

Brave Budget should keep ratings agencies at bay

By Dr Roelof Botha, Adjunct Faculty, GIBS

Global capital markets reacted positively to South Africa's National Budget for the 2018/19 fiscal year, with the rand/dollar exchange rate strengthening by 1.7% between 21 February (the day before the budget) and the weekend after the budget.

The benchmark R186 bond yield also provided a stamp of approval, shedding ten basis points between 20 February and 26 February.

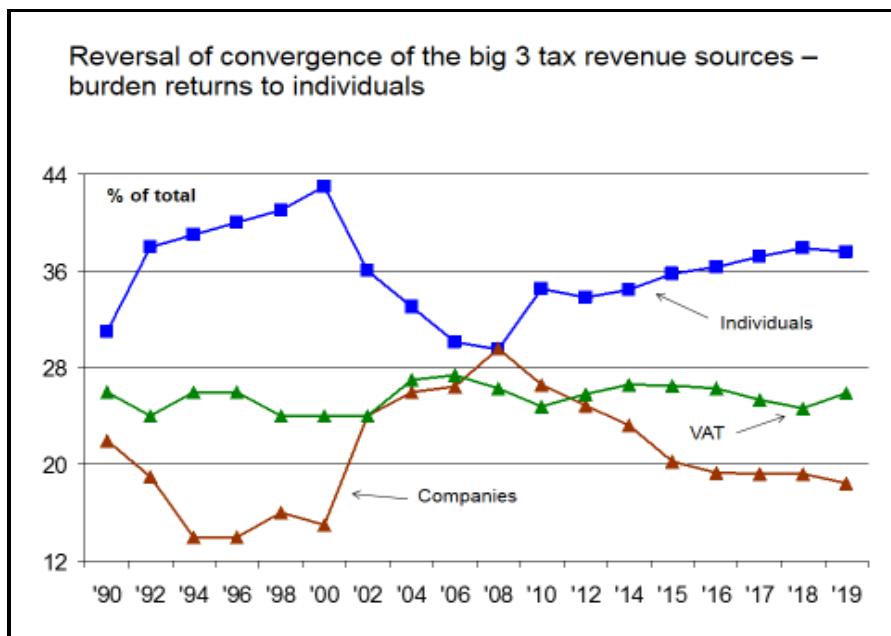
It would therefore have come as a surprise to a casual observer that the finance minister who had presented such a budget (which contained plans for fiscal consolidation) was removed less than a week later, but such are the vagaries of public office in the aftermath of the Zuma era.

Not that the market reaction to Mr Gigaba's successor was negative – the new finance minister was, after all, the incumbent until just before Christmas in 2015, when he was unceremoniously dismissed by Mr Zuma – ostensibly to take up a senior position at the Brics Development Bank.

It subsequently transpired that this bank knew absolutely nothing about any imminent appointment of Mr Nhlanhla Nene to its ranks and that one of the key reasons for him being forced to vacate his office was, in fact, his refusal to approve the ridiculously expensive and totally unnecessary nuclear power deal proposed by Mr Zuma.

Mr Nene's track record, together with a highly competent team of experts at National Treasury, is such that markets have generally welcomed his reappointment, particularly due to his support for scrupulous standards of public sector financial management and aversion towards any form of corruption or tender fraud.

Returning to the budget, the most notable talking point remains the increase in the VAT rate from 14% to 15%, which has been severely criticised by several organisations.



Unfortunately, this criticism is largely unfounded. The rationale for an increase in the VAT rate is rather comprehensive and logical, as briefly explained by the following points:

- Firstly, the tax burden has been shifting noticeably towards individual taxpayers for a full decade. In 2008, individuals contributed roughly the same as companies, namely just below 30% of total tax revenue. In 2018, this had increased to almost 40%.
- The traditional objection by some trade unions and the SACP to raising the VAT rate is based on the erroneous premise that such a move will be regressive in nature, i.e. “make the poor poorer”. The facts suggest otherwise, as South Africa possesses two VAT rates, namely 0% and 15%. The expenditures of the poorest income groups in the country are mostly linked to zero-rated items and the VAT rate hike has a minimal effect on their standard of living.
- A further riposte to the anti-VAT rate increase brigade is that empirical research confirms the neutrality, from an equity perspective, of a broad-based consumption tax (which VAT effectively is). Such a tax is neither regressive nor progressive over a person’s lifetime.
- A strong argument in favour of a VAT rate increase is related to its superior efficiency effect (compared to direct taxes on individuals and companies). Substantial research has confirmed that, for a given amount of tax revenues that needs to be raised, direct taxes exert a relatively larger negative effect on the economy (in terms of the initial negative impact on demand and output).
- It should also be remembered that National Treasury did not have much room for manoeuvring. The mini-budget of October last year was a damp squib, with absolutely no indication of a plan for the fiscal consolidation required to avert further sovereign bond rating downgrades. No measure of tinkering with a variety of other taxes would remotely have been able to produce the amount of more than R22 billion which the VAT rate increase is expected to generate.

South Africans were acutely aware of the difficult political, economic and fiscal situation underpinning this year’s budget and that some element of pain would be forthcoming.

Under these circumstances, National Treasury has tabled a sound budget that, combined with the recovery of business confidence and improved growth prospects, should lead to further stability in the financial markets and the country’s public finances.