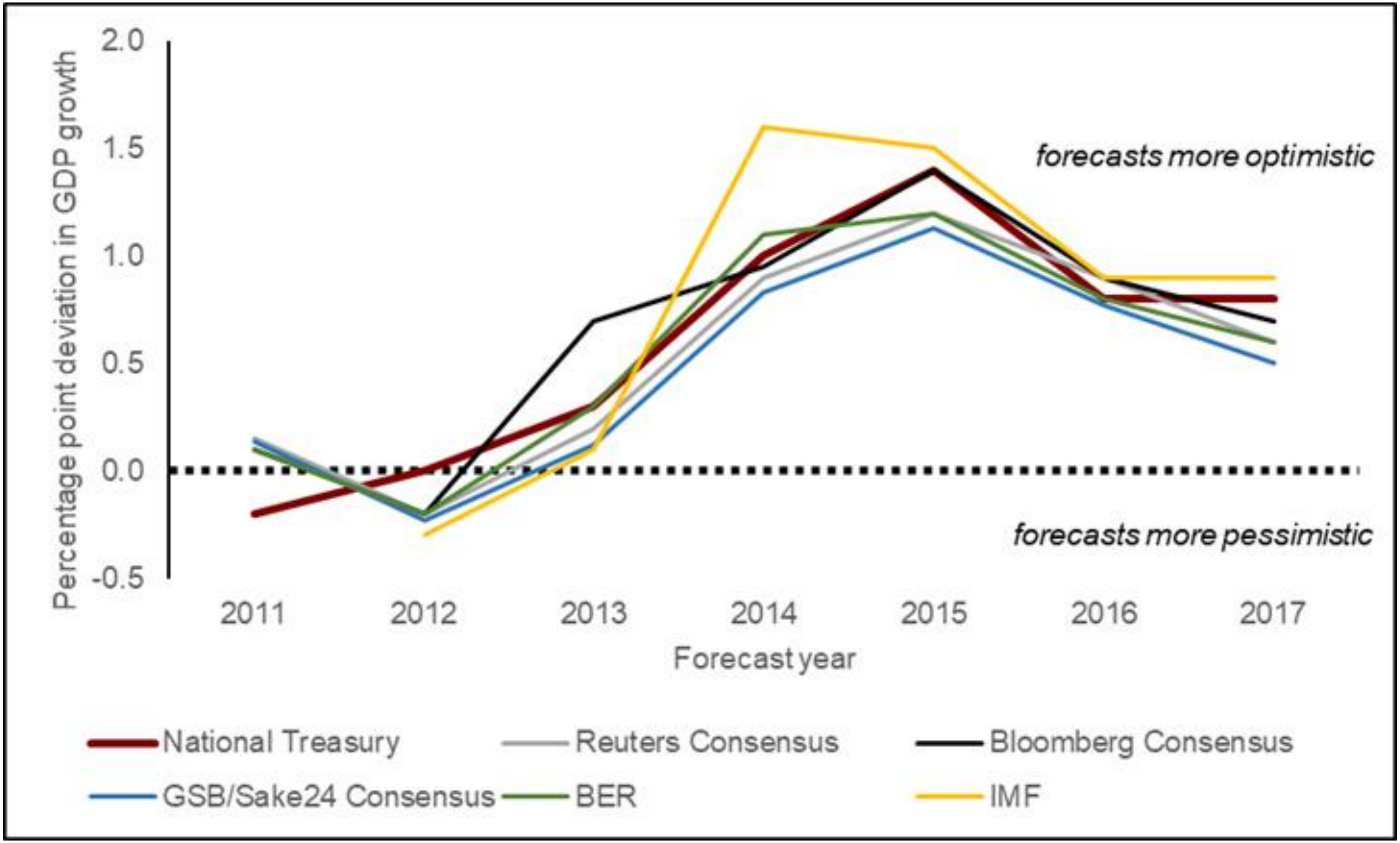
Root mean square errors of GDP forecasts, 2010 – 2017



Projections use the latest available data prior to the Budget. Bloomberg Consensus uses projections at (or closest to) 20 February in each year

Sources of basic data: National Treasury, Reuters, Bloomberg, BER, IMF, Stats SA

Trend of forecast errors are the same across institutions

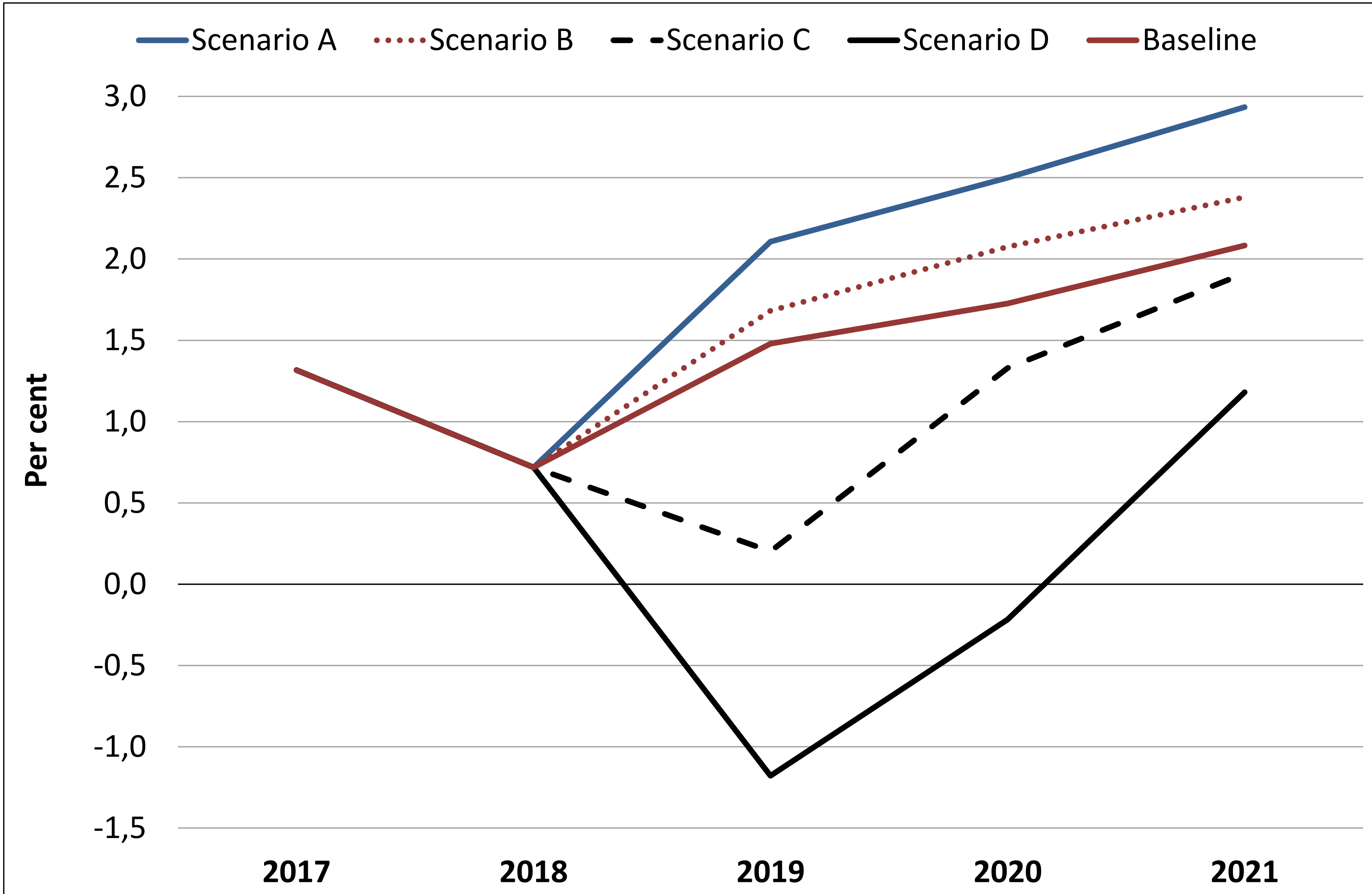


Sources of basic data: National Treasury, Reuters, Bloomberg, BER, IMF, Stats SA

No single institution has the best forecast over time

- National Treasury are on par with, or better than, market projections (see van der Wath (2013); Parliamentary Budget Office (2016); and Barclays (2017))
- From a recent study by F. Bhoola, J. Rossouw & M. Giannaros (2018), Comparing Macroeconomic Forecasts for SA from 2001 to 2017 (from p27 – conclusion):
- "We compared the forecasts of the National Treasury and the South African Reserve Bank to the consensus forecast (Media 24) and the Bureau for Economic Research at Stellenbosch University. **The result of the absolute accuracy analysis for growth forecast is inconclusive in declaring a single entity as unanimously accurate**."

Budget 2019 baseline forecasts and scenarios



VAT refunds and overall tax buoyancy

- Value-added tax refunds were revised up by R8 billion compared to MTBPS (over half of the R15bn deterioration in expected revenues since MTBPS due to this revision).
  - VAT credit book started the year at around R30 billion, went up to R42 billion by September, but concerted effort to reduce credit book has brought it down to below R25 billion by mid February.
  - MTBPS estimated VAT credit book should be around R19bn if all VAT refunds paid in time. Budget 2019 adjusted this to R22bn – more taxpayers are submitting returns for VAT refunds, and higher level of potential fraud cases. One-off additional VAT refunds of R8bn.
- **Without VAT refund one-off payment, tax buoyancy would have been 1.08 in 2018/19 and 1.06 in 2019/20 (before tax measures). But changes to 0.98 and 1.15 due to impact of VAT refunds.**
- **Buoyancy increases to 1.31 in 2019/20 from additional tax revenues of R15bn in Budget 2019.**

Revenue forecasts are clear and transparent

- Given large shortfalls in previous years, buoyancies have reduced from 1.3 to 1.1 for personal income tax and from 1.1 to 1.0 for domestic VAT.
- All buoyancies, except personal income tax, at 1
  - 10% growth in consumption leads to 10% increase in domestic VAT
  - Assumes the same level of performance from SARS (no improvements included in outer years)

Table C.4 Tax revenue and tax bases

R million/percentage change	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
		Outcome		Estimate		Projections	
Personal income tax	**388 102**	**424 545**	**460 953**	**504 233**	**549 104**	**601 604**	**657 819**
Wage bill [1]	*7.8%*	*7.9%*	*7.5%*	*6.8%*	*8.0%*	*8.6%*	*8.5%*
Buoyancy	*1.27*	*1.19*	*1.14*	*1.38*	*1.12*	*1.11*	*1.10*
Corporate income tax	**191 152**	**204 432**	**217 412**	**225 331**	**235 979**	**249 792**	**264 918**
Net operating surplus	*2.4%*	*5.4%*	*9.0%*	*5.3%*	*4.7%*	*5.8%*	*6.1%*
Buoyancy	*1.40*	*1.28*	*0.70*	*0.69*	*1.00*	*1.00*	*1.00*
Net value-added tax	**281 111**	**289 167**	**297 998**	**328 088**	**367 583**	**397 670**	**430 240**
Household consumption	*6.2%*	*7.1%*	*6.9%*	*6.6%*	*7.6%*	*7.9%*	*7.9%*
Buoyancy	*1.23*	*0.40*	*0.44*	*1.53*	*1.59*	*1.03*	*1.04*
Domestic VAT	**297 422**	**321 475**	**336 279**	**377 375**	**405 975**	**438 211**	**472 794**
Household consumption	*6.2%*	*7.1%*	*6.9%*	*6.6%*	*7.6%*	*7.9%*	*7.9%*
Buoyancy	*0.60*	*1.14*	*0.67*	*1.85*	*1.00*	*1.00*	*1.00*
Import VAT	**150 745**	**149 265**	**152 789**	**170 712**	**186 199**	**203 011**	**219 105**
Nominal imports	*3.0%*	*1.0%*	*2.7%*	*6.2%*	*9.1%*	*9.0%*	*7.9%*
Buoyancy	*3.45*	*-1.02*	*0.88*	*1.88*	*1.00*	*1.00*	*1.00*
VAT refunds	**-167 056**	**-181 574**	**-191 071**	**-220 000**	**-224 591**	**-243 552**	**-261 660**
Nominal exports	*3.9%*	*8.6%*	*2.6%*	*6.6%*	*7.5%*	*8.4%*	*7.4%*
Buoyancy	*0.79*	*1.01*	*1.98*	*2.30*	*0.28*	*1.00*	*1.00*

Progressivity of personal income taxes increased since 2010

Progressive changes to the personal income tax system in recent years include:

- One percentage point increase in 2014/15 across all the brackets
- New top bracket of 45 per cent above R1.5 million from 1 March 2017
- Moving from a medical tax deduction to a medical tax credit
- Limiting the deduction available for retirement fund contributions
- Increasing the effective capital gains tax rate from 10 per cent to 18 per cent
- Other measures to improve progressivity include increasing ad-valorem excise duties on luxury products and a higher estate rate of 25% on estates with assets of more than R30 million

The 280 000 taxpayers with taxable incomes of more than R1 million are expected to pay over 40% of personal income taxes

Table 4.5 Estimates of individual taxpayers and taxable income, 2019/20

Taxable bracket	Registered individuals		Taxable income		Income tax payable before relief		Income tax relief after proposals		Income tax from medical tax credits		Income tax payable after proposals	
R thousand	Number	%	R billion	%	R billion	%	R billion	%	R billion	%	R billion	%
R0 - R70[1]	6 369 806	–	183.4	–	–	–	–	–	–	–	–	–
R70 - R150	2 385 046	31.2	254.0	10.0	10.3	1.9	-0.34	28.5	0.05	5.0	10.1	1.8
R150 - R250	1 949 150	25.5	387.4	15.2	36.4	6.6	-0.32	26.9	0.20	23.1	36.2	6.5
R250 - R350	1 169 590	15.3	349.9	13.7	49.6	9.0	-0.19	15.8	0.21	22.1	49.7	9.0
R350 - R500	984 790	12.9	408.5	16.0	75.9	13.7	-0.16	13.2	0.23	21.9	76.0	13.7
R500 - R750	610 331	8.0	367.1	14.4	89.1	16.1	-0.10	8.2	0.15	14.3	89.2	16.1
R750 - R1 000	261 631	3.4	224.7	8.8	66.1	12.0	-0.04	3.5	0.07	6.1	66.2	12.0
R1 000 - R1 500	161 868	2.1	193.9	7.6	65.8	11.9	-0.03	2.2	0.05	4.4	65.8	11.9
R1 500 +	120 751	1.6	362.7	14.2	159.8	28.9	-0.02	1.6	0.04	3.2	159.8	28.9
Total	**7 643 157**	**100.0**	**2 548.1**	**100.0**	**553.0**	**100.0**	**-1.18**	**100.0**	**1.00**	**100.0**	**552.9**	**100.0**
Grand total	**14 012 963**		**2 731.5**		**553.0**		**-1.18**		**1.00**		**552.9**	

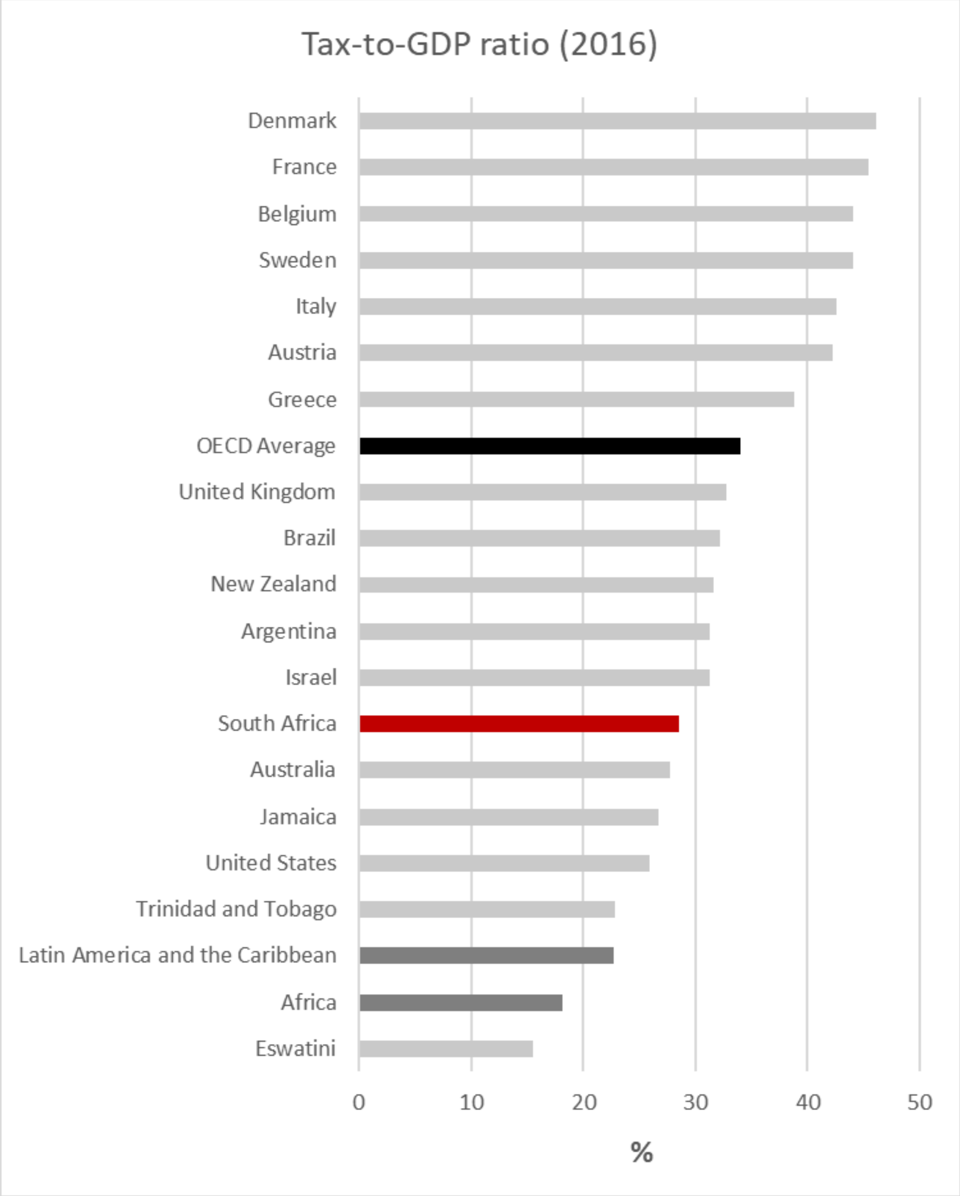
1. Registered individuals with taxable income below the income-tax threshold

Source: National Treasury

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

South Africa is below OECD average for tax-to-GDP ratio

- World Bank measure explicitly states that it does not include social security contributions or state/provincial taxes
- Since South Africa does not rely heavily on social security contributions or provincial taxes, will lead to skewed results (SA higher than Sweden or Austria and many other developed countries)
- More appropriate measure is from OECD, which includes SSCs - http://www.oecd.org/tax/tax-policy/about-global-revenue-statistics-database.pdf



Raising revenue from corporate income taxes

Raising the CIT rate may sound desirable to improve progressivity and tax capital owners more, but this objective is unlikely to be met:

- CIT rate is one of the aspects investors consider (in addition to political/policy certainty and others) when making investment decisions, which affect economic growth
- 340 companies have taxable income > R200mn and contribute 56% of total CIT revenue
- With a 28% rate for the past decade, SA is a high-tax country and is becoming an outlier relative to key trading and investment partners – UK (19%), Netherlands & US (21%), China (25%), Mauritius (15%)
- The bigger the gap, the more incentive to shift profits out of South Africa, resulting in less CIT revenue (base erosion and profit shifting – BEPS); more than 40% of CIT revenue is generated by SA subsidiaries of foreign MNEs
- SA has implemented a number of proposals to counter BEPS, but needs specialised skills to enforce the proposals, legislation alone will not be effective
- Business/capital owners are not likely to bear the full burden (DWT can proxy): companies can pass on higher taxes to employees (lower wages) and/or consumers (higher prices) – study in Canada found a large impact on workers

Specific budget matters

Taxation

- Carbon tax implementation date
- Impact of fuel levy on paraffin, LPS and biofuels;
- Clarity on VAT refund figures
- HPL levy increase
- Policy of retrospective amendments
- Wealth tax

Expenditure

- Early retirement intervention and service delivery
- Financial support for Eskom
- Doubling of the December old-age grant
- Subsidisation of insurance premiums for emerging farmers

Thank you