Watch out for tax increases, experts warn

Cape Town – Eugene du Plessis, head of tax at Grant Thornton in Johannesburg said overall he is impressed with the way Finance Minister Nhlanhla Nene handled his first budget presentation.

"He was well spoken, his points were clear and the delivery was good."

Du Plessis applauded Nene for his attention to focus on cost cutting within government and hopes to see some notable improvements in the future as hard evidence to back up his statement.
"Unfortunately, Finance Minister Nhlanhla Nene is in a difficult position as he starts his term as the new finance minister. Our previous ministers served their time during easier economic times," said Du Plessis.

"Even former Finance Minister Pravin Gordhan had room to move because he had greater access to borrowings. Now, Nene comes in at a time when there is nothing left to cut from surpluses or anything left to borrow."

Nene's ability to manoeuvre is very restricted and he will unfortunately have to look to increases in taxes, according to Du Plessis.

"He doesn't have much else to work with and he unfortunately will become unpopular due to this fact."

What is clear to Du Plessis from the mini budget is that there is definitely going to be an increase in taxes next February 2015.

The exact detail is lacking, though.

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"I predict that this increase will be targeted at the higher net worth individuals or higher tax brackets. The tax increases which Nene hinted at will affect individuals," said Du Plessis.

"While the 'tax policy' element that Nene mentioned refers to expected increases in individual taxes to be announced in February 2015, the 'administration' item probably refers to how the ministry will be policing some elements even more in future. A good example here is the new tax return, which has been developed for trusts, which has made disclosures here quite a lot more onerous."

Weak income growth

South Africa's mini budget is a concerted effort to halt the country's deteriorating fiscal dynamics through the announcement of a fiscal package to "reinforce sustainability", according to Arthur Kamp of Sanlam Investments.

"National Treasury recognises that a weak income growth environment poses a challenge to South Africa's fiscal sustainability," Kamp.

It has lowered its expectations for gross domestic product (GDP) growth to an average 8.5% to 8.75% (current prices) per year for the next three years, from a previously forecast average of close to 9.5%.

This implies government's gross loan debt ratio is expected to increase further than previously expected – specifically to 49.7% of GDP by 2016/2017 (and 49.8% of GDP in 2017/2018), compared with the previous estimate of 48.3% of GDP by 2016/2017 published at the time the budget was read in February this year.

"To show the stabilisation of debt at even this higher level,

Nene has needed to budget for a marked improvement in government's main budget deficit from -4.8% of GDP in 2014/2015 to –3.0% of GDP in 2017/2018," said Kamp.

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Meanwhile, the consolidated deficit is budgeted to decrease from -4.1% of GDP in 2014/2015 to -2.5% of GDP in 2017/2018. Importantly, for the numbers to add up, the consolidated primary budget balance needs to improve from a deficit of 0.9% of GDP in 2014/2015 to a surplus of 0.8% of GDP by 2017/2018.

"What that means is that excluding government's interest payments on its debt, Nene eventually intends spending less than government's revenue," said Kamp.

To achieve the expected improvement in the deficit, National Treasury has needed to cut government spending outright in the coming fiscal years relative to previous budget estimates, and increase taxes.

Specifically, spending is cut by R10bn in 2015/2016 and R15bn in 2016/2017 relative to government's previous projections.

At the same time, as regards tax increases, there is no detail in the mini budget other than the indication that changes to tax policy and administration (an improvement in tax efficiency) are expected to raise 'at least' R12bn in 2015/2016, R15bn in 2016/2017 and R17bn in 2017/2018, while enhancing 'the progressive nature of the tax system'.

"This suggests a focus on taxing higher income earners," warned Kamp.

"Over time, unless the structure of the economy changes or the tax regime is altered, government tax revenue should grow in line with GDP in current prices. This mini budget implies that tax revenue, which has been increasing 1.3 times nominal GDP in recent fiscal years, can be expected to continue advancing

faster than total GDP."

"That's not growth enhancing and, with GDP increasing just 6.4% (current prices) in the year to the second quarter of 2014, the economy needs to accelerate significantly to meet even the revised GDP forecasts," said Kamp.

"It is the expenditure cuts that are likely to attract most interest, however. Firstly, they were unexpected and secondly, they are backed by clear guidelines as to how government intends to rein in spending."

READ: Nene: Govt first to tighten belt

The main focus of government's effort here is the government wage bill. To start, government personnel headcounts are to be frozen, while Treasury has planned its budget "on the neutral assumption that cost-of-living adjustments will track consumer price index (CPI) projections' of 5.9%, 5.6% and 5.4% in 2015, 2016 and 2017 respectively.

Treasury also warned that, should public sector wages significantly outpace inflation, government will be forced to cut services (either social spending or capital expenditure) or cut government jobs.

In addition, Treasury intends to freeze budgets for "non-essential goods and services", including travel allowances, advertising, spending on consultants and catering – although these amounts are relatively small in the grand scheme of things, according to Kamp.

Overall, the impact of these measures are reflected in the weak government consumption expenditure forecasts of Treasury, as real government consumption is expected to advance, on average, by just 1.5% per year from 2015 to 2017.

In tandem, Treasury notes, the increased taxes and proposed expenditure cuts are expected to improve the fiscal position

by R22bn in 2015/2016 and R30bn in 2016/2017.

The rest of the fiscal package includes strengthening the budgeting process by focusing on long-term sustainability ‘within a fiscal framework that links aggregate expenditure and economic growth beyond the medium term’.

“Also, a ‘deficit neutral’ approach is to be adopted to financing state-owned companies. For example, the mini budget includes government funding of R20bn for Eskom, which is to be financed by the sale of non-strategic assets, in a ‘deficit neutral’ manner, while Eskom is to borrow R250bn over the next five years, supported by government guarantees,” said Kamp.

“All in all, South Africa’s weak economic performance has enforced material consolidation of fiscal policy. In the absence of the expected expenditure cuts and tax raising measures announced, Treasury would have needed to show an increase in government’s gross government debt level to significantly above 50% of GDP – a historically high level.”

In drawing the line on continued fiscal slippage the mini budget, while recognising the constraints imposed on it in a weak economic environment, provides detail on how it intends to rein in spending.

“Now we need income growth to accelerate as forecast,” concluded Kamp.

– Fin24