Monday, 26 February 2018

RE: SUBMISSION ON THE 2018 BUDGET FISCAL FRAMEWORK AND REVENUE PROPOSALS

ATT: HON YI CARRIM, CHAIRPERSON OF THE STANDING COMMITTEE ON FINANCE
HON C DE BEER, CHAIRPERSON OF THE SELECT COMMITTEE ON FINANCE

C/O: MR ALLAN WICOMB

Dear Chairpersons,

Please see attached a written submission on the proposed Fiscal Framework and Revenue Proposals (as per section 8 of the Money Bills Amendment Procedure and Related Matters Act of 2009).

I will not be able to be present to make an oral submission during the public hearings scheduled for the 28th of February, but I will attend the meeting on the 1st of March 2017 in which National Treasury are scheduled to respond to submissions.

Yours sincerely,

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SUBMISSION ON THE 2018 BUDGET: FISCAL FRAMEWORK AND REVENUE PROPOSALS

The purpose of this submission is to provide a short overview of the main aspects of the 2018 Budget's fiscal framework and highlight a few important issues raised by the fiscal framework and revenue proposals. Furthermore, continuing a theme addressed in previous submissions, I suggest how the finance committees could facilitate greater participation in relation to revenue proposals within the constraints of the current Money Bills Act (2009).

PUBLIC FINANCE CONSIDERATIONS

1. The fiscal framework: a partial return to fiscal consolidation

Fiscal consolidation

A notable aspect of the 2017 MTBPS was the abandonment of the strategy of fiscal consolidation without any alternative being proposed.

The Treasury and Ministry of Finance subsequently argued in their defence that the MTBPS had stated that: "Additional measures to reduce expenditure, raise revenue and improve the impact of public resources on economic growth will be announced in the 2018 Budget". But this is an absurd defence because it contradicts the point of the MTBPS: why table a medium-term projection for consultation when the government itself does not intend to keep to the proposal outlined, but also without details of the alleged changes it will make? Understandably, then, those assertions were treated as lacking credibility and two ratings agencies then downgraded the country's sovereign debt ratings.

The 2018 Budget reveals that only after the downgrades, which arguably were the result of dramatically lower revenue collection than expected and a failure of political leadership, a cabinet subcommittee met at the end of November to decide on R85billion in expenditure cuts over the medium-term. This does not reflect good public finance management.

Expenditure cuts and continued uncertainty about higher education

It remains unclear what assumptions were made by the cabinet subcommittee about 'free higher education'. The Budget indicates that the allocation to higher education is based on the decisions of a separate interministerial committee on higher education, but does not explain the degree to which that committee was aligned to the proposals irregularly announced by then-President Zuma in mid-December. It is concerning that the 2018 Budget repeatedly refers to future higher education costs as 'uncertain', suggesting much more information is required from the Executive in this regard.

The associated issues can be addressed in more detail during oversight of the division of revenue and appropriations bills, but it is questionable whether such a large increase to the higher education budget is consistent with the Constitution given the underfunding of other socioeconomic rights that are given greater priority in the Constitution. For example, whatever issues may arise in relation to spending performance, it is hard to see how higher education funding can be increased while the baseline of the school infrastructure backlogs grant is cut by R3.6billion over the medium-term.

The overall picture is that for 2018/19 the Budget proposes R26.38billion in cuts to planned expenditure baselines, offset by a R12.35billion increase in funding for higher education. Of the R14billion 'saved', R6billion is provisionally allocated to deal with the drought and, although higher than proposed in the MTBPS, the contingency reserve is R2billion *less* than proposed in the 2017 Budget. The net result is a proposal that total main government expenditure be cut by R10billion relative to the 2017 Budget proposals.

Revenue: significant unplanned increases

The 2018 Budget proposes R36billion in tax increases for 2018/19. MPs should remember that R15billion in additional tax measures for 2018/19 had already been proposed in the 2016 Budget, so this effectively amounts to proposals of R21billion over-and-above what had previously been envisaged. These additional increases, along with a slightly improved growth forecast, are expected to lead to a R40billion revenue shortfall (relative to the 2017 Budget) rather than the R70billion shortfall indicated in the 2017 MTBPS.

Net result: deficit and debt increase less than in 2017 MTBPS but more than in the 2017 Budget

The net result is that even with the 2018 Budget proposals, the main budget deficit in 2018/19 is R20billion larger than proposed in the 2017 Budget. This is expected to lead to gross loan debt of 55.1% of GDP in 2018/19, lower than the 57% proposed in the 2017 MTBPS but still significantly higher than the 52.9% proposed in the 2017 Budget.

As in previous years, this raises questions about appropriate (fiscally sustainable) national debt levels and the credibility of national budgets given repeated failures to meet debt consolidation targets.

2. Revenue proposals

General note on revenue buoyancy figures and undercollection

Concerns have previously been raised in recent years about tax administration and the effect this is having on revenue collection. Those issues appeared to be reflected in declines in 'tax buoyancy' statistics. It is important to note that the majority of the buoyancy figures reported in the main text of the 2018 Budget reflect the additional tax proposals and are therefore, for most purposes, at best useless and at worst misleading. Treasury should report buoyancy figures excluding the impact of tax proposals.

In this regard, it is notable – and concerning – that part of the Treasury's rationale for not using personal income tax increases (over-and-above fiscal drag from inflation) to address the revenue shortfall is that: "Increased avoidance in response to tax increases may also be playing a role" in the personal income tax shortfall. While avoidance (as opposed to 'evasion') is legal, this does raise the question as to what Treasury and SARS could/should do to reduce the scope for such avoidance.

Use of indirect taxes

The revenue proposals – intended to raise R36billion in 2018/19 – rely heavily on increases in so-called indirect taxes, notably VAT, the fuel levy and excise duties. In comparison to personal and corporate income tax, it has been established by various pieces of research that these taxes are paid to a much greater degree by poor and working class South Africans. In that sense, increasing reliance on these instruments reduces the 'progressiveness' of the tax system as a whole. (See below for a note on 'progressive' versus 'regressive').

The Budget, and subsequent statements by the Minister and Deputy Minister, justify this decision by arguing that there is no further scope to raise personal or corporate income tax. Furthermore, that measures such as a small additional allocation to social grants and the existing zero-rating will significantly limit the impact on the poor. However, the basis for these arguments seems thin.

Repeated failure of National Treasury to provide evidence on the distributional effects of taxation

A recurrent concern – raised in a number of previous submissions – is National Treasury's failure to provide evidence/information on the distributional effects of revenue proposals. Without such evidence/information it is questionable whether statements in the Budget Review can be taken at face value.

In the current case, the section of the Budget Review [p.44] dealing with "distributional effects of a VAT increase" is very superficial and arguably misleading in certain respects. Given the significance of

such a change in tax policy, one would have expected National Treasury to provide some substance to its assertions. If Treasury has done modelling of the effect this should be made public so it can be the subject of public engagement and oversight; if it has not done such modelling, what basis is there for the claims made?

'Progressive versus regressive' in relation to taxation

It is important to separate the technical usage of the terms 'progressive' and 'regressive' from the more common political/normative usage.

With reference to the current case, research by Woolard et al (2014) defines a progressive tax as one where: "individuals with higher taxable incomes pay progressively higher proportions of their income in tax".

Those authors estimate that VAT with zero-rating in South Africa was 'slightly progressive'. What this means is that, overall, wealthier South Africans paid a slightly higher *proportion* of their income in VAT than poorer South Africans.

However, a technically 'progressive' tax can still have a very negative impact on the poor. Furthermore, increasing reliance on 'less progressive' taxes (such as VAT) and decreasing reliance on more progressive taxes (such as personal income tax) reduces the overall progressiveness of the tax system.

Whether MPs think of such changes as 'progressive' or 'regressive' is a somewhat different question and depends on views about inequality, who is responsible for funding the state and so forth.

PROCEDURAL CONSIDERATIONS

Purpose: to explain how and why the finance committees can report on the fiscal framework and revenue proposals, while nevertheless allowing more time for substantive consultation on revenue proposals.

Summary: the finance committees can accept the total revenue proposed in the fiscal framework while rejecting some of the proposals that underlie that estimate; this allows the appropriations committees to proceed with their obligations (Division of Revenue and Appropriations) while allowing greater time for consultation and possible amendment to revenue proposals.

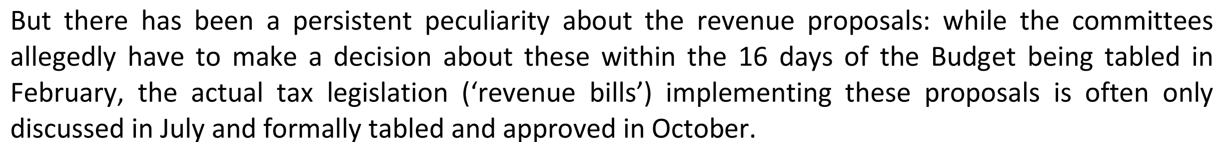
As noted above, the 2018 Budget raises critical issues about government's revenue-raising mechanisms. Various civil society and political organisations have argued that the revenue proposals need to be subject to greater scrutiny and debate. The purpose of this brief comment is to suggest how such participation and oversight can be facilitated within the constraints of current legislation.

The Money Bills Amendment Procedure and Related Matters Act ('Money Bills Act') requires that the finance committees "must within 16 days after the tabling of the national budget submit a report to the National Assembly and the National Council of Provinces, as the case requires, on the fiscal framework and revenue proposals".

In that report, the committees "must include a clear statement accepting or amending the fiscal framework and revenue proposals".

According to the Act, any such decision must be based on a host of considerations [s8(5)]. This is particularly burdensome for any changes to the fiscal framework, which would arguably have to satisfy all 7 requirements.[1] In principle, changes to a revenue proposal would [s8(6a)] have to satisfy separate criteria for amendments to revenue bills [s11(3)].

[1] Although whether even the National Treasury demonstrates that *its* proposed fiscal framework satisfies these requirements is an open question.


But there has been a persistent peculiarity about the revenue proposals: while the committees allegedly have to make a decision about these within the 16 days of the Budget being tabled in February, the actual tax legislation ('revenue bills') implementing these proposals is often only discussed in July and formally tabled and approved in October.

For example, the Rates Bill accompanying the 2016 Budget was presented in draft form with the Budget but only formally tabled in the National Assembly in October and passed in that House in November.

In the current case: the increase in VAT from 14% to 15% qualifies as a 'revenue proposal', but it is enacted into law by the 2018 Rates and Monetary Amounts Amendment Bill ('Rates Bill'). It would arguably be illogical for Parliament to have to commit itself to a decision on a revenue proposal before considering the actual legislation required for that proposal: doing so would render the subsequent oversight process redundant.

Given the above: the committees could accept the fiscal framework proposed in the Budget while withholding an opinion on the VAT increase. In other words, with whatever stated reservations, the committees could accept the Budget's proposal as to the total amount of revenue to be raised.

This would allow other oversight processes assigned to the appropriations committees – in relation to the Division of Revenue and Appropriations Bills – to proceed. The committees can then interrogate the underlying revenue proposals (VAT, fuel levy, etc) in much greater detail and with more substantive public participation.