Press Release

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South African Institute of Race Relations

The power of ideas

Government is on the brink of fiscal catastrophe – IRR report

IRR COO Gwen Ngwenya said the budget presented by the Minister of Finance yesterday suggested "a government at the brink of fiscal catastrophe and without a plan for either growth or austerity".

In order to finance expenditure the minister introduced a bevy of tax proposals including a top marginal tax rate of 45%, a sugar and carbon tax, an increase in the fuel levy of 30c/l and in the Road Accident Fund levy of 9c/l. Ngwenya argues that, "the Treasury's plan is an exercise in extracting blood from a stone by squeezing an already over bled tax base."

According to Ngwenya, "Tax revenue as a proportion of GDP has increased from 21.9% in 1994/95 to a projected 29.8% in 2017/18. The state is therefore taking a greater proportion of the wealth generated in the economy. The implication is that the state believes it is able to spend more effectively and efficiently than consumers and the private sector."

"A related point is that government expenditure as a proportion of GDP has increased from 26.4% in 1994/95 to a projected 33% in 2017/18. By international standards this is a very high level. Our data on the subject extends back to the 1960s and the current level is the highest on record.

"In 2008/09 debt levels bottomed out at 26% of GDP – more than twenty percentage points below the 1994 level. However, debt levels have since escalated sharply and now sit at 50.7% of GDP."

"As debt levels have increased, so too has the government's interest bill. The state's debt cost amounted to 8.8% of total expenditure in 2013/14 but is forecast to increase to 11% in 2019/20. At that level, servicing the debt bill will be equivalent to spending on health or housing and community development. Debt is therefore starting to crowd out other areas of expenditure."

More…

According to the IRR six options are available to the government:

- The first is to increase corporate tax rates above the current 28%. But threats to property rights, counter-productive labour policy, and onerous empowerment requirements have already reduced South Africa's economic competitiveness to a point where corporate tax increases will do more harm than good.
- The second is to increase the VAT rate. The political consequences of such a move would be too difficult for the minister to consider, so alternatives have been found in secondary taxes such as those on sugar-sweetened beverages.
- The third is to further increase the individual income tax rate. The minister raised the top individual tax level from 41% to 45% and, while further increases are possible in future years, the law of diminishing returns risks playing itself out.
- The fourth option is to spend less money. Around 60% of the budget goes to social protection expenditure. Personnel expenditure accounts for 35% of the budget. These are the only two areas of expenditure that offer the government any real fiscal breathing room.
- The fifth option is to cut wastage and corruption, the extent of which is hard to quantify but could probably be measured in points of GDP. However, the political will to do so does not exist.
- The sixth option is, of course, the most obvious one – to grow the economy faster. But many in the Cabinet remain hostile to the structural reforms necessary to entice higher levels of investment into the country. Neither the President in his recent State of the Nation Address nor the Minister of Finance in his budget speech made any compelling statements that suggest the government is serious about reform.

According to Ngwenya, "Our view is that the government has come close to maxing out the revenue it can extract from the economy – but has no workable plan to create new revenue. Taxpayers are over bled, further borrowing will raise debt levels thus hasten the prospects of rating downgrades and austerity will serve to directly undermine the political future of the ANC. The government has very little room to manoeuvre. If current growth and revenue collection targets are not met, the government may find itself in a considerable degree of fiscal, and therefore political, difficulty".

Watch Gwen Ngwenya on the Budget 2017 here.

Ends.