2020 BUDGET

RESPONSE TO PUBLIC HEARINGS ON THE BUDGET 2020

6 March 2020

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

List of organisations that made submissions for public hearings on the 2020 Budget

- Action 24
- Black Tobacco Farmers Association (BTFA)
- British American Tobacco South Africa (BATSA)
- Budget Justice Coalition
- Congress of South African Trade Unions (COSATU)
- Financial and Fiscal Commission (FFC)
- Fiscal Cliff Study Group
- Limpopo Tobacco Processors (LTP)
- National Council Against Smoking
- National Union of Metalworkers South Africa (NUMSA)
- Parliamentary Budget Office
- PricewaterhouseCoopers (PwC) Tax Services (Pty) Ltd
- Rural Health Advocacy Project (RHAP)
- South Africa Tobacco Transformation Alliance
- The South African Institute of Chartered Accountants (SAICA)
- Tobacco Control Advocacy Alliance
- TWISP
- Organisation Undoing Tax Abuse (OUTA)
- Vapour Product Association

Summary of main discussion points

- Appropriateness of the budget given the current economic situation (fiscal consolidation vs stimulus debate, and implications for growth)
- Wage bill and other baseline proposals, and implications
- Tax proposals, particularly as they relate to the need for additional revenue, as well as tobacco products

Debate on the fiscal stance of Budget 2020

- Government is proposing a tough budget because we are facing an unsustainable fiscal outlook that, left unchecked, could result in crisis.
- The longer we wait to address this issue, the larger the future fiscal adjustment will need to be to stabilise debt. Debt-service costs will continue to be the fastest growing area of expenditure, crowding out social expenditure
- Total consolidated spending rises from R1.84 trillion this year to R2.14 trillion in 2022/23. Goods and services and capital budgets continue to grow faster than inflation. The wage bill grows below inflation.
- Reductions reflect lower growth in spending, relative to baselines that were founded on more optimistic forecasts of revenue and growth.
- Even with these changes, the deficit widens to 6.8 per cent of GDP (R370.5 billion) in 2020/21 and debt to will rise to R3.6 trillion.
- Debt does not stabilise as a share of GDP over the medium term, but Budget 2020 takes a first step towards this target.

Wage bill proposals

'*Government recognises that public-service employees should be fairly remunerated, but is obligated to balance compensation demands with the broader needs of society as reflected in the budget*'. Budget Review 2020, page 3

- Government is not proposing a reduction in nominal wages or a reduction in headcount. The proposal is to reduce wage bill growth to below CPI.
- Budget 2020 makes provision for slower increases in the consolidated wage bill, which grows by 1.5 per cent next year, and by 4.5 per cent and 4.4 per cent in the following two years. In addition, government has provided some PIT relief in 2020/21.
- Over the past 12 years, public service wages have increased by 40 per cent in real terms. In recent years, wage bill growth has outpaced the rest of the economy.
- The current wage agreement has been more generous than envisaged, because CPI has been revised down for this year and last year.
- Compensation bill reductions now can open the door to increased hiring of teachers, health workers and others in future.
- Complementary efforts to combat wasteful expenditure and make spending more efficient are required. However, these changes are not sufficient to close the deficit.

Growth and the budget

- Slower spending growth will have an impact on GDP, everything else being equal. This is reflected in the growth and revenue forecasts used in the Budget 2020
- However, an unsustainable fiscal outlook increases the cost of capital and lowers investment.
- Higher interest rates makes investing more expensive for the whole economy, thereby reducing potential GDP growth.
- This is also the case for government, where yields on our debt have risen, despite a very accommodative international climate.
- The stimulus/austerity debate implies that South Africa is facing a short-term cyclical slowdown in growth. Government's view is that our growth problems are largely structural.
- South Africa has been running large deficits for the past ten years, while GDP growth continues to decline.

Growth reforms to lower the cost of doing business

- **Electricity:** Acquire additional electricity from existing IPPs, open bid window 5, procure additional 2 000 - 3 000MW of emergency power, allow municipalities to procure power from private sector, make changes to electricity regulations to allow for self-generation.
- **Ports**: Accelerate corporatisation of National Ports Authority.
- **Rail**: Economic Regulation of Transport Bill to be put before Parliament; implicit subsidisation of road freight should cease.
- **Telecoms**: Accelerate digital migration and continue work to release spectrum through an auction. ICASA must enforce open access conditions and issue rapid deployment guidelines.
- Support small business, enhance industrial policy by implementing:
  - Competition Commission recommendations on retail and telecoms
  - Ease of Doing Business project proposals (i.e. launch of the Bizhub portal)
  - Sectoral Master Plans to boost investment and employment

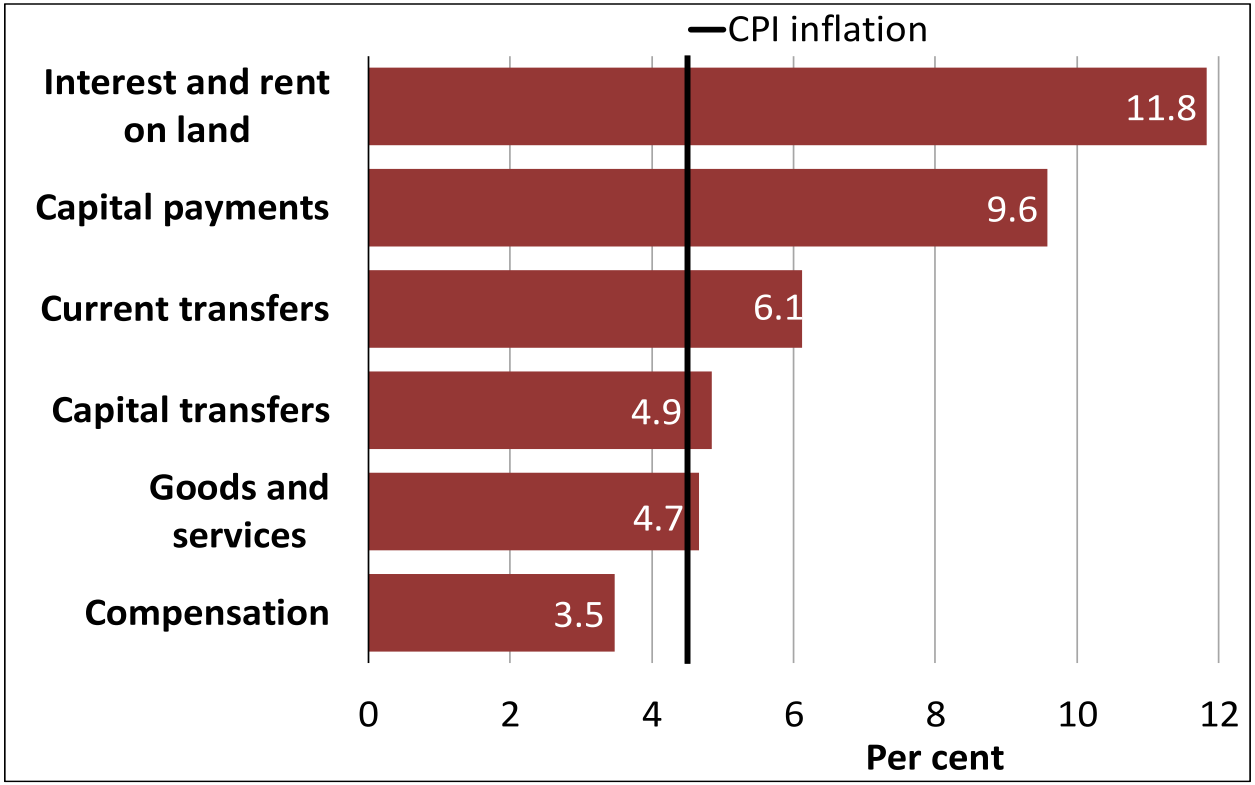
Other reductions to spending baselines

'Achieving fiscal sustainability requires public spending levels to be closely aligned with the revenue-raising potential of the economy.' Budget Review 2020, page 26

- The Budget Review sets out the implications of spending reductions on the other areas of spending, which may include slower roll out of programmes, potentially negative effects on maintenance, and increased accruals.
- Cost pressures, including new and urgent priorities, have been funded through a combination of reallocations and reprioritisations over the MTEF.
- The space for across-the-board reductions has become increasingly limited, implying the need to review programmes, possibly resulting in closure or downscaling over the medium term, and more efficient spending.
- This year, the National Treasury and the Department of Planning, Monitoring and Evaluation will undertake a new round of expenditure reviews to identify cost savings and improve efficiency.

Average spending growth over the MTEF by economic classification

Figure 3.4 Average nominal growth in consolidated spending, 2020/21 — 2022/23



- Consolidated wage bill is projected to grow by an annual average growth of 3.5 per cent over the medium term
- Current transfers and capital payments grow faster than CPI inflation

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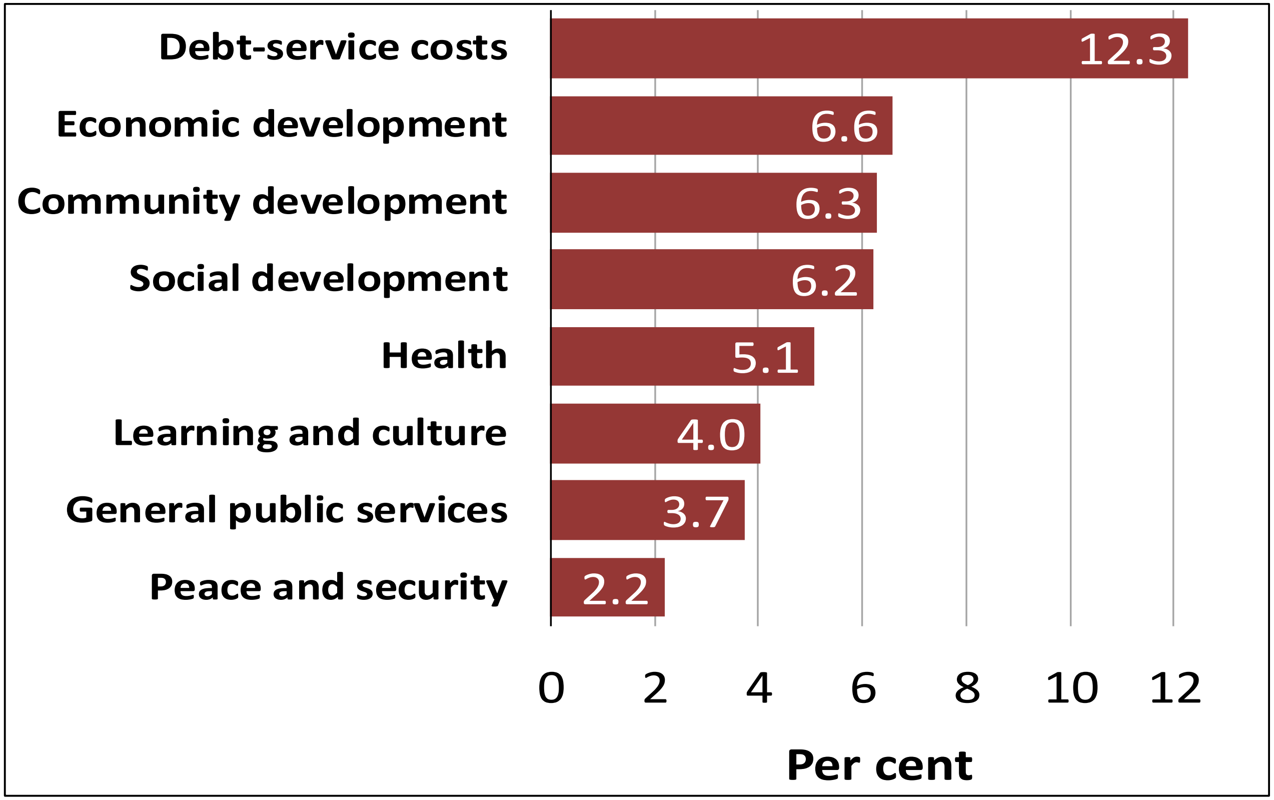
Average spending growth over the MTEF by function

Figure 5.1 Average nominal growth in spending, 2020/21 — 2022/23



- Fastest-growing functions include economic development and community development
- Slower growth in health, learning and culture, and peace and security reflects the effect of lower compensation growth

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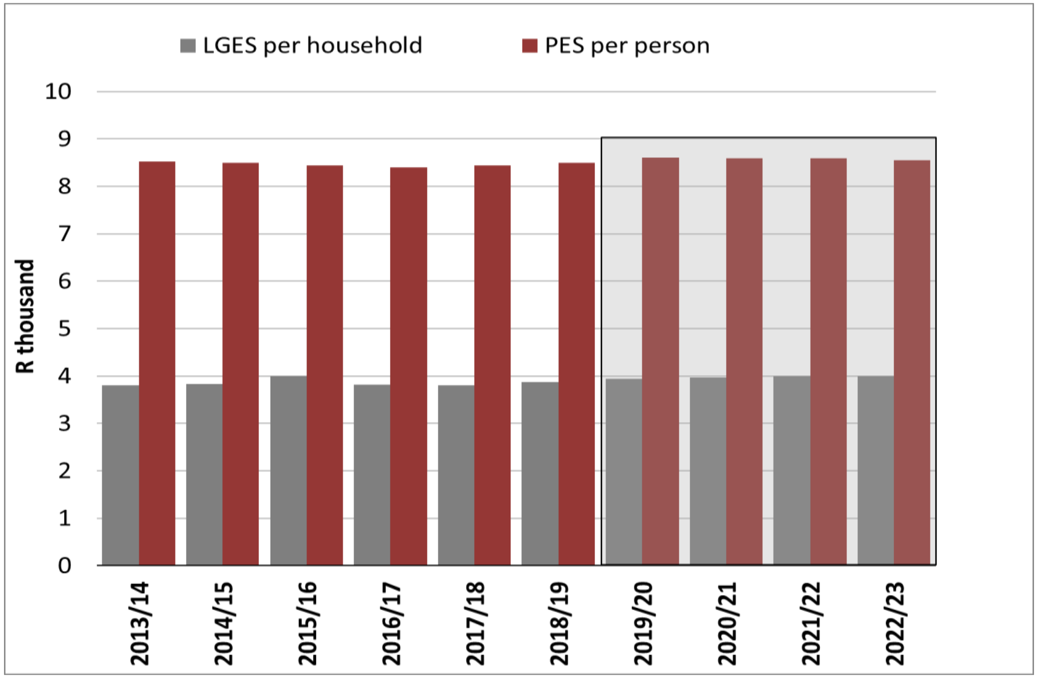
Protecting provincial and municipal transfers to for social spending

- Majority of budget is for social services
- Operational budgets funded through equitable share allocations increase to compensate for growing populations
- Reductions to conditional grants are focused on areas where funds are not being fully spent, or spent ineffectively and where projects can be delayed
- Transferring national departments and provinces/municipalities are accountable for the performance of individual grants

Transfers to fund operational costs of social services in provinces and free basic services in municipalities have been protected in real, per capita terms



Does not include provisional reductions to compensation of employment

Heath financing:

- NT and DoH will review health conditional grants system to ensure alignment to NHI and improve delivery. Development components to assist rural provinces added in 2 grants in 2020. Ongoing review of equitable share formula is also examining costs of rural services.

Improving spending efficiency and reducing waste

- **Procurement** – reforms required to make legitimate procurement easier without undermining the necessary anti-corruption safeguards. Draft Public Procurement Bill has been gazetted for public comment
- **Sub-national reforms** – Government has reduced unfunded municipal budgets and is piloting initiatives to improve municipal revenue collection. Following a review, government is introducing several changes to the provincial grant system.
- **Claims against the state** – work has begun to limit unreasonable medico-legal claims against the state.
- **Tax incentives** – Over medium term, government will conduct a review of tax incentives, repealing or redesigning those that are redundant, inefficient or inequitable.
- **Public-sector remuneration** – Government will publish a new law this year introducing a remuneration framework for public entities and state-owned companies.
- **Public office bearers** – There will be no increase in the salaries of public office bearers in 2020/21. This follows a reduction in benefits stemming from changes to the Ministerial Handbook.
- **Other costs will need to be controlled**: over the coming year, government will report on the causes of unauthorised and wasteful expenditure, and examine ways to reduce state litigation, accommodation and information technology costs.

No tax increases due to weak economy

- Over past 5 years majority of fiscal consolidation has come through tax increases, yet revenue shortfalls have been getting consistently larger
- Government decided not to raise additional tax revenue due to weak state of the economy, which was expected to grow by 0.3% in 2019 (0.2% actual)
- Additional tax revenue from carbon tax and plastic bag levy offsets R2 billion in relief for personal income tax
- Some of the comments suggested that there was no tax increase as the tax-to-GDP ratio is too high and that government is recognizing that they cannot raise additional revenue
  - Although the tax-to-GDP ratio is relatively high for the country at our level of development, there could still be scope for tax increases if economy recovers.
  - Government does not believe future tax increases would be ineffective
- Others felt that there should be larger tax increases by not providing personal income tax relief and increasing the VAT and CIT rates
- Some stated that government should not stick to a limit of 25% tax-to-GDP
  - There is no 25% ceiling in place (tax-to-GDP is already at 26.2%) and this would not be an overriding factor in future tax policy decisions

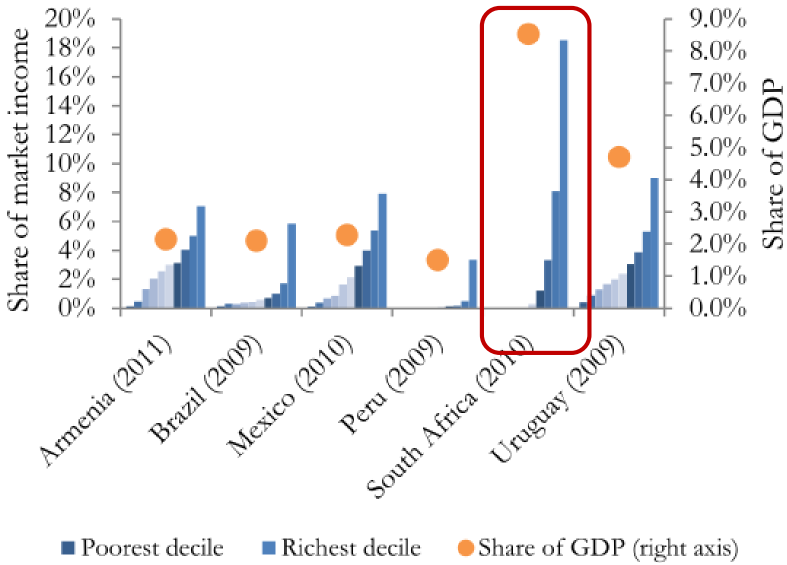
Excise duty increases on tobacco reflect the policy guideline

- In relation to excise duties on cigarettes, government has a targeted excise burden of 40% of the price of a pack of the most popular brand
  - This is a policy guideline to provide an element of certainty to industry, however it is not a legislative requirement and adjustments are still up the discretion of the Minister of Finance
- Some commentators wanted <u>no increase</u> in excise duty on cigarettes to get closer to 40%
- Other commentators are advocating for a <u>far higher increase</u> than the 4.4%
- In recent years, excise duty increases on tobacco have been above inflation to assist with fiscal consolidation through tax increases - led to a excise duty burden that is above the guideline of 40% (influenced by price adjustments)
- Previous discussion paper stated that increases would be either in line with inflation or at a higher amount to move towards the guideline
- Support for tax on heated tobacco products, will hold workshop within the next few weeks on the taxation of electronic cigarettes (vaping) from 2021
- But also need complementary measures to assist in increasing excise revenue (enforcement) and reducing harm (e.g. action on vaping in schools)

The progressivity of the personal income tax system

- Amendments to income taxes have substantially increased the progressivity of the income tax system over the past five years, these include:
  - A 1 p.p. increase in tax rates across all the income brackets (importantly this did not include the bottom bracket); a new top income tax bracket with a rate of 45% for taxable incomes above R1.5 m; increasing the dividends tax *rate from 15% to* 20% and capital gains inclusion rate from 25% to 40%

- The tax free threshold (now at R83 000) takes many individuals outside of the personal income tax system
- World Bank analysis (figure on the right) suggests that: (i) only the top 40% of households by income pay personal income tax and (ii) the amount of personal income tax paid increases steeply for those in the top deciles



Source: Inchauste, Gabriela; Lustig, Nora; Maboshe, Mashekwa; Purfield, Catriona; Woolard, Ingrid. 2015. *The distributional impact of fiscal policy in South Africa (English).* Policy Research working paper ; no. WPS 7194. Washington, DC: World Bank Group.

- Government agrees with comments that we would like to review tax incentives to potentially raise revenue and improve progressivity of the overall tax system

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Other comments on taxation

- Tax system is primarily to raise revenue, but in some instances are used for health and environmental objectives
- Carbon tax rate should be higher and allowances curtailed
- Support for a tax on single use plastics, revenue from this and plastic bag levy should be used to support recycling
- What is the progress on the export tax on scrap metal
    - Budget Review announced consultation over introduction of export duty for ferrous, aluminium and copper
    - Since this is a new tax, the legislative tax policy process will be followed, with consultation taking place immediately with all affected parties on the potential impact of its introduction
- Significant changes have been made for financial surveillance by moving to a new capital flows management framework, which will improve oversight of flows and make it easier for individuals to keep ties with South Africa
- NEDLAC has also come to an agreement on retirement reform proposals