



# Financial and Fiscal Commission: Submission on the 2020 Fiscal Framework and Revenue Proposals

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*For an Equitable Sharing of National Revenue*

02 March 2020

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**List of acronyms**

GDPG	Gross Domestic Product
HCI	Human Capital Index
IMF	International Monetary Fund
MTBPS	Medium Term Budget Policy Statement
PRASA	Passenger Rail Agency of South Africa
SARB	South African Reserve Bank
SONA	State of the Nation Address
Stats SA	Statistics South Africa
UIF	Unemployment Insurance Fund



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## 1. Background and overview

This document is prepared in terms of Section 4 (4c) of the Money Bills Amendment Procedure and Related Matters Act, 2009 (Act No. 9 of 2009), as amended, which requires parliamentary committees to consider any recommendations of the Financial and Fiscal Commission (FFC) (hereafter the Commission) when considering Money Bills. It is also made in terms of the Financial and Fiscal Commission Act, 1997 (Act No. 99 of 1997), as amended, which requires the Commission to respond to any requests for recommendations by any organ of state on any financial and fiscal matter.

In this document the Commission recaps the key features of the current socio-economic and fiscal situation and prospects, as also set out in Budget documents. It then summarises the government economic and fiscal strategy (the latter reflected in estimates for the fiscal framework and revenue) and makes comments on these. This is done in two sections, one dealing with broader economic developments and economic policy and a second dealing more narrowly with the fiscal framework and fiscal policy stance.

The continued weakening of the South African economy as reflected in declining per capita economic growth numbers and further rising unemployment is threatening the social gains South Africa has made over the last 25 years.

After 1994, and continuing up until 2017 in terms some estimates, South Africa has managed to reduce poverty substantially and can be argued to have seen a slightly improved class structure. However, there has been little progress in terms of inequality, which remains among the highest in the world.

The last decade, on the back of sustained government investment, has seen an improvement in basic education outcomes as measured in international standardised assessments. This was accompanied by a substantial expansion and transformation of our post-school education sector. Average life expectancy is estimated to have increased by nearly 10 years over the last decade. These substantial achievements in building the human capital and capabilities of South African cannot be lost. They are, however, threatened by the current economic and fiscal trajectory. Slow growth has impacted on government revenues leading to rising deficits and debts which is constraining government's ability to invest in society and economy. Further investments are required if inequality is to be redressed.

The government strategy as outline in Budget 2020 focuses on driving structural change in the economy, improving the efficiencies and impact of government, and on fiscal consolidation.

In terms of driving **structural change**, Budget 2020 reiterates an ambitious transformation strategy to deal with network industries, levels of competition and access in the economy, expanding exports and supporting labour intensive sectors. It also lists several areas where government is busy or intends to resolve regulatory matters, in order to create policy certainty and open opportunities (Examples are the Integrated Energy Resources Plan and energy generation, visa reforms and spectrum licensing).

While progress on all these matters are important the Commission believes that, given the complexity of the task, careful prioritisation and a phased approach over time is necessary. In order to start creating trust through visible progress, a focused strategy could start with a more decisive turnaround at the South African Revenue Services and at the Director of Public Prosecutions. Progress in this area by enforcing the rule of law, but also through creating certainty on government's fiscal resolve and a faster turnaround in government revenue, will ripple through to the economy.

The Commission also believes that South Africans should take stock of the factors underlying policy uncertainty and unsatisfactory implementation. These could be the result of intense conflict in society between those who expect to gain and those who expect to lose from structural and other change leading to blocking of innovative change. South Africa is replete with examples, from the introduction of e-tolls and ride-hailing to conflicts around spectrum release and the migration to digital television. At the heart of the conflict lies inequality and the unequal benefits of change.

Societies require mechanisms to buy-in those who stand to lose from change. Otherwise change and implementation of change will be blocked, whether through activism or unobtrusively. This points to the inadequacy of our social protection system and other mechanism to deal with the impact of change. The Unemployment Insurance Fund is an example in the way it covers only a small part of the unemployed and of those at risk of unemployment. It is in this context that South Africans should see the President and government's raising the notion of a sovereign wealth fund which could be seen as a mechanism to give all South Africans a positive stake in economic and social change.

In terms of **fiscal stabilisation and the fiscal framework** the South African government clearly shows the rapid weakening of South Africa's fiscal situation and the threat coming from the costs of an increasing deficit and debt. Urgent action is indeed necessary to reduce the annual deficit and slow down debt accumulation and government's resolve is welcomed.

Government proposes consolidation through downward adjustment of spending baselines and rapidly arresting the growth of government expenditure. Restraining expenditure comes primarily through reducing some large infrastructure grants (most to provinces and local government) and reducing the provision for wage payments. Slowing wage growth will require renegotiation of the current wage agreement with public sector unions as the agreement makes provision for above inflation increases for certain categories of workers in April 2020. Government leaves the tax structure mostly intact except it makes adjustments for inflation and argues that an attempt to increase revenues through taxes is likely to hamper economic recovery and that from a comparative and competitive perspective South African tax (and expenditure) ratios are already high.

The Commission respects the government's judgement on constraints on the revenue side but questions whether the cost of fiscal adjustment could not have been spread beyond civil servants, and the users of public services who are likely to see a reduction in service levels. While there is an argument to make that civil servants have benefited strongly from economic and social change, there are other groups at the top of the SA income distribution that have also gained and may have gained more. In addition, the Government makes neutral assumptions in the budget about the potential revenue gains from the rebuilding of the South African Revenue Service. This seems to be a situation that calls for a more comprehensive social pact to distribute the cost of consolidation among all those who are likely to benefitting.



In terms of the fiscal framework the Commission notes the sometime exciting, sometimes destructive changes that the world is increasingly subject to. Climate change, population change, and migration, new technology and power shifts are creating opportunities for South Africans, but also risks. The country should more intensively investigate and deliberate on how these changes could impact our fiscal framework on both the revenue and expenditure sides. On the revenue side the questions relate to how technological change will affect social assets and income streams and how to ensure that the fiscal system does not lag, obstruct or miss these developments. The taxation of the digital economy is a case in point. But also, on the expenditure side South Africa should deliberate on their potential fiscal futures and whether current assumptions about appropriate revenue and expenditure to GDP ratios can give us the society we want with high levels of solidarity, mobility and equality.



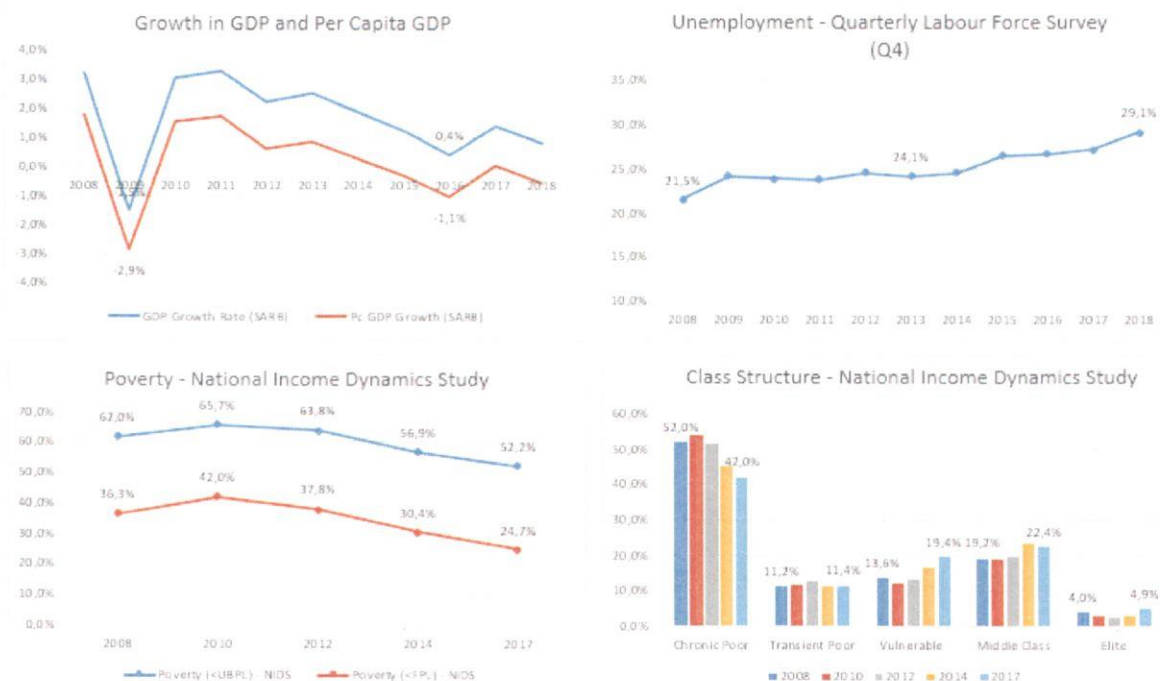
## 2. Economy and society

### 2.1 State of the economy and implications

Budget 2020 tells a now well-known story of a South African economy that has weakened over the last decade, and its implications for South Africans.

After recovering somewhat from the great recession of 2009, South African economic growth has been on an almost constant deceleration. From 3.3 per cent in 2011 (**Error! Reference source not found.**), economic growth dropped to 0.4 per cent in 2016 and has moved sideways since then (with the latest SARB estimate for 2019 again at 0.4 per cent<sup>1</sup> and the National Treasury's estimate at 0.3 per cent). Declining growth, combined with population growth at about 1.5 per cent per year, translated into negative real *per capita* growth from 2015 onward. On average, the income available to South Africans to sustain themselves and invest for the future is declining.

**Figure 1 - Socio-economic trends 2008 to 2018**



Source: Data from South African Reserve Bank (2019) StatsSA (2019); Zizzamia, Schotte and Leibbrandt (2019)

Declining growth has been mirrored by rising unemployment, increasing from the very high rate of nearly 22 per cent in 2008 to 29.1 per cent at the third quarter of 2019<sup>2</sup>. Taking into account broad unemployment (including the discouraged work seekers), youth unemployment and the high share of long-term unemployment, the situation is even more alarming. current reports suggest that the progressive weakening of the economy will see further rises in

<sup>1</sup> Parliamentary Monitoring Group. 2020. SARB on Economic Performance and Outlook. Minutes of Parliamentary Finance Standing Committee 18 February 2020.

<sup>2</sup> Statistics South Africa. 2019. *Quarterly Labour Force Survey 4 2019*. Pretoria: Government Printer.



unemployment. Given the limited support for the unemployed in South Africa (primarily through means of the Unemployment Insurance Fund (UIF) which covers only formal sector workers and a small proportion of the unemployed) and the relatively small size of the informal and unrecorded sector in South Africa, these levels of unemployment translate into huge pressure on those who are working or receiving a social grant to provide the safety net for those not working.

Somewhat surprising, but only taking up to 2017 into account, recent poverty and inequality measures do not show an increase in poverty and inequality which could be expected given the weakening growth. The National Income Dynamics Study (NIDS) (Figure 1) reports that after spiking to 65.7 per cent in 2010 (as a result of the great recession), poverty measured with the upper-bound poverty line declined consistently to 52.2 per cent in 2017. Statistics South Africa (Stats SA), however, measured an increase in poverty between 2011 and 2015 (from 53.2 per cent to 55.5 per cent on the upper-bound poverty line), but nevertheless remaining well below the 66.6 per cent level of 2006.<sup>3</sup>

Regarding inequality Stats SA reports a slight improvement in inequality between 2006 and 2015 (with the Gini-coefficient at 0.65 in 2015 against 0.67 in 2006 and the share of the top 10 per cent of income earners declining from 57.2 per cent to 52.6 per cent)<sup>4</sup>. Taking a different approach to inequality through defining different economic classes, Zizzamia *et al* shows the continuing huge inequality in South Africa with a very small “middle class” (22.4 per cent and the majority of South Africans (72 per cent falling into the categories of “chronic poor”, “transient poor” and “vulnerable”).<sup>5</sup> While there is no doubting the continuing extreme poverty and inequality in South Africa, comparing 2008 and 2017 shows a decrease of those in chronic poverty from 52.0 per cent to 42.0 per cent of the population, which is balanced by an increase in the transient poor (0.2 percentage points), the vulnerable (5.8 percentage points), the middle class (3 percentage points) and the elite (0.9 percentage points). (See Figure 1)

<sup>3</sup> Zizzamia, R, Schotte and Leibbrandt, M. 2019. *Snakes and Ladders and a Loaded Dice: Poverty dynamics and inequality in South Africa between 2008 and 2017*. WIDER Working Paper Series wp-2019-25, World Institute for Development Economic Research (UNU-WIDER). Stats SA. 2018. *Subjective Poverty in South Africa: Findings from the Living Conditions Survey 2008/2009 – 2014/2015*. Pretoria: Government Printer. The latter study argues that subjective poverty levels in South Africa have declined between 2009 and 2015 when they are measured by the three subjective poverty measures: Self-Perceived Wealth Indicator (SPWQ), Minimum Income Question (MIQ) and Income Evaluation Question (IEQ). According to the SPWQ indicator, subjective poverty levels decelerated from 39.2 percent 2009 to 35 percent in 2015. Based on the MIQ indicator, subjective poverty levels fell from 59.3 percent in 2009 to 50.7 percent in 2015. In terms of the IEQ indicator, subjective poverty levels decreased from 58 percent in 2009 to 50.4 percent in 2015.

<sup>4</sup> Stats SA. 2019. *Inequality ...*. Pretoria: Government Printer.

<sup>5</sup> Zizzamia *et al*. describe their definitions for “social stratification” as follows: “... we distinguish those with chances of exiting poverty below the observed average exit rate and thus face a comparatively high risk of poverty persistence – the chronic poor – from those with above average chances of making it out of poverty – the transient poor. Analogously, among those currently above the poverty line, we distinguish those who face an above average risk of slipping into poverty – the vulnerable – from the more secure “actual” middle class, whose members face a below-average risk of falling into poverty and thus have better chances of sustaining a living above the subsistence level.”

The significant question is how rapidly economic deterioration will impact more strongly on (measured) poverty and inequality which is likely to fuel substantial further social pressures. Increasing social tensions will lead to worsening of social protest, unrest, crime and corruption. While some indicators show South Africa as quite “normal” in terms of corruption (in the sense that corruption levels are “predictable” given our level of development, inequality and state capacity)<sup>6</sup>, further worsening of social indicators will impact on protest, crime and corruption and is likely to drive further weakening of economic confidence.

In addition to raising the spectre of social disintegration and a downward spiral of instability and economic weakening, the weakening economy is also impacting on the availability of government revenue and the fiscal situation and thus the ability of government to intervene in ameliorating hardship and social pressures. The weakening of the South African fiscal situation, indicated by continuing high deficits and a rapidly growing debt burden, is discussed as part of the next chapter on the fiscal framework. It is, however, a key factor in economic performance as debt ratios influence confidence levels as well as the cost of capital, and hence investment.

Income streams (production) and social conditions are rooted in a range of underlying factors of which an important part is the assets ownership of South Africans. The assets available to South Africans<sup>7</sup> to mobilise or leverage through organisations<sup>8</sup> are central to livelihoods and jobs and thus the standard of living. In seeking to envisage futures, it is therefore also important to ask about the asset status of South Africans.

Asset poverty is even more common than income poverty among South Africans and asset inequality is even higher than income inequality. Stats SA found that in South Africa, wealth inequality is considerably higher than income inequality, with the wealth Gini coefficient being estimated at 0.94 in 2014/15. Furthermore, while the top 10 per cent of the population has a 56-58 per cent share of income, it has approximately 95 per cent of all wealth.<sup>9 10</sup>

Regarding human capital (mostly educational attainment, skills and health), the South African situation is also regarded as quite dismal. The World Bank’s Human Capital Index (HCI) can range from 0 to 1 (with 0 at the worst end of the scale and 1 at the best end) and focuses on health and education achievements by calculating a composite index including child and adult survival rates, stunting and completed school years adjusted for amount of learning (with

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<sup>6</sup> See International Monetary Fund. 2020. South Africa – 2019 Article IV Consultation Staff Report (IMF Country Report No 20/33), Figure 10, “*Better governance has multitude of benefits, including higher tax revenue.*” Washington, DC: International Monetary Fund.

<sup>7</sup> From natural resources and land to physical and financial assets but also human capital and social capital.

<sup>8</sup> Markets, firms, associations, communities, households.

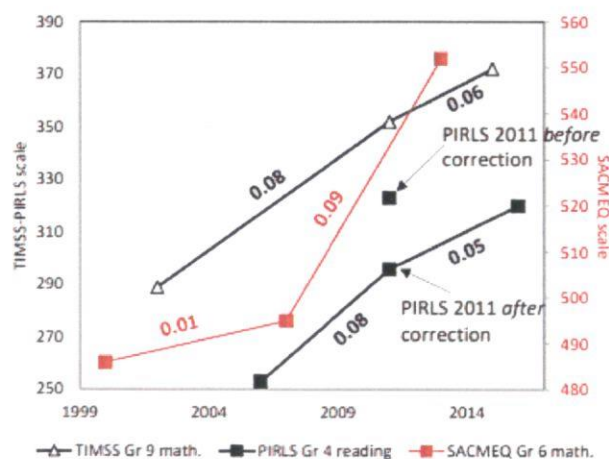
<sup>9</sup> Statistics South Africa. 2019. *Inequality Trends in South Africa: A multidimensional diagnostic of inequality.* Pretoria: Government Printer.

<sup>10</sup> See also Wittenberg, M. and Leibbrandt, M. 2017. They argue that a “picture of falling asset inequality [between 1993 and 2008] contrasts sharply with the money-metric analysis of inequality over the same period. The latter narrative is one of very high inequality in 1993 that does not fall over the post-apartheid years. Substantively, our empirical work suggests that the money-metric approach to inequality measurement in South Africa may have obscured the real progress in large portions of the population and in important dimensions of inequality.”

learning measured through performance in international standardised test). In 2018, the South African HCI was 0.41, far down the ranking, with South Sudan in the worst position at 0.30 and Singapore in best position at 0.88. Brazil is at 0.56 and Rwanda at 0.37.<sup>11</sup>

If one goes beyond ranking to direction of change, there may be more room for positive expectations. Education analysts have pointed out that on international standardised assessments, South African education results have improved as rapidly as can be expected and that the problem is with the starting point, i.e., the huge schooling inequalities as an apartheid heritage, rather than the direction and rate of change. In a recent review of the evidence Gustafsson concludes that of the three main international standardised assessments in which South African participates, basic education output quality is improving at what is an “international speed limit”<sup>12</sup>. Much remains to be done, and much of the improvement may be due to general environmental factors such as lower poverty and rising general literacy, rather than focused improvement of the education situation, but the fact of improvement impacts positively on South Africa’s prospects.

**Figure 2 - Trends in basic education output quality**



Source: Gustafsson 2020

The successful implementation in a heavily resource-constrained health system of the largest anti-retroviral programme in the world has also been associated with a dramatic turn-around in South African life expectancy. StatsSA in its 2019 mid-year estimates indicates that average life expectancy at birth improved from 55.9 to 64.7 between 2002 and 2019. This was associated with a decline of the infant mortality rate from 56.5 per 1 000 births to 22.1 per 1 000 over the same period and a decline in the under-5 mortality rate for 79 per 1 000 to 28.5

<sup>11</sup> See <https://www.worldbank.org/en/data/interactive/2018/10/18/human-capital-index-and-components-2018>. A guide is provided in Kraay, A. 2019. The World Bank Human Capital Index: A Guide. World Bank Research Observer 43(1). pp 1-33. Washington, DC: The World Bank

<sup>12</sup> Gustafsson, M. 2020. A revised PIRLS 2011 to 2016 trend for South Africa and the importance of analysing the underlying microdata. Stellenbosch Economic Working Papers: WP02/2020.

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per 1 000. While there is also a long way to go in respect of life expectancy rates, these improvements imply substantial reductions in the costs of morbidity and loss of lives.

While economic and social conditions are therefore threatening and seemingly on a downward slope, the turnaround in human capital endowments and shifting access to a complete range of assets and opportunities may be offering a foothold for the future. Much, however, will depend on the policy responses to the current situation which will have to focus on ensuring that gains over the past two decades are not reversed.

## 2.2 Economic prospects

South Africa faces a daunting economic and socio-political future. In neither the international nor the domestic environment do factors point to a rapid turnaround in growth prospects. As pointed out clearly by the government in the budget presentations and documents, growth projections have been adjusted downward for several years and projections going forward are for muted growth rates.

According to the South African Reserve Bank (SARB), growth is expected to significantly accelerate to 1.2 per cent and 1.6 per cent in 2020 and 2021 respectively. The World Bank projects growth to reach 0.9 per cent in 2020 before further increasing to 1.3 per cent in 2021. The IMF projected the most pessimistic growth outlook at 0.8 per cent for 2020, 1 per cent for 2021 and then recovering somewhat to 1.3 per cent and 1.5 per cent in 2022 and 2023 respectively. GDP growth is therefore projected to stay below population growth for the next three years.<sup>13</sup>

On the demand side of the economy, household consumption is a vital driver of economic growth. On year-on-year basis, the growth rate of this sector declined from 2.1 per cent in 2017 to 1.8 per cent in 2018. On a quarter-on-quarter basis, growth in the sector fell from 2.6 per cent in the second quarter of 2019 to only 0.2 per cent in the third quarter. The average growth of the sector in the first three quarters of 2019 was 1.1 percentage point higher than in the corresponding period of 2018. The sector added only 0.1 per cent to GDP in the third quarter of 2019. The main positive contributors to growth in the sector were expenditures on food and non-alcoholic beverages as well as restaurants and hotels. The performance of the sector is consistent with the slower growth in households' real disposable income and weaker consumer confidence. Households are confronted with a number of challenges including high and rising unemployment, slow wage growth, higher taxes, and rapidly rising electricity and water prices. Moreover, the FNB/BER Consumer Confidence Index declined significantly from 5 index points in the second quarter of 2019 to -7 in the third quarter. The prospects for this important driver of economic growth appear bleak.

Fixed investment has been stuck in a low trend, but the SARB reports that some momentum is emerging. On year-on-year basis, investment declined from an expansion of 7.2 per cent in

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<sup>13</sup> International Monetary Fund. *Ibid.*

2013 to a contraction of 1.4 per cent in 2018. On a quarter-on-quarter basis, gross fixed capital formation expanded by 4.5 per cent in the third quarter of 2019 after increasing by 5.8 per cent in the second quarter. Investment by the private business enterprises expanded by 10.8 per cent in the third quarter of 2019, following an expansion of 15.8 per cent in the second quarter. Public corporation investment increased marginally by 0.2 per cent in the third quarter of 2019, following a substantial contraction by 11.9 per cent in the second quarter. Investment by general government contracted sharply by 17.8 per cent in the third quarter, following another massive deceleration by 16.3 per cent in the second quarter. Fixed investment added only 0.9 per cent to GDP in the last quarter of 2019, after adding 1.1 per cent in the second quarter. Weaknesses in human capital, infrastructure, and the business environment are key factors that constrain private investment and growth in South Africa. Innovation, a key condition for productivity growth, is extremely low with private research and development (R&D) accounting for only 0.3 per cent of GDP<sup>14</sup>. These factors make it difficult to move to higher-value activities in agriculture, manufacturing, and services that are needed to boost growth in South Africa.

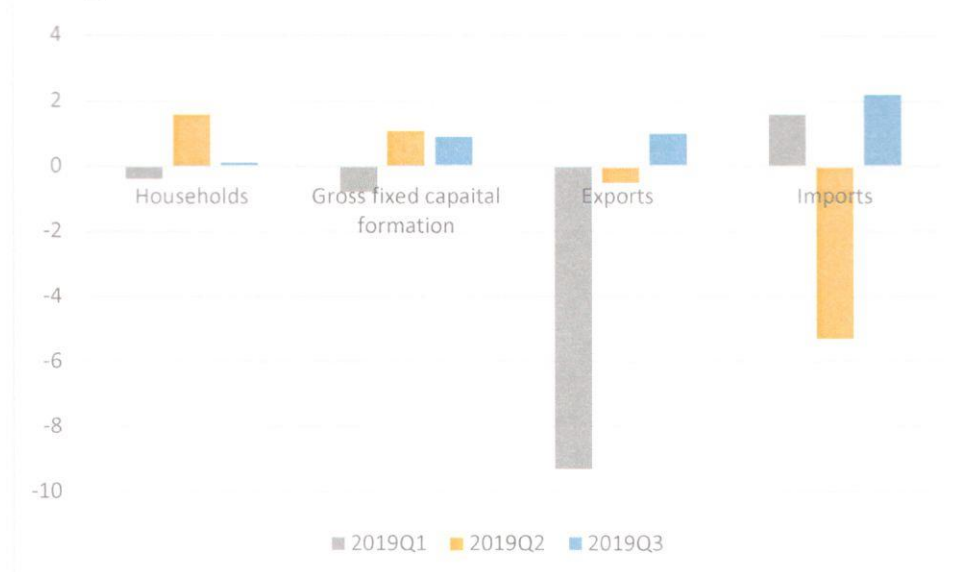
The importance of structural reforms is underscored by the lukewarm performance of international trade. On year-on-year basis, exports have declined from an expansion of 4 per cent in 2013 to 2.6 per cent in 2018. Imports have decelerated from an expansion of 5 per cent in 2013 to 3.3 per cent in 2018. On a quarter-on-quarter basis, exports increased by 3.5 per cent in the third quarter of 2019, followed by a contraction of 1.5 per cent in the second quarter. Imports decelerated by 6.8 per cent in the third quarter of 2019, followed by an expansion of 18.3 per cent in the second quarter. Figure 3 shows the contributions to growth in expenditure on GDP for selected sectors from the first to the third quarters of 2019. Relatively high wages, an inadequate logistics infrastructure, the regulatory burden on private companies and policy uncertainty make it difficult to compete with low-cost manufacturing destinations and build a more export-oriented economy.



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<sup>14</sup> See The World Bank. 2017. *South Africa Economic Update: Innovation for productivity and inclusiveness*, Washington, DC: The World Bank.

**Figure 3 - Contributions to growth in expenditure on GDP for selected sectors, 2019Q1-2019Q3**



Source: South African Reserve Bank, 2019

The national saving rate (gross saving as a percentage of nominal GDP) for South Africa declined marginally from 14.8 per cent in the second quarter of 2019 to 14.5 per cent in the third quarter. The decline is a result of dissaving by general government. The saving rate of corporate business enterprises increased moderately whereas that of households stagnated or remained constant. Gross saving as a percentage of GDP for the corporate sector accelerated to 13.5 per cent in the third quarter of 2019 from 12.6 per cent in the second quarter. General government saving rate decelerated from 0.9 per cent in the second quarter of 2019 to a dissaving of 0.4 percent in the third quarter. This reversal in government saving rate could be explained by the decline in government revenue as a result of lower corporate and personal income tax receipts, which was not fully compensated for by the slower pace of increase in government's nominal expenditure. Gross saving by the household sector as a percentage of GDP remained unchanged at 1.4 per cent in the third quarter, as the increase in nominal disposable income was fully offset by that of nominal consumption expenditure.

On the supply side of the economy, the finance, real estate, and business services sector remains South Africa's main engine of growth. On year-on-year basis, the sector has grown since 2015 more than any other sector. On a quarter-on-quarter basis, it is the only sector that has not contracted since the first quarter of 2016. In the first three quarters of 2018, the sector grew at an average of 2.6 per cent. In the third quarter, the main reasons for the strong performance are financial intermediation, auxiliary activities, real estate activities and business services. The sector added 0.3 per cent to GDP in the third quarter of 2019, the second highest contribution across all sectors.

The manufacturing sector continues to struggle. On year-on-year basis, the sector has not grown by more than 1 per cent since 2013. On a quarter-on-quarter basis, the manufacturing sector contracted by 3.9 per cent in third quarter of 2019 and shaved off 0.5 per cent off GDP

growth. Six of the ten manufacturing divisions recorded negative growth rates in the third quarter of 2019: basic iron and steel; non-ferrous metal products; metal products and machinery; petroleum, chemical products, rubber and plastic products; and wood and wood products; paper, publishing and printing.

Th rising input costs, reductions in some commodity prices, inconsistent electricity supply and moderation in global economic growth continue to suppress activity in the mining sector. On year-on-year basis, the growth rate of the sector has plummeted from an expansion of 4 per cent in 2013 to a contraction of 1.7 per cent in 2018. On a quarter-on-quarter basis, the mining sector contracted by 6.1 per cent in the third quarter of 2019 and by an average of 2.2 per cent in first three quarters of 2019. The sector subtracted 0.5 percentage points from GDP growth in the third quarter, with platinum group metals (PGMs), iron ore, coal and other metallic minerals contributing the most to the decline.

The large swings in production in the agriculture sector continues to have significant impacts on economic growth. On a year-on-year basis, the growth rate of the sector decelerated from a significant expansion of 21.1 per cent in 2017 to a contraction of 4.8 per cent in 2018, resulting in the sector being the main reason for the technical recession in 2018. On a quarter-on-quarter basis, the agriculture sector contracted by 3.6 per cent in the third quarter of 2019, and by 9.1 per cent in the first three quarters of 2019 than in the corresponding period of 2018. It subtracted 0.1 percentage points from the GDP growth in the first quarter of 2019. The decrease resulted from a decline in the production of field crops. Figure 4 shows contributions to growth in GDP for selected sectors from the first to the third quarters of 2019. The sector urgently requires more effective support to emerging farmers in order to increase its contribution to growth. It is structurally dualistic primarily because production it is highly dependent on a small number of large capital-intensive commercial farms, while smaller farms face low economies of scale and inadequate access to financing. Emerging farmers also lack critical skills to enable them to exploit knowledge and technological advancements in the sector. The sector is also being held back by fragmented governance that is spread across several departments.

**Figure 4 - Contributions to growth in GDP for selected sector, 2019Q1-2019Q3**

Source: South African Reserve Bank, 2019

The assumptions underpinning the slightly improved growth prospects are accelerated structural reforms and increases in public and private investments. The electricity supply outages and external demand are expected to restrain economic growth to less than 2 per cent in the medium term.<sup>15</sup>

### 2.3 Diagnosis and government strategy

In the 2019 Medium Term Budget Policy Statement (MTBPS), the National Treasury discusses the great deceleration of growth in the South African economy over the last decade and what must be done. In response to the question, “The growth puzzle: why so weak so long?”, the National Treasury argues that the international environment (steadily rising growth and low interest rates) and monetary policy (depreciating currency, contained bond yields, inflation anchoring) have been generally supportive or accommodating of stable growth in recent years (drought, however, is noted as a complicating factor). Politics and policy have, however, it is argued, been unable to deal decisively with a range of “structural problems that are well understood”. The National Treasury then suggests that while the appropriate macroeconomic policies are in place, the focus needs to be on “microeconomic policy” and reforms, presumably to deal with the structural factors, and “ensur[e] a well-regulated, efficient business environment that encourages innovation and the creation of new businesses.”<sup>16</sup> Progress on these “policies” has been limited and, presumably together with actual economic conditions, “policy and political uncertainty” have impacted negatively on business and consumer confidence and hence investment and growth.<sup>17</sup>

<sup>15</sup> International Monetary Fund. *Ibid.*

<sup>16</sup> For similar thinking, also shifting the focus away from monetary and fiscal policy and pointing to structural factors, “microeconomic policy” and “politics” (in the case of Sachs) see Naidoo, K. 2019. Don’t blame the goalie if the striker can’t score, and Sachs, M. 2019. Both directions at once: Fiscal policy in South Africa. Both in *New Agenda South African Journal of Social and Economic Policy*, Vol 75.

<sup>17</sup> See The National Treasury. 2019. Medium Term Budget Policy Statement. Pretoria: Government Printers.



Under structural issues, the National Treasury in the MTBPS 2019 lists “high levels of inequality, spatial disparities, low levels of education, the uneven quality of public services and inadequate state capacity”.

In terms of structural constraint and the microeconomic constraints on growth, Budget 2020 reverts more to the National Treasury’s August 2019 discussion document, “Economic transformation, inclusive growth, and competitiveness: Towards an economic strategy for South Africa”<sup>18</sup>. A central mechanism in this approach is to reduce the costs of doing business, of finding work and the cost of living. This could be seen as a strategy to remove obstacles to citizens using opportunities, and to empower citizens as producers (both as workers and business people) and as consumers.

This empowerment through lowering costs or obstacles targets can be seen as including<sup>19</sup>:

- Continuation of current macroeconomic policies (low and stable inflation, a flexible exchange rate, and a sustainable fiscal framework) to reduce uncertainty and risk in investment decisions, and support business and consumer confidence.
- Modernising and reforming network industries, restructuring inefficient and state-owned companies and inviting private-sector participation
- Promoting competition and small businesses.
- Export-orientated industrial policy for stimulated export demand.
- Promotion of labour intensive sectors (especially, agriculture, services and within (or across) the latter, tourism.
- Focused and flexible industrial and trade policy.

The IMF<sup>20</sup> also refers to the “structural nature of the growth slowdown” and the need for “reforms that reduce the cost of doing business and boost private investment” but have a perhaps somewhat narrower list than the National Treasury. The IMF and National Treasury lists do not overlap perfectly. The IMF’s list of structural issues includes governance which is related to the Treasury’s quality of public services and state capacity and SOE weaknesses, which point to network industries. In its indicators, the IMF is more explicit about corruption, reflecting South Africa’s standing in the global corruption rankings and also refers specifically to quality of schooling: “from the supply side there is much room to improve education and attainment and skills”. The primary difference between the National Treasury and the IMF is the centrality of focus of the IMF on concentration, lack of competition and elevated price levels in product markets (and hence the need for stronger competition policy) and in maintaining its critique of the inflexibility of South African labour markets.

<sup>18</sup> The National Treasury. 2017. *Economic transformation, inclusive growth, and competitiveness: Towards an Economic Strategy for South Africa*. Pretoria: The National Treasury.

<sup>19</sup> The National Treasury summaries of the strategy highlight different parts in different contexts. Normally macro-economic policy is not included, but it is in the case of Budget Review 2020 which identifies only three of the five strategies in the discussion document.

<sup>20</sup> International Monetary Fund. *Ibid.*

In addition to the broad thrust of the economic strategy, with a longer-term focus, National Treasury also raises:

- Measures already in progress (in the MTBPS falling under blockages in Budget 2020) including the Integrated Energy Resources Plan, visa reforms and spectrum licensing; and
- Reforms to be implemented without delay, including further tourism and red tape reform, opening up energy generation, conditions for the expansion of fibre infrastructure and improvements in business and deeds registration.

## 2.4 Comment by the Commission

The Commission agrees that the obstacles to South African economic and social development are not easy or superficial, and hence could be called structural. These structural problems or constrain citizens as business owners and entrepreneurs, as workers and as consumers. The focus therefore on the cost of living, the cost of working and the cost of doing business (as in Budget 2020) is useful as an intermediate objective. What becomes less helpful in the National Treasury and IMF approaches are the proliferation of structural factors, the lack of reasoned prioritisation and the vagueness of strategies.

The Commission also points out that in trying to reduce cost to business, workers and consumers it is important to value collective provision and collective action as mechanisms to reduce costs. While National Treasury and the IMF continue to raise privatisation and more flexible regulation, the high cost of work in South Africa is primarily due to the apartheid spatial structure and the failure to address this structure through spatial planning and public transport. More attention is therefore required on the issues of why some aspects of public provision have failed or remain so resistant to change? Policy uncertainty in the shape of failure to make decisions or force their implementation, and the lack of accountability seem to play an important role in these failures. Specific examples of failures include digital transition of television, availability of spectrum, roll-out of fibre, current stalemate with regard to e-tolls and the continuing stand-off between Uber-drivers and metered taxis.

In many cases, this policy uncertainty relates to more than just weak leadership and incompetent officials; it is part of real conflicts of interests between different groups of South Africans and often to different groups in business. South Africa has been changing rapidly and has to go through a range of further change as a number of structural drivers impact on the country, including population change and migration, climate change, technological change and innovation, and power or political economy shifts. These shifts bring benefits to some South Africans (e.g. those with the ability to invest in solar power, thereby decreasing their contribution to climate change) on the one hand, but risks and costs to others (e.g., coal miners and coal transporters who lose jobs and income respectively as reliance on coal is decreased as part of addressing climate change) on the other. If South Africans who stand to lose are not included in significant numbers, a range of potentially positive structural changes will be resisted. The mechanism devised by societies to deal with the costs and resistance to change

are social protection and negotiation and pacts about costs and benefits. South Africa has such mechanism of social protectionism such as UIF, but the coverage is generally woeful and in the case of negotiation between social partners, NEDLAC seems to be failing us.

In his State of the Nation Address (SONA), President Ramaphosa urged South Africans to overcome fear. Many of the country's citizens fear change because, as the NIDS analysis shows, the socio-economic positions in which they find themselves are tenuous. Society will have to support its citizens in removing those fears through fair negotiation of the costs and benefits of change and putting in place the mechanisms to ensure buy in by those who temporarily loose economically through no fault of their own. Otherwise politics, policy and the economy will remain gridlocked, as is currently happening in respect of the Gauteng freeway system as a result of conflict and indecision about financing.

Technological change will provide South Africa with the tools to move forward if we can negotiate a fair distribution of the gains from technological change which will bring new assets and income potentials. In this context, a sovereign wealth fund as a tool for inclusion through investing in South African and their assets may provide a vehicle for moving forward.

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### 3. Fiscal Framework and Revenue Proposals

#### 3.1 The South African fiscal framework

**Table 1 - The consolidated fiscal framework (R billion, selected years)**

	2016/17	2019/20	2022/23
R billion	Outcome	Revised estimate	Estimate
Revenue	1 285,6	1 517,0	1 791,3
Expenditure	1 442,6	1 843,5	2 141,0
Non-interest expenditure	1 286,0	1 628,5	1 840,3
Budget balance	-157,0	-326,6	-349,7
Gross loan debt	2 232,9	3 176,1	4 383,6
Debt-service costs	162,6	205,0	290,1
Borrowing requirement	253,8	410,0	424,1
GDP at current prices	4 419,4	5 157,3	6 126,3

Source: National Treasury, Budget Review 2020

The South African fiscal framework has changed significantly in recent years. While government revenue grew modestly between 2016/17 and 2019/20, at a real average rate of about 1.1 per cent per annum, expenditure has been growing at just under 4 per cent per annum in real terms. The result is that the deficit (or budget balance) more than doubled in nominal terms over the last three years with knock-on effects on gross loan debt (rising from R2.3 trillion in 2016/17 to R3.2 billion in 2019/20), debt service cost from R162.6 billion to R205 billion per year over the same period and the annual borrowing requirement from R253.8 billion to R410 billion) (Table 1).

Table 2 - The consolidated fiscal framework (elements as percentage of GDP, selected years) presents the fiscal data in terms of key ratios relative to nominal GDP. For 2019/20 revenue is expected to reach 29.4 per cent of GDP and expenditure 35.7 per cent of GDP. The result is a rapid widening of the deficit to 6.3 per cent of GDP, a ballooning of gross loan debt to 61.6 per cent of GDP, upward pressure on debt-service costs to 4 per cent of GDP in 2019/20 and the borrowing requirement to nearly 8 per cent of GDP in 2019/20.

**Table 2 - The consolidated fiscal framework (elements as percentage of GDP, selected years)**

	2016/17	2019/20	2022/23
% of GDP	Outcome	Revised estimate	Estimate
Revenue	29,1%	29,4%	29,2%
Expenditure	32,6%	35,7%	34,9%
Non-interest expenditure	29,1%	31,6%	30,0%
Budget balance	-3,6%	-6,3%	-5,7%
Gross loan debt	50,5%	61,6%	71,6%
Debt-service costs	3,7%	4,0%	4,7%
Borrowing requirement	5,7%	7,9%	6,9%

Source: National Treasury, Budget Review 2020

Over the next few years, government's budget measures announced are estimated to stabilise at the level of these revenue and expenditure ratios. However, these shifts will fail to decisively turn around the gross loan debt as a proportion of GDP. The debt ratio is expected to reach 71.6 per cent of GDP by 2022/23 which will not yet represent a turning point.

Weak nationally-collected revenue growth was the result of the continuing deceleration of growth on one hand, and, on the other, governance issues at the South African Revenue Service (SARS) as a result of corruption. Expenditure growth pressures relate to continued population growth, expanding mandates in an environment of lack of government-wide prioritisation and inefficient service delivery execution, and pressure in terms of input costs, including salaries and wages of civil servants which grew faster than inflation. Thus, despite growth in expenditure, service delivery remains under pressure because of demand factors, cost factors and inefficiencies. In addition, for several reasons, including cleaning up governance, government has been increasingly focussing on compliance with bureaucratic process and rules. Such compliance activities also impose costs of their own and sometimes impinge on actual service delivery. A balance between capacitating and containing government has to be found.

Going forward, slow revenue growth, estimated at about 1.1 per cent on average per annum, results from low economic growth projections (1.3 per cent per annum on average over the MTEF), keeping the tax regime and rates unchanged (except for inflation adjustments to eliminate fiscal drag on income taxes and to maintain tax takes on excise taxes) and factoring in an expectation of reduced tax buoyancy (tax revenue growth being slower than economic growth). This slow growth in revenue thus comes from:

- Prevailing foreign and domestic economic conditions;
- A policy decision to maintain the tax burden at current real levels relative to inflation;
- Expectations that the tax take for every Rand of growth will decline; and
- The intention to contain wage growth in the public sector.

Potential improvements in tax administration are not yet factored into government's revenue estimates, according to the National Treasury.

Given the explosive growth in debt and debt projections, fiscal consolidation is required. Continued debt growth will lead to future debt costs that will be increasingly difficult to fund and will impact on country confidence and credit rating. This in turn will impact directly and negatively on investment and the cost of credit and negatively impact on government spending on services for citizens. In this context, government is opting for a very specific consolidation strategy.

### 3.2 Strategy for fiscal consolidation

To consolidate the fiscal situation more immediately, government is opting to not raise more revenue through adjusting tax rates beyond the correction for effect of inflation, but rather to constrain expenditure. According to the Budget 2020, consolidated government spending reached an historic high of 36 per cent of GDP in 2019, and it is asserted that “this level of spending is unsustainable”.<sup>21</sup>

The policy decision not to raise tax burdens seems to be motivated by the view from government that:

- Tax to GDP ratios (26.2 per cent) are close to their “democratic-era peak”, which is then presumably seen as an upper ceiling which should not be breached without a credible strategy on how such expenditure will impact positively on growth. Real expenditure growth over the last decade, it could be argued, has not been able to ignite or even maintain growth;
- South African tax rates seem to be relatively high. Reference is made by the National Treasury to the South African “tax burden” of close to 26.3 per cent of GDP being relatively high compared with other upper-middle-income countries. For example, Turkey is at around 25 per cent, Chile at about 20 per cent and Mexico at about 16 per cent. It is however, also shown that the South African “burden” is below that of Tunisia (just over 30 per cent), Brazil (at about 33 per cent) and Hungary (well on its way to 40 per cent). With regard to corporate income tax, the National Treasury refers to the fact that South Africa’s corporate income tax rate has remained unchanged at 28 per cent for more than a decade, while in many countries the trend has been towards downward adjustment. The National Treasury therefore refers to a growing tax rate gap between South Africa and its trading and investment partners;
- In the context of low growth, government argues that substantial tax increases may obstruct short-term recovery.

Consolidation is therefore to be effected through constraining expenditure growth to an average annual real growth of 0.5 per cent compared to the 3.8 per cent of the previous three years. This is to be done by reducing programme baseline (Budget 2019) allocations by R101 billion and

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<sup>21</sup> Information and statistics in this section from The National Treasury. 2020. Budget Review 2020. Pretoria: Government Printer

the consolidated wage bill by R160 billion. The reduction will require a renegotiation of the current collective wage agreement which makes provision for above inflation increases for certain categories of workers in April 2020.

The consolidation strategy will also impact on both the functional and economic composition of expenditure and on the division of revenue. In this regard the main points are that:

- After having shifted towards national between 2016/17 and 2020/21, the division of revenue rebalances over the MTEF. From a share of 50.1 per cent in 2019/20 (driven by financial support to SOEs), the national share reduces to 47.5 per cent in 2022/23. After having grown strongly in real terms over the last three years, the national share is estimated to decline in real terms by an average annual 1.9% over the next three years. In contrast the provincial share grows by 1.4% per year in real terms and the local government share by 2%. While provincial conditional grant grows marginally over the MTEF (0.2% per year), the equitable share grows by 1.7% per year. While the local government equitable share continues to grow strongly (by 4.5% per year in real terms following on average annual growth of 5% per year over the previous three years. Local government conditional grant, however, continue their real decline. After declining by 1.4% per year over the previous three years, they decline by 2.1% per year over the next three years.

**Table 3 – Division of revenue, growth in available funds**

R billion	Average annual real growth 16/17 to 19/20	Average annual real growth 19/20 to 22/23
<b>National departments</b>	5,2%	-1,9%
<b>Provinces</b>	2,4%	1,4%
Equitable share	2,5%	1,7%
Conditional grants	1,5%	0,2%
<b>Local government</b>	2,1%	2,0%
Equitable share	5,0%	4,5%
Conditional grants	-1,4%	-2,1%
<i>General fuel levy sharing with metros</i>	0,9%	2,3%
<b>Non-interest allocations</b>	<b>3,7%</b>	<b>-0,9%</b>

Source: National Treasury, Budget Review 2020

- Functional allocations by grew by an annual average of 3.3% per annum over the period 2016/17 to 2019/20 but the growth rate declines to 0.4% per annum over the 2020 MTEF. Overall, service delivery will, therefore, be under significant pressure. While there is compensation for inflation, there is no funding provided for demand growth (including population change) and cost increases above CPI. In the past, remuneration has increased significantly above inflation cutting into the purchasing power of

departmental allocations. Service delivery levels will therefore hinge critically on reaching agreement with employees for overall salary adjustments below those of recent years.

- Several functional and programme areas grow more slowly than the average, and indeed below inflation thus shrinking in real terms, as debt service costs is rising significantly faster than inflation at a real annual average of 7.2% per annum. Peace and Security Budgets are set to decline by 2.2% per year on average, General Public Services by 0,8% per annum and Learning and Culture by 0,5% per annum. The level of agreement on salaries and wages will therefore be fundamental to these functions – if the current agreement of CPI plus 1% stands, real reductions will be significant.
- Current payments dominate consolidated government expenditure. Between 2016/17 and 2019/20 current payments (salaries and wages, goods and services, and interest) grew by an average of just over 3 per cent per year in real terms. This contrasted with payments for capital assets that declined by 8.2 per cent per year on average in real terms. The biggest component of current expenditure, compensation of employees, grew by 2.6 per cent per year in real terms with goods and services growing by just under 2 per cent per year. The rapid growth in debt service costs (an annual average of 7 per cent) and compensation is impacting on funds available. While capital expenditure under this heading does not encompass all government capital expenditure (the bulk is contained in transfers to local and provincial government and certain public entities such as PRASA and ESKOM), the data shows capital spending declining by a real annual average of over 8 per cent over this period.
- As reflected in Table 4, Budget 2020 attempts to reverse some of these trends in the composition of expenditure. Real annual average growth in current payments is projected to slow to under 1 per cent per annum over the next three years. As was the case previously, growth is driven by rapid growth in debt service costs of, on average, 7 per cent per annum. The next three years will see government attempt to rein in spending on compensation and shift emphasis to capital spending. To this end, real growth in compensation spending is projected to decline by 1 per cent per annum over the next three years. Conversely capital spending is set to grow by a strong real annual average of 4.8 per cent per annum over the 2020 MTEF period. Both goods and service and transfers and subsidies will experience slower real growth over the next three years.



Table 4 - Consolidated expenditure by economic classification, 2016/17 to 2022/23

R billion	Audited Outcome 2016/17	Revised Estimate 2019/20	MTEF Estimate 2022/23	Real Annual Average Growth Rate - 2016/17-- 2019/20	Real Annual Average Growth Rate - 2019/20- 2022/23
<b>Current payments</b>	<b>872.0</b>	<b>1,095.9</b>	<b>1,286.3</b>	<b>3.2%</b>	<b>0.9%</b>
Compensation of employees	510.3	629.2	697.1	2.6%	-1.0%
Goods and services	208.1	251.7	288.5	1.9%	0.1%
Interest and rent on land	153.6	215.0	300.7	7.0%	7.0%
<i>of which: debt-service costs</i>	<i>146.5</i>	<i>205.0</i>	<i>290.1</i>	7.0%	7.4%
<b>Transfers and subsidies</b>	<b>472.9</b>	<b>599.7</b>	<b>713.4</b>	<b>3.5%</b>	<b>1.4%</b>
<b>Payments for capital assets</b>	<b>93.6</b>	<b>82.8</b>	<b>109.0</b>	<b>-8.2%</b>	<b>4.8%</b>
Buildings and other capital assets	72.8	63.7	85.7	-8.5%	5.6%
Machinery and equipment	20.8	19.1	23.3	-7.1%	2.2%
<b>Total</b>	<b>1,445.7</b>	<b>1,843.5</b>	<b>2,136.0</b>	<b>3.7%</b>	<b>0.5%</b>
<b>Contingency reserve</b>	<b>-</b>	<b>-</b>	<b>5.0</b>		
<b>Consolidated expenditure</b>	<b>1,445.7</b>	<b>1,843.5</b>	<b>2,141.0</b>	<b>3.7%</b>	<b>0.5%</b>

Source: National Treasury, Budget Review 2020

### 3.3 Structure of revenue and additional revenue initiatives

Given the decision not to change tax structure and rates in real terms, there is little change to the structure of revenues and the relative importance of the different taxes. By 2022/23, taxes on income and profits will bring in R921 billion out of a total gross tax revenue of R1.6 trillion, compared to property taxes at R20 billion, taxes on goods and services at R577 billion and taxes on trade and transactions at R70 billion. The three major taxes remain: personal income tax (R621 billion in 2022/23), VAT (R406 billion) and corporate income tax (at R258 billion in the same year) (See

**Table 5).**

**Table 5 - Structure of budget revenue**

	2016/17	2019/20	2022/23
	Outcome	Revised estimate	Estimate
<b>R million (nominal)</b>			
Taxes on income and profits <sup>2</sup>	664 526	778 280	921 375
Personal income tax <sup>3</sup>	424 545	527 584	621 602
Corporate income tax <sup>4</sup>	204 432	216 718	258 357
Skills development levy	15 315	18 576	21 970
Taxes on property	15 661	16 038	20 165
Domestic taxes on goods and services	402 464	488 711	576 525
VAT	289 167	344 202	405 598
Taxes on international trade and transactions	46 102	57 330	69 622
<b>Gross tax revenue</b>	<b>1 144 081</b>	<b>1 358 935</b>	<b>1 609 657</b>
Non-tax revenue <sup>5</sup>	33 272	36 142	34 586
Less: SACU6 payments	-39 448	-50 280	-63 366
<b>Main budget revenue</b>	<b>1 137 904</b>	<b>1 344 796</b>	<b>1 580 877</b>
Provinces etc	147 700	172 192	210 442
<b>Consolidated budget revenue</b>	<b>1 285 605</b>	<b>1 516 988</b>	<b>1 791 319</b>
GDP (R billion)	4 419,4	5 157,3	6 126,3
Tax buoyancy	0,97	1,15	1,01

Source: National Treasury, Budget Review 2020

In addition to the “no change” policy on taxation, government announced several intentions and initiatives with regard to taxes going forward in the Budget Review 2020. These include:

- For both the income tax and corporate tax system, the government’s aim is to broaden the base and reduce the rate. These intentions are partly actioned through announcing sunset clauses for certain incentives. Government will also systematically review tax incentives and repeal or redesign those found to be redundant, inefficient or inequitable. Government will be moving forward specifically to curtail excessive corporate interest deductions and limiting the use of assessed losses to reduce taxable income.

- In respect of initiatives to rebuild governance at SARS and enhance tax administration, the former includes potential legislative amendments to strengthen governance and the Office of the Tax Ombud and consideration of the establishment of an inspector-general to oversee governance and conduct at SARS.
- The budget allocates R1 billion over the Medium Term Economic Framework (MTEF) for infrastructure-related projects.
- Government is participating in international fora deliberating on taxing the digital economy (which often avoids taxation in countries where it does substantial business) and is preparing an environmental fiscal reform review paper.

### 3.4 Considerations of the fiscal framework and revenue proposals

#### 3.4.1 Distributing the cost of consolidation

It is by no means straightforward to calculate the distribution of the costs of fiscal consolidation on citizens and other role-players. As with most strategies there will be some short-term winners and losers. The current fiscal strategy appears to impose the cost of consolidation on civil servants who consist primarily of teachers, nurses, doctors, social workers, police and other security sector workers.

The argument seems to be that this category of South Africans has in recent years benefitted disproportionately. It should, however, be remembered that some of the adjustment in wage structure was effected in order to correct, for example, a very flat age- and experience-related remuneration in education and nursing, which made it difficult to motivate and attract quality and more experienced personnel. Workloads in some parts of the civil service have also increased. Government staff and unions are therefore raising concerns about what could be seen as the one-sided distribution of the cost of fiscal consolidation. It could be asked whether it would not be possible to negotiate a fiscal strategy that would see a more fair distribution of costs between public and private sector workers and between workers and business-owners?

There also seems to be an assumption that the current fiscal strategy will not impact on service delivery to citizens where government service delivery mostly supports the lower-income earners in the population. This should also be factored into discussions of the distribution of the costs of consolidation. Relative needs must be weighed up in terms of a balance between engendering future inclusive growth for South Africa on the one hand, and catalysing such growth on the other.

#### 3.4.2 Credibility and soundness of consolidation strategy

Government's fiscal strategy is premised on reaching agreement with government workers to change an existing wage agreement. What is the possibility of renegotiating with creditors and has this been considered? Interest rate costs of servicing the country's debt is rising more dramatically than wage costs, but importantly, substantial scepticism about the willingness of the unions to concede to government's strategy exists. In addition to the risk of not being able

to reach an agreement, the markets also seem to be concerned about government's ability to stave off further demands for support to state-owned enterprises (SOEs).

An alternative to an expenditure reduction strategy or a tax raising strategy for fiscal consolidation would be a strategy to maintain deficits but ensure the generation of greater returns to government spending than in the past – in effect committing to and implementing government efficiencies and value for money strategies that will enhance government's impact on the economy. Here government also faces a credibility constraint. There is a general perception that because of policy uncertainty, inefficiency and corruption, government is not able to generate a turnaround and the required significantly more positive impact on the economy.

The government credibility gap and the current status of the country may point to the need for government in its expenditure and delivery strategy not to be too ambitious at the outset, but rather to focus on some of the basic foundations of public administration (e.g., revenue collection, prosecutions, citizen services through the Department of Home Affairs) which impact directly on the cost of living, and address corruption, provision of the social wage for the poor, and the cost of undertaking business. These are government spending areas in which small investments and improvements can have a significant ripple effect, particularly with follow up initiatives into the future. The same may be true for services such as early childhood development (child minding and nurturing) which not only invests in children at the most appropriate time in their lives but easily targets the most vulnerable communities and creates jobs on a significant scale.

### 3.4.3 Fiscal futures (revenue and expenditure)

Some of the government fiscal revenue initiatives (e.g., taxing the digital economy and environmental fiscal reform) relate to the impact of rapid technological change (which includes digitisation) and climate change. Government's capacity to assess these critical global change drivers (which also induce and include population and health shifts, shifts in international power or political economy and shifts in values and outlook) and to respond through appropriately adjusting the fiscal and revenue system is critical. If government is slow to respond to these trends, South Africans will be the losers (some believe that middle-income countries are the major losers as a result of the slow progress with reforms on taxation of the digital economy).

This is an area in which the National Treasury and other fiscal bodies (SARS, the Parliamentary Budget Office and the Commission) should increasingly cooperate and also mobilise the South African research community in TVET colleges, universities and science councils. South Africa has strong comparative advantages in the science and higher education and research fields, built up over many decades and already significantly transformed. However, little research is focused on global drivers of change and our fiscal future as technology creates new assets (and reduces the value of others) and thereby employment opportunities, wealth and income.

In addition to a much greater focus on fiscal revenue futures (and indeed also in the local government sphere where technological change, especially in energy, is rapidly transforming the revenue raising capacity), there must also be much more deliberation and investigation by South Africans about our fiscal expenditure future. Fiscal ratios are not only bland numerical ratios that must be balanced for fiscal accountancy health, but also speak directly to the inherent character of a country's democracy. Societies face a choice between liberal democracy, as in the United Kingdom and the United States, which have low tax and expenditure ratios co-existing with high levels of inequality, lower levels of social solidarity and mobility, on the one hand, and, on the other hand, more extensive social democracy, as in the Nordic and some Asian countries, with attendant high levels of tax and expenditure producing much greater social solidarity, equity and social mobility. The type of democracy South Africans will get is not only about fate but about imagination and choice. The choice ultimately provides the policy direction beacon, addressing uncertainty and the appropriate supporting fiscal policy follows. Government implementation follows accordingly. Not making the key choice about our vision for South Africa's democracy leaves the country trapped on all other fronts such as fiscal policy and microeconomic reforms.

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