# Submission to the Standing Committee and Select Committee on Finance with respect to the Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill

24 April 2018

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## 1. Introduction

As civil society organisations (CSOs) we reject the fiscal framework contained in the Rates and Monetary Amounts and Amendment of Revenue Laws Bill ('the Bill'), in particular its regressive tax measures and the harsh spending cuts that will result from the proposed revenue levels.

As raised in our original submission regarding the 2018 National Budget, we are concerned about the negative effects these measures will have on poor and low-income households. Such choices were not inevitable and, as previously demonstrated, alternative progressive taxation measures, which would reduce inequality and support growth, are available to the Executive.

We acknowledge and appreciate the detailed process of engagement, under the imposed unreasonable time frames, by the Standing Committee and Select Committee on Finance ('the Committees') and are pleased by the opportunity to make this submission. This submission responds to the Bill, in a general manner, and to the Report of the Standing Committee on Finance ('the Committee') on the 2018 Fiscal Framework and Revenue Proposals ('the Report'), dated 06 March 2018.

## 2. The role of the budget

**We welcome the Committee's acknowledgement in their Report that the budget must be seen as a means to secure economic growth and transform the economy** and that transformation requires "a fundamental shift in the way that wealth is created and shared". [1] In our view the budget should also be expressing aimed at realising constitutional rights, especially the socio-economic rights to food, health care services, land, housing, water, education, social security and social services.

**Unfortunately, this year's budget, and the revenue raising proposals contained within the Bill, fails in these regards.** The Minister, as referenced by the Committee, misleads us in arguing that the budget is "tough" but "hopeful"; it is patently not correct that the budget "supports economic cohesion through increased education, health and social development funding".[2]

## 3. Austerity

**The magnitude of overall revenue raised, and the distribution thereof, will, of necessity, entail cuts or limited increases for essential social expenditure**. This includes education, health and social welfare, as well as economic infrastructure. This will disproportionately hurt vulnerable groups: the poor, low-income households, and women and children, who rely heavily upon state services.

[1] Standing Committee on Finance, 'Report of the Standing Committee on Finance on the 2018 Fiscal Framework and Revenue Proposals' (Parliament of the Republic of South Africa, 6 March 2018), 28.
[2] Standing Committee on Finance, 1.

We welcome the concern expressed by the Committees regarding "the reductions in the infrastructure grants as part of the expenditure saving".[3] The Committees correctly note that: "In particular, a decision taken by NT [National Treasury] to cut capital expenditure at provinces and municipalities, the faces of service delivery, is a major cause of concern for the Committees because social infrastructure is needed to grow the economy and deliver services to the people."[4] It is worth pointing out that the devil is in the detail here, with various spending squeezes happening that are not immediately obvious in the budgets. For example, the Eastern Cape Education Department has reduced per capita funding to no-fee public schools by excluding all children at the schools who don't have birth certificates from the funding formula.

We further support the call for National Treasury to undertake spending reviews and the instruction that National Treasury "quantifies and manages the impacts of cutting capital budgets on service delivery, schools, clinics, and hospitals, given the current backlog". Civil society will engage with the quarterly reports to the Committee that have been requested from National Treasury.

**We support a review of the public sector wage bill that intends to support not curtail front-line services and protect critical frontline posts in health and education.** The Committees' requested National Treasury "to provide a detailed analysis in respect of the 2018/19 budgeted annual increases in compensation of employees including: structural remuneration changes, notch adjustments, promotions, seniority increases, performance bonuses, annual general adjustments". This analysis should explicitly note: 1. The importance of protecting front-line services, and expanding them where there are critical shortages; 2. The role that public sector wage spending plays in stimulating the economy and supporting non-wage-earning dependents; 3. That any assessment of the public sector wage bill must specifically target making the wage structure more progressive and reducing inequality.

## 4. The VAT hike: Increasing the regressivity of the tax mix

**The increase in VAT and the fuel levy makes the tax mix more regressive, increases the taxes paid by poor and low-income households and reduces their spending.** While the most recent research shows that, due to zero-rating, VAT in South Africa is not in itself regressive, we welcome the Committee's rejection of this narrow technocratic approach.[5] The tax increase is projected to raise the share of VAT in the overall tax mix and hence the share of tax contributed by the poor and low-income households – this *makes the tax mix more regressive*.

We similarly welcome the rejection of the argument that a VAT increase is justifiable because "our current rate is lower than the global and African average"[6] and agree that this does not take account of extreme levels of poverty and inequality in South Africa and the policy objective to reduce these.

[3] Standing Committee on Finance, 30.
[4] Standing Committee on Finance, 31.
[5] Standing Committee on Finance, 35.
[6] Standing Committee on Finance, 35.

**We reject the view that VAT is the most appropriate way of raising additional revenue.** Not only does it make the tax mix more regressive and reduce the incomes of poor and low-income households but large scale VAT fraud, in South Africa and elsewhere, calls into question whether VAT is the "most efficient" tax option.[7] We accept that revenue raised by the VAT increase can be spent on pro-poor social spending but so too can revenue raised from other sources as extensively outlined in our original submission.

**Further, raising VAT can stifle economic growth as household disposable income falls and domestic demand is depressed. Increases to both VAT and the fuel levy will spur inflation, including on basic foodstuffs and other essential goods.**

The Committee appeared rightly hesitant to endorse the VAT increase[8] and yet does so if it approves the Bill before it.

## 5. Zero-rating

**We welcome the Committee's strong stand on the importance of zero-rating as well as the Government's decision to establish an Expert Panel to review the need for additional zero-rating of essential goods.**

**However, it is important to note that zero-rating is not the panacea to ensuring poor and low-income households have access to basic foods and other essential goods and services**. This requires not only improved incomes but also rethinking the manner in which society gains access to basic goods and their associated supply chains as well as other measures to support and provide better services for poor and low-income households.

As in our original submission we support the Committee when it notes that:

- The current zero-rating of a limited number of goods is insufficient to cushion "the effects of the VAT increase on significant sections of the poor and low-income earners";
- National Treasury has not provided evidence to support their assertion that these zero-rated items and increases to social grants offer sufficient protection;
- The Committee strongly believes "that the list of zero-rated items needs to be expanded taking into account the needs of the poor and low-income earners". We note again that such zero-rating should take account of not only the needs

[7] BBC, 'The Fraud Costing the UK More than £1bn', *BBC News*, 27 November 2017, sec. Business, http://www.bbc.com/news/business-42143849; Dave Chambers, 'R300-Million VAT Scam Earns Company Directors 25 Years in Jail', *Times Live*, 17 August 2017, https://www.timeslive.co.za/news/south-africa/2017-08-17-r300-million-vat-scam-earns-company-directors-25-years-in-jail/; Mxolisi Mngadi, '9 Alleged Members of R99m VAT Fraud Syndicate Arrested', *News24*, 1 February 2018, https://www.news24.com/SouthAfrica/News/9-alleged-members-of-r99m-vat-fraud-syndicate-arrested-20180201.

[8] "Noting: the Committees believe that it might be reasonable to accept the VAT increase" [emphasis added] and "Even if we reject the VAT increase through the Fiscal Framework it will still be implemented on 1 April in terms of the legal provision in s7(4) of the Value-Added Tax Act."

of the poor in general, but be sensitive to cost pressures faced by women and children;

- Current zero-rating can in certain instances be more effectively targeted;
- Consideration should be given to "incrementally introducing a multi-rated VAT system in which VAT on luxury goods is higher than VAT on goods bought by the poor and lower income earners" or to increasing the tax on luxury goods by adjustments to ad valorem tax; and
- National Treasury "is required to conduct an on-going impact study on the effect of the VAT increase on the poor and low-income earners and report to our Committees on this every quarter".

It is important to note that for approximately two-thirds of VAT zero-rated items the poorest 70% derive more than 70% of the financial benefits of zero-rating. This indicates that VAT zero-rating is both an effective pro-poor measure and can, in certain instances, be better targeted. The Appendix contains a list of items which deserve investigation as to whether they meet this benchmark and should be zero-rated. This said, this is not the appropriate test for all items. In certain instances other reasons may prevail, for example a gender-equity argument in support of zero-rating sanitary pads, or a child-rights argument in support of zero-rated school uniforms.

Despite our respect for Professor Ingrid Woolard who has been appointed to lead the Expert Panel investigating the potential for further zero-rating we are concerned that she is a primary author on the Davis Tax Committee's Final VAT Report[9] that rejects further zero-rating. This indicates that she potentially has a conflict of interest.

## 6. Reducing the regressive impact of the VAT increase by increased budgets for social programmes

**We welcome the expanded mandate of the Expert Panel to consider additional means of reducing the negative impact of the VAT increase for the poor, for example increasing social grant amounts or funding of the school nutrition programme.** The impact of the fuel levy increase is also important and we support greater subsidisation and price regulation of public transport as well as universal free school transport. Programmes that result in direct cash transfers or price reductions for poor and low-income households should be prioritised such as increases to social grants, complex systems of conditionality and sub-contracting should be avoided. Similarly, it should be noted that the majority do not receive social grants and a system of comprehensive social security should be on the table. This does not replace the need for further zero-rating of basic goods – these are complementary not mutually exclusive interventions – or the need to explore changes to the food system.

We look forward to engaging with the Expert Panel with our ideas of expansions to programmes that directly benefit poor and low-income households. We request to be given more information on how to engage with the panel as communication efforts on

[9] Dennis Davis and Ingrid Woolard, 'Final Report on VAT' (Davis Tax Committee, March 2018).

our part thus far has been unsuccessful and we are concerned that short notice of engagements will reduce our ability to engage meaningfully.

## 7. The wealthy: Paying their fair share

**Wealthy South Africans live an extraordinary opulent lifestyle amidst a sea of poverty and deprivation.** White South Africans have retained almost all their economic privilege with research showing that their incomes and wealth have increased at a faster rate in democratic South Africa than under apartheid. Despite this, the discourse of the wealthy often paints them as victims and resists meaningful transformation.

**Taxation has an important role to play in redistribution and transforming the economy.** We reject a view that sees taxation narrowly as simply a means to raise funds, as implied by some inputs from National Treasury during the Committee's oral presentations. A well-established body of literature highlights the role taxation can play in either entrenching or reducing inequality.[10]

**Fair taxation also contributes towards social cohesion.** Given the understandable level of frustration among poor and low-income households, and the youth in particular, it is critical that all policies both meaningfully advance transformation and are seen to do so. The fact that the VAT increase was not accompanied by substantial other taxes on the wealthy increased the reality and perception of an unfair system which makes the poor shoulder the burden.

**Our original submission outlined in some detail how increases in corporate income tax, personal income tax on higher income-earners, luxury consumption taxes and wealth taxes on net wealth or fixed property, could close the necessary fiscal shortfalls.** We welcome the forward-thinking approach to tax adopted by the Committee when they note that: "National Treasury needs to look into other forms of raising taxes apart from VAT. Among other options, the majority of the Committee members believe that consideration needs to be given to increasing *ad valorem* excise duties on luxury goods, estate duty rates for the wealthy and inheritance taxes, and investigating the possibility of either a net-wealth tax or an additional tax on immovable property."[11]

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[10] See, for example, Era Dabla-Norris, Kalpana Kochhar, and Nujin Suphaphiphat, *Causes and Consequences of Income Inequality : A Global Perspective* (International Monetary Fund, 2015); Ingrid Woolard et al., 'How Much Is Inequality Reduced by Progressive Taxation and Government Spending?', *Econ3x3*, October 2015, http://www.econ3x3.org/sites/default/files/articles/Woolard%20et%20al%20%202015%20Fiscal%20policy%20progressivity%20FINAL4_0.pdf; Daniel Jeongdae Lee and Zheng Jian from the Macroeconomic Policy and Financing for Development Division, 'Taxing for Shared Prosperity', MPDD Policy Briefs (United Nations Economic and Social Commission for Asia and the Pacific (ESCAP)), accessed 23 April 2018, https://ideas.repec.org/p/unt/pbmpdd/pb46.html.

[11] Standing Committee on Finance, 'Report of the Standing Committee on Finance on the 2018 Fiscal Framework and Revenue Proposals', 36.

## 8. Efficient tax collection and expenditure

**We welcome the Committee's insistence that "government needs to do much more to reduce corruption and wasteful and unnecessary expenditure and significantly improve the efficiency and quality of spending".** While we believe there are areas of the government budget that can be reduced in a progressive and pro-poor manner we caution against: a. using this as a backdoor to impose austerity; b. punishing municipalities that are unable to effectively spend their allocations by reducing those allocations rather than improving skills, management and systems in those municipalities, and clamping down on corruption, to ensure effective spending. The Committee notes that this falls under the National Treasury's PFMA mandate and that National Treasury "is urged to address the root causes of underspending rather than confiscating and reallocating the monies unspent".[12] In addition an audit of provincial resource allocation strategies, as well procurement strategies, needs to be undertaken, together with the release of provincial human resource plans – ensuring value for money will contribute towards service delivery and expanding coverage.

**We also support the need to clamp down on tax evasion and avoidance and improve the efficiency of tax collection.** The majority of revenue foregone from such activities is due to the actions of corporations and the wealthy as well as corrupt political leadership in cohorts with SARS officials. We support not only more effective investigation but also stiff penalties for such unconscionable behaviour. We welcome the recent administrative changes at the South Africa Revenue Service (SARS) and support the rooting out of corrupt officials and the re-hiring of competent staff with the investigation skills necessary to ensure increased revenue collection.

## 9. Debt levels

**We are concerned with the speed and gusto with which National Treasury aims to reduce debt levels although we do not favour unchecked borrowing.** By international standards South African debt is moderate. International evidence is also unequivocal in indicating that austerity following reduced borrowing retards growth, hurts poor and low-income households and increases inequality, as acknowledged by even the International Monetary Fund (IMF).[13] Effective expenditure of borrowed funds, particular on activities that expand the economy and spur economic growth – is a far more effective means of reducing the debt-to-GDP ratio than harsh cuts in borrowing and subsequent spending.[14]

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[12] Standing Committee on Finance, 31.

[13] Jonathan David Ostry, Prakash Loungani, and Davide Furceri, 'Neoliberalism: Oversold?', *Finance & Development* 53, no. 2 (June 2016), http://www.imf.org/external/pubs/ft/fandd/2016/06/ostry.htm; Brad Plumer, 'IMF: Austerity Is Much Worse for the Economy than We Thought', *Washington Post*, 12 October 2012, sec. Wonkblog, https://www.washingtonpost.com/news/wonk/wp/2012/10/12/imf-austerity-is-much-worse-for-the-economy-than-we-thought/.

[14] CSID, 'Mitigating the Impact of South Africa's Debt Downgrades: International Experiences' (University of the Witwatersrand, September 2017).

We are aware of the realities of rating agency downgrades but research clearly indicates that sharply curtailing borrowing in the short-run does not lead to rating agency upgrades.[15] We believe that debt levels should not be used a 'bogey man', nor rating agency as a sword of Damocles, to justify harsh spending cuts and that it is possible to stabilise debt at moderately higher levels over the medium-term rather than pursue the debt targets laid out by National Treasury.

## 10.State-owned enterprises

We share the Committees' concern that "state-owned enterprises continue to pose significant risks to the fiscal framework due to, among other reasons, corruption, mismanagement, operational inefficiencies and rising financial costs". We support the view the SOEs can "support economic transformation and strengthen the state's ability to accelerate national development, rather than impede it, as it is currently the case". However, we view with caution, the support given by the Committee to "private sector participation in SOEs" and believe this statement is pre-emptive and in need of deeper interrogation.

## 11.Public engagement

We appreciate the seriousness with which the Committee took the issue of changes to the tax system and the need for public engagement in this regard. In particular we welcome that:

- The process of amending the Money Bills Act with the aim to "to give both the public and parliament more time to process the budget";
- The Committees insistence that "in future the MTBPS tabling can better prepare for such taxation changes";
- The National Treasury should present "quantified alternative measures, options and scenarios when introducing new or adjusting tax rates and utilise the MTBPS to enhance transparency of the budget processes, especially on indirect taxes which pose little risks for tax restructuring and avoidance"; and
- The Committees sympathy regarding the timeframes for consultation, noting that they are "aware of and sympathise with concerns civil society organisations and the public at large have that they did not have enough time to prepare submissions for the Fiscal Framework hearings".

**Unfortunately the Committee's instruction to the National Treasury regarding engaging with civil society has not been fulfilled.** The Committees noted that National Treasury must "fully engage in a variety of workshops and through other ways with stakeholders, especially those who oppose the VAT increase, before the late April public hearings on the Draft Rates and Monetary Bill".

[15] CSID.

A limited number of CSOs received an invitation from National Treasury on 11 April 2018 to attend a workshop on 18 April 2018 in Pretoria, which is extremely short notice. The CSOs were not consulted regarding the date or programme, nor invited to offer presentations. National Treasury approached this engagement as an opportunity to "reply" to our submissions. No funding was offered for CSOs based outside of Gauteng. The majority of undersigned CSOs were therefore not able to attend. We have subsequently engaged with National Treasury raising these concerns and have received a positive and productive response and we are working out a process of suitable engagement. However this process needs to be closely monitored and the Committee should reiterate this instruction.

Our desire to engage in the process over the fiscal framework is premised upon three foundations:

1. Ensuring democratic public participation;
2. That this process determines the size of the fiscal envelope and once this is determined it then fundamentally shapes expenditure. We do not wish to limited our engagement to budget allocations only but also to contribute to shaping how much we as a country should be spending and from where it should come; and
3. This process includes taxation measures that have strong consequences for equity and growth, directly affecting the lives of our members or constituencies.

## 12.Proposals

We call on Parliament to:

- Ensure:
  - The VAT rate be returned to 14% on April 2019;
  - The expansion of zero-rated basic goods;
  - At least a further 3% increase in social grants beginning in October 2018 accounted for through the adjustment budgets. In particular the Child Support Grant of R400 must be increased as it is currently the lowest grant and below the food poverty line;
  - Increases in the 2018 MTBPS to social programmes, following a detailed process of engagement, that directly reach the poorest households;
  - A guaranteed minimum annual social grant increase of CPI plus 3% for the next three years;
  - The initiation of public process that investigates necessary changes to the food system with the aim of advancing the right to food and eradicating hunger and malnutrition;
  - Consideration is given to "incrementally introducing a multi-rated VAT system in which VAT on luxury goods is higher than VAT on goods bought by the poor and lower income earners"; and
- Require National Treasury to:
  - Hold pre-budget engagements with civil society;
  - Hold detailed public engagements on tax policy well in advance of the budget;

    - Make available, in full, the evidence upon which it bases its claim that rising direct taxes (such as PIT and CIT) is harmful to economic growth, including the assumptions and models upon which these are based and engage on the evidence which suggests a contrary view;
    - Provide detailed evidence regarding the distributional effects of its proposals;
    - Provide evidence and reasoning regarding the level and rate of proposed reductions in borrowing with the view to optimising potential economic growth;
    - Release a detailed programme of public engagement with the Expert Panel; and
    - Ensure any review of the public sector wage bill aims to secure and expand front-line services while reducing wage differentials within the sector.
- Require SARS to release plans that outlined how:
    - Tax targets will be met;
    - Administrative systems will be improved;
    - Critical vacancies will be filled with staff who are not compromised; and
    - Tax evasion and tax non-compliance be handled decisively.
- Reaffirm:
    - The principle that tax increases should land upon the wealthy, higher-income earners, and corporations.
- Monitor:
    - Wasteful, corrupt and inefficient government spending in order to shift expenditure to pressing social needs.
- Clarify the process by which the 2017 Mandate Paper by the Department of Performance Monitoring and Evaluation was authored. If the Mandate Paper approach is to be maintained, transparency needs to be established with regards to the process by which it is developed. If the mandate paper is influencing budget decisions, opportunities for participation in the process need to be established.

## 13.Appendix

The following items should be including in investigation for zero-rating:[16]

Flour
Maas
Frozen chicken
Chicken feet and gizzards
Canned vegetables
Processed meats (e.g. polony)
Inyama yangaphakathi
Salt
Curry powder
Tea
Sugar
White bread
Apricot jam
Candles
Matches
Soap
Washing powders
School uniforms
Education related goods (e.g. notebooks and school stationery)
Instant coffee
Basic medicines (including generics and possibly those purchased in public institutions)
Energy saving appliances including energy saving light bulbs
Sanitary pads

[16] This list is not intended to be comprehensive, but indicative of some important items which should be considered. The final list should draw from PACSA's food basket, StatSA construction of the food poverty line and Budlender et al. (2015) construction of the SALDRU poverty line