**1. REPORT OF THE SELECT COMMITTEE ON FINANCE ON THE 2017 FISCAL FRAMEWORK AND REVENUE PROPOSALS, DATED 7 MARCH 2017.**

The Select Committee on Finance and the Standing Committee on Finance (the Committees), having considered the 2017 Fiscal Framework and Revenue Proposals, report as follows;

**Part 1**

1. **INTRODUCTION AND BACKGROUND**
	1. The Minister of Finance (the Minister), Mr. Pravin Gordhan, tabled the 2017/18 National Annual Budget (the Budget) before Parliament on 22 February 2017 in line with section 27 of the Public Finance Management Act, Act No. 1 of 1999 (PFMA) and section 7 (1) of the Money Bills Amendment Procedure and Related Matters Act, Act No. 9 of 2009 (Money Bills Act).
	2. The Minister briefed the Committees on 23 February. We received input from the Parliamentary Budget Office (PBO) and the Financial and Fiscal Commission (FFC) on 28 February, in line with their statutory mandates. Public hearings were held on 1 March and the National Treasury (NT) responded to the inputs and submissions made on 2 March, addressing the specific requirements of section 8 (3) of the Money Bills Act.
	3. The Committees received written and oral submissions from the Congress of South African Trade Unions (COSATU), the National Education, Health and Allied Workers’ Union (NEHAWU), the Fiscal Cliff Study Group (FCSG), Public and Environmental Economics Research Centre of the University of Johannesburg’s Public and Environmental Economics Research Centre (PEERC), Mr Guy Harris, PriceWaterhouseCooper (PwC), the South African Institute of Chartered Accountants (SAICA), South African Institute of Tax Professionals (SAIT), and Manufacturing Circle. Mr Rashid Osman sent a letter addressed to the Finance Minister and Coca Cola Beverages and Growthpoint Properties. withdrew due to unforeseen circumstances

**Part II**

1. **MINISTER’S OVERVIEW OF THE NATIONAL BUDGET (2017/18)**
	1. **Minister’s Briefing to the Committee**
		1. The Minister stressed the key theme of ‘transformation for inclusive growth’, which built on his Budget Speech in which he said “Our growth challenge is intertwined with our transformation imperative. We need to transform in order to grow, we need to grow in order to transform. Without transformation, growth will reinforce inequality, without growth, transformation will be distorted by patronage.”
		2. He pointed out that 95 percent of wealth is owned by 10 percent of the people.
		3. Growth, he said, has been slow with 1 percent per year in real per capita terms over the past 25 years. This was well below comparable countries such as Brazil, Turkey, Indonesia, India and China.
		4. The Minister stated that in order to realise the vision of the Constitution, the country needed transformation that opens a path to inclusive growth and development. The 2017 Budget will play a central role in transforming the country’s economic landscape as it seeks to redistribute and direct scarce resources towards transformation and growth.
		5. The Budget, according to the Minister, also aims to mobilise private and public capital investments to assist in modernising and diversifying the economy.
		6. According to the Minister, stronger and more inclusive growth was needed and the country must concentrate on transforming the patterns of asset ownership and production, promote competition and de-concentrate markets.
		7. Global growth was expected to accelerate, with the world economy projected to grow by 3.4 percent in 2017 and 3.6 per cent in 2018. While advanced economies were projected to remain around 2 percent over the medium term, developing countries were expected to remain the main contributors to higher global growth, notably India and China. The outlook for sub-Saharan Africa was expected to improve in the next financial year.
	2. **DOMESTIC ECONOMIC OUTLOOK**

**Economic Growth**

* + 1. The 2016 Medium Term Budget Policy Statement (MTBPS) lowered the growth projections for 2016 and 2017 from 0.9 percent to 0.5 percent and from 1.7 percent to 1.3 percent respectively.[[1]](#footnote-1) The economy is expected to grow by 2 per cent in 2018 on the strength of several developments
* The real exchange rate has depreciated, boosting competitiveness.
* The severe drought has eased in several farming regions.
* An uptick in commodity prices is expected to carry through into 2017.
* Electricity supply has stabilised.
* Improved labour relations.[[2]](#footnote-2)

**Unemployment**

* + 1. Unemploymentrecorded its highest level since 2003 in the third quarter of 2016, but recovered marginally in the fourth quarter. The South African unemployment rate, as narrowly defined, is 26.5 percent and overall the youth consists of the largest share in long-term unemployment at 43 percent.[[3]](#footnote-3)

**Investment**

* + 1. During the first three quarters of 2016, investment in fixed capital fell by 3.9 per cent – the first decline since 2010. The main reason was investment by private business, which fell by 5.9 per cent. Reversing this contraction requires renewed efforts to strengthen business and consumer confidence. The level of investment remains low compared to emerging markets like India and Indonesia. The NDP targets an investment ratio of 30 percent by 2030.[[4]](#footnote-4)
	1. **THE CONSOLIDATED FISCAL FRAMEWORK**
		1. The 2017 Budget proposes to lower the spending ceiling over the medium term expenditure framework period by reducing spending on non-core goods and services, and compensation of employees. The expenditure ceiling will be reduced by R10 billion in 2017/18 and R16 billion in 2018/19. Government is committed to a measured path of fiscal consolidation that reduces the budget deficit and stabilises public debt. The combination of a lower expenditure ceiling and higher taxes will narrow the consolidated budget deficit from an estimated 3.4 per cent of GDP in 2016/17 to 2.6 per cent by 2019/20.
		2. In total, Government is expected to spend R5.054 trillion over the three years relative to a revenue envelope of R4.617 trillion. Over the 2017 Medium Term Expenditure Framework (MTEF), non-interest expenditure is expected to remain stable at 26.2 per cent of GDP over the medium term. Tax revenue will increase from 26 per cent of GDP in the current year to 27.2 per cent of GDP in 2019/20.
		3. The Budget is strongly aligned with constitutional imperatives. About two-thirds of it is allocated to functions dedicated to realising constitutionally mandated social rights – including education, healthcare, social security and housing.
	2. **REVENUE TRENDS AND TAX POLICY**
		1. The growth of gross tax revenue has decreased for 2016/17 in three of the four main tax instruments by R30.4 billion lower than the original estimate at the time of 2016 Budget.
* Personal Income Taxes are expected to show large shortfalls at R15.2 billion mainly due to lower wages and reduced bonus pay-outs.
* VAT at R11.3 billion - a decline in VAT imports, partially offset by strong domestic VAT collection, but VAT refunds were higher than anticipated therefore reducing net revenue.
* Customs at R6.5 billion
	+ 1. Corporate income tax receipts are expected to marginally outperform projections as a result of higher commodity prices and labour stability in the mining sector, along with strong performance in the financial sector.[[5]](#footnote-5) There is significant uncertainty regarding the path of revenue collection and these risks include weaker-than-expected economic growth, and concerns about tax morality, compliance and administration.
		2. The tax proposals this year will raise an additional R28 billion. A marginal income tax bracket for individuals combined with partial relief for bracket creep is expected to contribute R16.5 billion, with R6.8 billion coming from the increased dividend withholding tax rate. A new top personal income tax rate of 45 per cent for those with taxable incomes above R1.5 million is expected to bring in R4.4 billion.
		3. South Africa has three main fuel taxes – the general fuel levy, the customs and excise levy on petrol, diesel and biodiesel, and the Road Accident Fund (RAF) levy. They fund general government expenditure, support environmental goals and finance the RAF. The general fuel levy’s proposed increase of 30c/litre contributes to the additional revenue requirement for 2017 and 9c/litre in the road accident fund levy.
		4. The 2017 Budget continues this trend with proposed excise duty rate increases of between 6.1 per cent and 9 per cent. This will lead to excise tax burdens that are slightly higher than the targets for beer and spirits.
		5. An increase in the transfer duty threshold from R750 000 to R900 00 will provide relief to the affordable housing market for lower- and middle-income households, effective from 1 March 2017. This proposal will encourage lower and middle income earners to move closer to becoming home owners.

**PART III**

1. **INPUT FROM STATUTORY INSTITUTIONS**
	1. **Parliamentary Budget Office**
		1. The PBO noted that the Budget maintained the objective of fiscal consolidation and aimed to give effect to the transformation action agenda. The agenda is attained by government financing expenditure programmes to ensure that many more people live in dignity every year, continuously improve access to services and economic participation across all racial lines, energise growth, create jobs and increase investment in all spheres of government. The government is consistent with its fiscal policy goal of containing the budget deficit and slow the pace of debt-to-GDP ratio. Key revenue proposals of the budget included the new tax bracket on personal income tax, accompanied by the limited bracket relief, increases in the fuel levy and dividends withholding tax from 15 percent to 20 percent.
		2. Lower economic growth may require additional consolidation measures both from the revenue and expenditure sides to realise current fiscal policy objectives. Tax expenditure was estimated at R127 billion or 14.7 percent of gross revenue, R50 billion of which is attributed to personal income tax, VAT accounts for R 48 billion, corporate income tax accounts for R 4,8 billion and customs and excise make up R 24 billion. The budget aims to encourage the culture of saving by increasing the contribution amount on tax free savings from R30 000 to R33 000. The duty free property transfer amount was raised to R900 000 from R650 000. The PBO noted the non-increment of the VAT rate given the current slow growth in the economy and the significant impact that consumption taxes have on the lower income households, and that a review of zero rated basket is warranted.
		3. In the 2017 budget review it was announced that NT is investigating the possibility of expanding the VAT base by removing fuel from the zero rated list for the 2018 budget. The PBO noted that this proposal requires considerable deliberation on the costs of transport and the implications of the fuel levy adjustment. Changes in taxes affect growth, consumption, income distribution and progressivity of the tax system. At least 22 percent of South Africans use mini bus taxi to get to work, so higher fuel costs will negatively affect most South Africans.
		4. Of the four main tax instruments[[6]](#footnote-6), only corporate income tax is expected to exceed the 2016 budget estimates. The under collection is expected mostly from personal income tax followed by VAT then customs duties. PBO noted that the reasons for the shortfall in collection warranted further oversight by Parliament. The low collection and slow growth in revenue adversely affected the tax buoyancy which is currently below 1, the lowest level since the 2009/2010 fiscal year.
		5. The PBO noted that government proposed further expenditure ceiling reductions of R 26 billion over the medium term to achieve fiscal policy objectives. At the same time, the PBO was concerned about underspending on infrastructure and other expenditure programs, given that spending on infrastructure had better multiplier effects in an economy. The 2017 fiscal year marks the end of three year public sector wage negotiation contract and the beginning of the negotiations of another contract to guide public sector wage increases, and all parties will need to consider the current fiscal position of the economy.
		6. The PBO further noted that the government’s contingent liabilities were on the increase and may pose a fiscal risk in the future. Parliament, the PBO advised, may need to increase oversight over government contingent liabilities.
		7. The PBO said that new tax proposals should strike a balance between competing demands, and that tax expenditure review is an option to increase the revenue baseline. The under expenditure for 2016/17 is expected to exceed R6 billion the biggest proportion being on capital expenditure.
	2. **Financial and Fiscal Commission (FFC)**
		1. The FFC acknowledged that the Fiscal Framework was being enacted in exceptionally difficult domestic and global conditions. South Africa’s Gross Domestic Product (GDP) growth was forecast to continue to be sluggish and remained lower than the 5.4 percent annual growth envisaged by the NDP to eliminate income inequality and achieve a 50 percent reduction in unemployment levels by 2030.
		2. The Commission welcomed the continuous infrastructure investment by government, and the State Owned Enterprises (SOEs). The Commission welcomes the declining levels of contingent liabilities of SOEs as this will enhance ongoing efforts to avoid fiscal slippage and ensure the reigning in of public debt.
		3. The Commission reiterated the point it raised in its 2016 Medium Term Budget Policy Statement (MTBPS) submission, that regular road maintenance is key to economic development and growth. As part of the reforms aimed at improving the country’s medium-term growth outlook, there are several specific imperatives that government has announced, to boost investment in the short term, safeguard South Africa’s investment-grade credit rating and measures to stabilise government debt. The Commission welcomes continued emphasis on fiscal consolidation and the resulting impact on overall budget credibility. The Commission notes the commitment by government to short term stabilisation measures.
		4. In November 2016, the Cabinet endorsed a framework to guide public-private partnerships on infrastructure projects and a process for establishing overarching legislation on shareholder policy for SOEs - the Commission welcomed this development.
		5. The 2017 MTEF division of revenue showed that despite the difficult fiscal environment, the Government has managed to maintain real growth in the resources allocated to the three spheres of government. The Commission emphasised the need for provinces to evaluate each aspect of their spending plans to ensure that any inefficiencies in provincial service delivery systems were eliminated.
		6. The Commission notes that unlike previous years, government has made no baseline adjustments to the provincial fiscal framework over the 2017 MTEF period. The Commission welcomes this decision as it brings stability to the finances and planning decisions of provincial governments.
		7. Government has also announced a review of the provincial equitable share formula and is expected to cover the funding burden of poorer schools, the cost of service provision and assessment of data reliability. The Commission welcomed this review and calls on government to provide clear milestones on the review process. The Commission welcomed this prioritisation especially in respect of the local equitable share allocation which is projected to grow by a healthy real annual average of 4.4 percent over the 2017 MTEF period.
		8. The Commission reiterated its caution around the use of indirect grants and the negative incentives it gives rise to, especially in relation to the dilution of accountability and upkeep of infrastructure developed through the use of indirect grants. The Commission is of the view that the use of indirect grants should be a measure of last resort whilst continuing to build capacity in provinces and especially, municipalities, to undertake their functions.
		9. The contingency reserve for 2017/18 has remained the same at R 6 billion in the 2017 Budget as the 2016 MTBPS. The Commission welcomed the new policy approach of maintaining consistency in the contingency reserve as it provides the fiscus with at least some room to manage ongoing fiscal pressures. The Commission further welcomed steps taken by government to reign-in the growth of compensation expenditure including the decision taken that the new wage settlement agreement due to begin during 2017 will take account of fiscal constraints.
		10. Since 2014/15 there has been a new focus on reducing spending on non-core goods and services, such as travel, subsistence and catering – which the Commission supports. The Commission welcomes efforts by the Office of the Chief Procurement Officer to expand centralised procurement for common goods and services which aims to save R25 billion over the MTEF period by renegotiating contracts with government’s 100 suppliers. The Commission would like to reiterate the need to monitor cost reductions from government cost containment initiatives so that savings in one area are not outweighed by increased costs in another.

**Part IV**

1. **INPUT FROM STAKEHOLDERS**
	1. **COSATU**
		1. Cosatu expressed appreciation for some of the key government commitments in the Budget but decried “government’s lack of a coherent integrated and targeted job protection and creation plan that would ensure that all South Africans are employed”, emphasising that the country needed to create 100 000 jobs per month in order to make a dent on the unemployment rate..
		2. Cosatu welcomed government’s decision not to increase VAT and rejected NT’s continued motivation for future increases. It also welcomed an increase in income tax through the creation of a new tax bracket for those who earned above R1.5 million per annum. It proposed the creation of a new tax category for the ‘super-rich’. Cosatu urged government to increase company tax for ‘well-off companies’ and taxes on import duty and luxury goods. It urged government to consult industry and labour further on the introduction of sugar sweetened beverages (SSB) tax as this would lead to loss of about 5000 jobs, according to NT’s estimates.
		3. Cosatu further proposed the introduction of a solidarity tax targeted at capping the growth in earnings of the top 10 percent of the population and accelerating the earnings of the bottom 10 percent; a tax on luxury items; a further increase in dividends tax; a land tax to aid the process of land redistribution; zero VAT ratings for medicines, water, domestic electricity and public education; export taxes on strategic minerals, metals and other resources to support downstream industries and to promote value-addition; investment tax credits to encourage local procurement of machinery and equipment; increased taxes on financial transactions above certain levels to limit short term capital flows; a tax on firms that are resistant to closing the wage gap; and the taxation of firms that pay below the statutory minimum wage and distribution of such tax proceeds to the workers concerned.

* 1. **NEHAWU**
		1. NEHAWU expressed disappointment at the National Budget and said it fell short on ‘radical economic transformation’ and on tackling the challenges of unemployment, poverty and inequality. NEHAWU said the rate of unemployment was unacceptable and called for ‘radical economic transformation’.
		2. NEHAWU further critiqued government’s fiscal policies as ‘orthodox, conservative, neoliberal’, particularly the fiscal policy stance on inflation targeting and deficit reduction. It also critiqued fiscal consolidation, spending ceilings and reduction of head counts in the public service and reliance on foreign savings which it said was caused by the current account deficit.
		3. NEHAWU proposed an alternative policy stance whose goals would be to achieve full employment, redistribution of income and power, social and economic transformation and an environmentally sustainable growth.
		4. NEHAWU proposed similar taxes as Cosatu and welcomed the fact that VAT was not increased.
		5. The union expressed disappointment with the expenditure ceilings and cuts in the general public service vacancies, arguing that this will negatively impact on service delivery and constrain economic growth.
		6. NEHAWU expressed further concerns about the slow progress on the National Health Insurance Fund and asked the NT to clarify and distinguish between it and the “Transitional Fund”, raising issues of the design of the scheme as a multi-layered model which will undermine costs and universal access to health care, instead of a ‘single-payer and single purchaser fund’.
	2. **Fiscal Cliff Study Group (FCSG)**
		1. Prof. Rossouw of the FCSG submitted that the biggest issue was to avert a downgrade of South Africa’s credit rating. He said this will occur if the Minister was dismissed. He argued that this would result in a substantial increase in government’s borrowing costs, which had been deteriorating since the mid-1990s. He expressed concerns about government’s social assistance spending which is projected at R164.8 billion for 2017/18, amounting to 11.9 percent of the budget.
		2. Prof. Rossouw also decried the civil service remuneration as a percentage of expenditure, which, in 2015/16, sat at 44.4 percent. The country closest to South Africa on civil service remuneration as a percentage of expenditure was the United States at about 30 percent, he said.
		3. Prof. Rossouw submitted that a moratorium on public service employment be retained and civil service remuneration upward adjustments be frozen. He further submitted that to avoid tax increases, expenditure cuts should be implemented.
		4. He submitted that VAT increases should be avoided since they impact heavily on the poor. Registration threshold for VAT vendors should be revised and increased. Inflation targets should be reduced to between 3 and 5 per cent. He warned that more wealth taxes can encourage emigration of skilled people. Prof. Rossouw further recommended that the SACU Agreement be renegotiated as in its current form, it is far too generous and is unaffordable for South Africa
	3. **Public and Environmental Economics Research Centre (PEERC)**
		1. The submission of PEERC of the University of Johannesburg was presented by Mr Jugal Mahabir and Dr Sean Muller. They said that they would limit their submission to the specific requirements of the Money Bills Act.
		2. Mr Mahabir said that although growth prospects were improving, South Africa remained vulnerable to unforeseen shocks and domestic policy uncertainty. He raised a serious concerns regarding the falling GDP per capita.
		3. He expressed support for fiscal consolidation measures and argued that the critique against the NT for compromising ‘radical economic transformation’ through fiscal consolidation was misguided. He however noted that government expenditure was not having the desired effect and suggested the fiscal measures were not working because of inefficiencies, ineffectiveness, corruption and supply-side issues.
		4. Dr Sean Muller spoke about the country’s wage bill. He submitted that public sector wages were not inherently wasteful as public servants are fundamental to service delivery in all areas, including social and economic. However, there were delivery failures which suggest a significant proportion of civil servants are either not competent or not exerting adequate effort.
		5. There was significant under-resourcing in ‘frontline’ posts (teachers, nurses, police officers, social workers), a large growth in bureaucracies (including new ministries) with unclear mandates but highly-paid staff, and wage agreements were not reflective of the fiscal environment that the country found itself in. Dr Muller concluded that government needs to change the *shape* of the public service and remove superfluous managers and fund frontline posts. This would lead to an increase in the number of jobs.
		6. On the estimated revenue shortfall of about R30 billion for 2016/17, Dr Muller attributed it to lower growth than previously projected, lower wage increases and reduced imports. He however observed the dramatic change in tax buoyancy which he said was from 1.47 to 0.86.
		7. Dr Muller claimed that VAT refunds were deliberately delayed in 2015/16 in order to ‘claim successes’ from inflated revenue collection figures. This could explain the shortfall in general VAT for 2016/17. He suggested that an assessment is perhaps required on VAT collection and refunds.
		8. Dr Muller submitted that the arguments against the new top tax bracket on the basis that many high net-worth individuals will emigrate as result were misplaced. He said these arguments appear implausible given the marginal effect. He nevertheless suggested that the country was an in uncharted territory and taxpayer compliance could not be taken for granted
		9. He highlighted that contingent liabilities remain a serious concern. Despite some assertions to the contrary, Eskom is heavily reliant on government guarantees (and received massive cash injection and balance sheet support in 2015 via Special Appropriation Bills) and over MTEF they seemed to be R50 billion higher than in the 2016 Budget. He further warned that the Road Accident Fund contingent liability seemed to be R55 billion more for 2018/19 compared to the 2016 Budget. Other SOEs that remained a concern were SAA and the new governance issues at ACSA.
	4. **Price Waterhouse Cooper (PwC)**
		1. PwC highlighted that the country faced serious challenges given the weak economic growth, high unemployment and inequality, persistent budget deficit, growing debt levels and spending pressures. The country was also running out of revenue raising options as tax increases were reaching record levels at about 27.5 percent of the GDP by 2019/20. PwC further claimed that South Africa’s tax-to-GDP ratio was ‘significantly higher than the world and African averages as well as for middle-income countries’.
		2. PwC highlighted its preferences for an increase in indirect taxes such as the fuel levy and the VAT instead of direct taxes such as personal and corporate income taxes, pointing out the risks to economic growth and *the Laffer curve*[[7]](#footnote-7) and arguing that increases in personal income taxes may dampen tax morality and lead to aggressive tax avoidance. They further pointed out that the tax that would be raised by imposing a tax rate of 45 percent on those who earn in excess of R1,5 million per annum should come to about R6,5 billion instead of the R4,4 billion projected by NT in its Budget Review.
		3. PwC emphasised that the country’s budget deficit problem was not a revenue problem but an expenditure one, which had ballooned from 27.2 percent of the GDP in 2007/08 fiscal year to 33.4 percent of GDP in 2015/16. It observed that expenditure had outstripped revenue growth and submitted that the expenditure ceiling would have to be lowered further in the future. PwC submitted that a major expenditure problem was the government’s wage bill and PwC welcomed the announcement by the Minister that government was working to reduce the head count.
		4. PwC raised concerns over the tax increases to raise an additional R28 billion in 2017/18 and R15 billion and 16.3 billion in the following consecutive financial years. They noted that there was no detail on what the increases in outer years would be made up of. They noted further that other tax proposals such as the SSB tax which would raise about R2 billion and donations tax on interest free loans which would raise about R1 billion were also not taken into account in the Budget’s tax increases of the additional R28 billion for 2017/18.
		5. PwC noted that under the Southern African Customs Union (SACU) agreement, the revenue formulae for sharing customs and excise duties was weighted heavily against South Africa and in favour of the other member countries (Botswana, Lesotho, Namibia and Swaziland). They warned that South Africa can no longer afford to subsidise the SACU countries to the extent that it is currently doing. They advised that while the fiscal stability of these countries is important and must be taken into consideration, the agreement should be renegotiated over the medium-term in order to provide for a more equitable sharing of revenue.
	5. **South African Institute of Chartered Accountants (SAICA)**
		1. SAICA raised concerns about the tax to GDP ratio and submitted that NT should provide a clear statement as to whether there is a limit to taxing an already overburdened society before economic harm results and if so, what is the appropriate level, if not the Katz commission’s 25 percent tax to GDP ratio.
		2. SAICA further noted the 400 percent growth in government revenues over the past 22 years and argued that government may seem to have a spending rather than a funding problem. SAICA submitted that the ‘Minister of Finance should clearly indicate what the long and medium term funding goals of the state are given the current economic condition.’ SAICA warned that government cannot expect the current funding increases to continue unabated and submitted that ‘the continual adjustment in medium term borrowings and spending indicates the state’s inability to keep to its spending plans, which provide little certainty to the public and stakeholders such as the rating agencies.’
		3. SAICA expressed concerns with the increases in the fuel levy which it claimed was a more regressive tax than VAT, as its pro rata impact on the poor, who spent more on transport as a percentage of their monthly income, was far greater. SAICA submitted that the use of regressive taxes, particularly the fuel levy, only harms the poor and exacerbates their plight. It further submitted that ‘the VAT remains the most prudent mechanism to fund’ the current government revenue shortfall.
		4. SAICA decried the level of unlawful expenditure (irregular, unapproved and wasteful) incurred by government, which had more than doubled from R35 billion to R60 billion over the last 6 years. SAICA expressed further concerns on government’s wage bill which had increased by nearly 80 percent from R359 billion in 2007 to R579 million in 2015. SAICA submitted that ‘government cannot demand fiscal morality from its citizens if did not abide by the same ethical standards and…continues to reduce its own fiscal morality’. They submitted further that more support was required from Cabinet for the Minister Finance to show citizens that government was willing to ‘lead from the front’ and walk the talk. The lack of fiscal morality, according to SAICA, undermined the social contract that government has with its citizens.
		5. SAICA made several other comments on SARS’s operating model and, particularly, the outstanding SARS Service Charter and Senior Official’s List, and communication challenges.
		6. SAICA further called for the renegotiation of the SACU agreement arguing that it had become the “proverbial milestone around South Africa’s neck’.
	6. **South African Institute for Tax Professionals (SAIT)**
		1. SAIT pointed out that increasing taxes for the upper income earners was understandable but warned that the tipping point was being reached for the increases in individual taxes.
		2. SAIT submitted that deeper spending cuts on government spending were needed and pleaded that increasing spending should not be at a greater rate than inflation.
		3. On the increase on the dividends withholding tax rate increase from 15 percent to 20 percent, SAIT raised concerns about its impact on pensioners and BBBEE (Broad-Based Black Economic Empowerment) shareholders and what it referred to as its retrospective application.
		4. SAIT welcomed the tightening of anti-avoidance rules in the form of low interest loans made to companies owned by trusts to avoid donations tax and other measures and called for adequate consultation.
		5. SAIT, like many other stakeholders, raised concerns about consultation with regards to the introduction of the SSB tax and made many other comments ranging from estate duty, base erosion and profit shifting, venture capital company regimes (VCC), real estate investment trusts (REITs), and the tax compliance burden for small businesses.
	7. **Manufacturing Circle**
		1. The Manufacturing Circle represents forty significant South African manufacturers that include companies such as Arcelormittal, Nampak and Denel. Its purpose is to promote the interests of manufacturers to enable job creating economic growth in South Africa. The Manufacturing Circle’s major concerns included that the manufacturing sector’s contribution to GDP had declined due to increased competition from imports; increased labour costs; high energy costs, lack of skills and policy uncertainty.
		2. The Manufacturing Circle submitted that the abovementioned challenges had unintended consequences of closure of businesses - leading to job losses; low fixed investment and a move from labour to capital intensity in an effort to save costs and enhance efficiency. The organisation was of the view that South Africa was not investing sufficiently in assets for growth, measured by the percentage of gross capital formation to GDP, compared to other countries like China and Germany. This put returns-on-investment in the manufacturing sector under pressure as the sector was already highly taxed. Manufacturing, according to Manufacturing Circle, was the second most taxed sector after electricity.
		3. The Manufacturing Circle submitted further that the proposed taxes in the 2017 Budget, plus possible future taxes such the SSB tax, the carbon tax, the Waste Management Act tax and uncertainties regarding future tax incentives will have a further negative impact on the sector.
		4. The organisation pleaded for further consultation on the SSB tax, counselling for a detailed strategic plan to address the many factors that influence obesity rather than an isolated focus on sugary beverages.
		5. The organisation proposed that NT should ring-fence the revenue collected from the proposed Waste Management Act tax to fund existing initiatives. Manufacturing Circle welcomed the R1.3 billion for sector specific support and Special Economic Zones (SEZ) support. The organisation expressed the manufacturing industry’s commitment to achieving investment, job creation and growth. Lastly, it made a plea for assurance and information on the level of support that can be expected by the manufacturing industry from government in the future.
	8. **Mr Guy Harris**
		1. Mr Guy Harris CA (SA) is the founder of KLOP Accelerator and an Education and Governance activist. He submitted that for South Africa to achieve transformation for inclusive growth, there is a need to transform and to be competitive through supply chain inclusion, substantially expand and strengthen the Small Medium and Micro Enterprises (SMME) sector and develop ways to graduate people from poverty into the formal business sector through jobs and entrepreneurship. Mr Harris is of the view that education and job creation are the key solutions to reducing inequality, unemployment and poverty. These could be done through a stronger and well-funded Early Childhood Development (ECD) base which provides clear lines of responsibility for and accountability between the provinces, the municipalities and the Department of Basic Education, as well as the SMME sector.
		2. Mr Harris acknowledged that the credit ratings downgrades were avoided and that for the economy to grow, NT must continue with strong fiscal management, policy certainty must be improved and government must improve its collaboration with SMMEs. On job creation, Mr Harris believes that SMMEs are the key lever but incentives must be increased; the 30 day payment requirement must be enforced and large scale deregulation is needed to make it easier to start and grow to critical mass.
	9. **PACSA (Pietermaritzburg Action For Christian Social Awareness)**

4.10.1 PACSA submitted that the annual pension increments and Child Support Grants (CSP) should be increased above Consumer Price Index (CPI) to be able to absorb electricity, food and transport costs for low income households. PACSA is of the view that CSG recipients and pensioners should receive a 13th cheque in December to absorb pressures during the period and enable families to start the new year in a better space to send children to school.

4.10.2 PACSA expressed concerns with the possible increase in VAT which it claimed was more regressive and counterproductive in building a strong social base and will impact on low income households disproportionately. NT should designate more zero-rated foods.

4.10.3 The organisation proposes that National Treasury intervenes more firmly in the annual NERSA (National Energy Regulation of South Africa) and Eskom negotiations on increasing electricity tariffs.

4.10.4 NT should be more effective in protecting certain categories of people against the negative impact of fuel levy.

4.10.5 PACSA argues that companies should be taxed at higher levels because these tax breaks do not appear to have yielded any significant returns in employment, raised wages or increased investment.

**Part V**

## ONEROUS TIMELINES OF THE MONEY BILLS ACT

5.1 As noted in the Committees’ previous reports, the timelines to finalise the Fiscal Framework and fulfil other aspects of the Money Bills Act are far too onerous and undermine the Committees’ effective processing of the Budget and need to be urgently reviewed. The Committees have begun with this process and will seek to effect appropriate amendments to the Act by the third quarter of this year. It is intended that this will be the last year in which the Fiscal Framework Report is finalised in such haste.

**PART VI**

1. **COMMITTEES OBSERVATIONS AND DELIBERATIONS**
	1. The Committees note that the differences among stakeholders who made submissions on the budget are wider than is usually the case and believe that it may reflect an understandable polarisation in South African society given the current economic and political climate. While some of the differences may be inevitable, the National Treasury, the Committees, parliament in general and other relevant structures should seek to do more to engage more effectively with a cross-section of stakeholders to secure at least a minimum degree of national consensus on the country’s goals on economic growth, job creation and development.
	2. The Committees note NT’s responses to the Committee’s 2017 Fiscal Framework Report to Parliament and requires NT to deal further with the recommendations in that Report at its March quarterly briefing to the Committees.
	3. The majority in Committees welcome government’s commitment to radical economic transformation which it understands to be, as defined by President Jacob Zuma in his “State of the Nation Address” as “fundamental change in the structure, systems, institutions and patterns of ownership, management and control of the economy in favour of all South Africans, especially the poor, the majority of whom are African and female”. It is in this context that the Budget has to be located.
	4. The Committees believe that in view of the slightly better circumstances, including the easing of the drought in several farming regions, increase in commodity prices, improved labour relations and electricity supply, it is possible to grow by 2 per cent in 2018/19. However, this will need the government to work together to implement the structural reforms necessary to boost economic growth and create jobs; the active implementation of the programmes being funded in the Budget; and the vigorous oversight by parliamentary committees, among many other considerations. In other words, subjective factors will be very important in reaching the growth target, even if 2% is below what the country needs.
	5. The Committees welcome the fact that the Budget has continued to protect the provision of social services and has provided further resources for the higher education sector to ensure that there are no fee increases for needy students.
	6. The PBO highlighted that the fiscal policy trajectory has not changed since 1994 and has been expansionary in approach. The PBO argued that the current fiscal and monetary policy mix, while it maintained government’s social and economic programmes, has failed to address the challenges of poverty, unemployment and inequality effectively enough and the policy trajectory needs to be reviewed. The Committees will engage the PBO further on this.
	7. The Committees note the Budget’s continuation of the fiscal consolidation path set out in the October 2016 MTBPS. However, NT’s 2017/18 growth forecast appears to be more optimistic than those by SARB, IMF and World Bank. The PBO suggested that NT’s growth forecast was more accurate than that of the IMF, the World Bank and the Bureau for Economic Research (BER) in 2016/17.
	8. The Committees welcome the proposal to lower further the spending ceiling over the medium term expenditure framework period by reducing spending on non-core goods and services and on compensation of employees and this is projected to narrow the budget deficit to 2.6 percent by 2019/20.
	9. The Committees note that the debt-to-GDP ratio sits at above 50 per cent, and has been projected to stabilise to 48.2 percent only in 2020/21. This is contrary to the previous projections of 46.2 in 2019. As stated in the Committees’ 8 November 2016 Revised Fiscal Framework Report, the Committees need to consider what might be reasonable debt levels given the country’s economic growth and development goals. While there is no general debt threshold for any country, as asserted by PEERC, high debt levels may have a negative impact on a country’s credit rating. However the FFC says that the country’s debt is not at an optimal level and there is no need for excessive fears about it.
	10. The Committees are deeply concerned about the decline in private sector investments. Investment growth was 2.6 percent in 2015 as compared to 26 percent in 2006, and this contributed to an increase in the number of the unemployed by 587 000. Government investment has replaced private investment in conditions of declining government revenues.
	11. The Committees note the decreasing revenue from CIT as a percentage of total tax revenue over the last five years, representing 17 per cent presently.
	12. The Committees are concerned about the largest revenue underperformance in 8 years, projected at about R30.4 billion for 2016/17. The Committees note the standard considerations that the revenue shortfall could be explained by lower growth than forecast, lower wage increases which led to lower personal income taxes being collected and reduced imports leading to lower import duty being collected. There has been a significant change in the tax buoyancy ratio from 1.47 to 0.86 and the suggestions by PEERC and others that the revenue shortfall and the uncharacteristic tax buoyancy may have been partly due to calculated delays in processing VAT refunds in 2015/16 in order to ‘claim success’. There are also claims that diesel refunds have been withheld. The Committees also note NT’s suggestion that the shortfall is also to be explained by SARS’ lack of capacity and SARS’s public rejection of this.
	13. The Committees welcome NT’s decision to not increase VAT at present. The opposing views by stakeholders for and against an increase in VAT is noted.
	14. The Committees note the support by some stakeholders of a fuel levy in order to raise additional revenues for fiscal consolidation. However the Committees believe that NT needs to take more account of the regressive impact that an increase in fuel levies has on the poor and working class who spend the most on transport as a percentage of their monthly income; it needs to be noted that 22 per cent of South Africans use min-bus taxis to commute.
	15. The Committees note NT’s explanations that the potential revenue collection for the SSB tax, donations tax on interest free loans and the SVDP tax were not included in the projected additional R28 billion increases for 2017/18. The NT representatives explained that they did not include the SSB tax and donations tax on interest free loans because they did not yet know their effective dates. With regards to the SVDP forecast, they did not know how much was kept offshore and will be repatriated through voluntary disclosures. They however expected between R3 billion to R6 billion from the SVDP.
	16. The Committees note the NT forecasts of additional tax increases for 2018/19 (R15 billion) and 2019/20 (16.3 billion) are not as a result of any tax decision for those years but trickle-downs from the 2017/18 revenue proposals.
	17. The Committees welcome the bracket creep relief for low income earners but believe more could have been done. NT explained that further bracket creep relief would also benefit the high-income earners and compromise the revenue collection targets significantly.
	18. The Committees welcome proposed NTs improvements of tax administration and tax collection aimed at clarifying the powers of the Minister to make regulations prescribing the duties for those who administer the VAT and Income Tax Acts and regulations governing the reporting of information to ensure tax administration and tax collection of PIT, CIT, withholding taxes and VAT.

## COMMITTEES RECOMMENDATIONS

* 1. The Committees require NT to give a more comprehensive response than it has done already to the key views of the stakeholders who participated in the hearings at its March quarterly briefing to the Committees.
	2. The Committees broadly agree with NT’s approach to the interrelationship between growth and transformation as part of radical economic transformation as set out in the Minister’s Budget Speech and Budget documents and as covered briefly in paragraph 2. 1.1 above. However, there seems to be a lack of understanding or agreement with NT’s approach to radical economic transformation from important role-players in government, the state and civil society. The Committees strongly recommend that NT engages with the relevant role-players on this approach.
	3. Related to what the Committees note in paragraph 6.1 above, it is recommended that NT plays a more active role in contributing to reducing the wide differences between key stakeholders. The Committees are aware that NT does make a significant contribution in this regard and the responsibility is not that of NT alone, but of all three spheres of government, the legislatures and other state organs, but recommends that NT seek to do more.
	4. The Committees repeat the call made in previous reports for government as a whole to work with business, labour and civil society to ensure greater economic growth.
	5. The Committees recommend that NT should, together with other government departments and other organs of state do more to induce business to invest. The Committees note that even though CIT has been reduced as a percentage of overall taxes, the private sector is not investing in the South African economy. If business continues to abstain from significantly investing in the economy, the Committees recommend that NT consider reviewing its reluctance to increase CIT.
	6. The Committees recommend that NT considers what the PBO has said, as noted in paragraph 6.6, and responds to this in the 2017 MTBPS Briefing.
	7. NT needs to consider the views of stakeholders expressed in the public hearings that it needs to explore alternative ways of implementing fiscal policy, such as reviewing the relevance of the inflation targeting framework including whether the blunt instrument currently used, interest rates, is the best alternative to achieve the objectives of monetary policy and support economic development.
	8. Based on the observations in paragraph in 6.9 above, the Committees require NT, the FFC and PBO to have a structured exchange with them on what a reasonable debt level should be.
	9. The Committees welcome the 30 percent set-asides in terms of the new Preferential Procurement Regulations and recommends that this percentage be increased over time. The Committees recommend much stronger penalties for companies involved in “fronting” and other forms of transgression of these regulations.
	10. The Committees are concerned about the levels of infrastructure under-spending. The Committee support NTs proposal to establish a new financing facility for large infrastructure projects that will project beyond the three-year MTEF cycle and recommend that this be finalised expeditiously.
	11. The Committees require NT to report on progress on the possible merger between SAA and SA Express and proposals on further funding of SAA at the Committee’s meeting with SAA in March.
	12. The Committees require NT to provide regular reports on the progress in disposing of non-strategic assets.
	13. While noting progress in this regard, the Committees recommend that NT seeks to do more to persuade Departments and other state organs to reduce spending on non-core goods and services.
	14. The Committees note the pending public sector wage negotiations and recommend that both government and the unions seek compromises in the interests of the country’s developmental goals.
	15. Based on the observations in paragraph 6.12 above NT and SARS must provide a more comprehensive explanation for the reasons for the R30,4 billion revenue shortfall for this financial year and, importantly, what is being done to address this. This process should be taken further at the March Quarterly Briefing to the Committees.
	16. The Committees recommend that NT and SARS do far more to reduce Illicit Financial Flows (IFFs) through aggressive tax avoidance and evasion. This must continue to be an important part of tax agreements with other countries. NT and SARS must report on progress in this regard at its quarterly briefings of the Committees, as well as the next sitting of the joint National Assembly committees meeting on IFFs on 15 March.
	17. Given the polarised views on the issue of possible VAT increases, the Committees urge the Minister to consult widely on any decision to increase VAT in the future and if VAT is to be increased, to opt for a model that would protect the poor and low income earners more. The Committees recommend that NT consider reviewing the basket of VAT consumer goods that are zero-rated to be more relevant and appropriately targeted to cushion the poorer people. Poor people also need to be educated about zero-rated goods. NT should explore the possibilities and efficiencies of higher VAT on luxury goods.
	18. Related to paragraph 6.17 above, the Committee recommends that NT do more to protect more low income taxpayers from the effects of “fiscal drag”.
	19. The Committees note the increase in fuel levies and recommend that NT should look at ways to minimise the impact of this on the poor, particularly those who use public transport.
	20. While supporting NT on the increases in taxes of higher-earning individuals, the Committees recommend that NT should note the submissions at the hearings that this could have the unintended consequence of people restructuring their salary packages to avoid higher taxes. NT needs to consider ways of reducing the prospects of this.
	21. The Committees note that the new top tax bracket for personal income tax is projected to raise about R4.4 billion rather than the R6.5 billion that could potentially be raised, accommodating a tax leakage of about R2.1 billion due to possible restructuring and tax avoidance. The Committees recommend that NT develops more effective anti-tax avoidance measures to reduce this potential leakage.
	22. The Committees believe that the many advantages of an SSB tax have to be balanced particularly with the disadvantages of job losses and the consequences for emerging African sugar cane growers. The Committees welcome the decision to process these and other related SSB tax issues through NEDLAC and strongly recommend that the NEDLAC process be finalised before a relevant Bill is brought to Parliament.
	23. We recommend that NT moves swiftly with introducing the legislative amendments to the tax laws to improve the administration, collection and reporting of information on PIT, CIT, Withholding taxes and VAT.
	24. The Committees request the Davis Tax Committee to provide a report within the next 6 months on progress in respect of its investigation into tax administration, including the implementation of the new operating model, at SARS
	25. The Committees note that there are no studies conducted in the South African context to test the ‘*Laffer curve’* theory and recommends that NT consider research in this regard.
	26. The Committees once again express their concern about the unproductive relationship between the Minister of Finance and the SARS Commissioner and recommends that the Leader of Government Business and/or the President attends to this matter expeditiously. The Committees once again recommend that the SARS Commissioner report fully to the Minister as required in terms of the law, norms and established practices and that the Minister oversees work of SARS in terms of the same criteria. This matter has become more urgent in view of the low growth rates, need for more revenue and shortfalls in tax revenue projected for the 2016/17 financial year.
	27. Related to paragraph 6.18 above, the Committees recommend that the relevant Bill be introduced to Parliament reasonably soon.
	28. The Committees are concerned about the levels of infrastructural underspending and note NTs proposal to establish a new financing facility for large infrastructure projects and address the shortcomings in underspending in this regard. The Committees recommend that NT move swiftly on the establishment of this facility.
	29. As raised in previous Reports, the Committees require a regular update on progress on the review of the Southern African Customs Union revenue sharing formula.

The DA reserves its position.

Report to be considered.

1. Financial and Fiscal Commission: Submission on the 2017 Fiscal Framework and Revenue Proposals [↑](#footnote-ref-1)
2. National Treasury Budget Review 2017 [↑](#footnote-ref-2)
3. *Ibid* [↑](#footnote-ref-3)
4. *Ibid* [↑](#footnote-ref-4)
5. *Ibid* [↑](#footnote-ref-5)
6. PIT,CIT, VAT and Customs and Excise [↑](#footnote-ref-6)
7. The ‘*Laffer curve’* theory posits that the higher the tax rate, the lower the revenue collection as taxpayers engage in aggressive tax avoidance and evasion. [↑](#footnote-ref-7)