INSTITUTE FOR ECONOMIC JUSTICE
RESEARCH POLICY ADVOCACY

STATEMENT

Postponed budget opens door for alternatives

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The proposed two percentage point VAT increase has sparked debate about priorities in the National Budget, the stability of the Government of National Unity (GNU), and raised important questions about how South Africa can raise revenue to support its developmental goals. While the tabling of the budget has now been delayed, the IEJ has analysed the scrapped budget documents to understand how the National Treasury was planning to resource strategic priorities in the Medium-Term Development Plan (MTDP). It is important to go beyond the rejected VAT increase and unpack how the National Treasury understands the economic outlook, and the assumptions that underlie it, and propose measures to raise revenue that are not as harmful as a VAT hike.

A fiscal strategy unfit for South Africa's realities

Recently, Stats SA reminded us that [12.3 million] people remain unemployed. We know that as of 2015, more than 18 million people lived below the food poverty line, with the National Treasury [acknowledging] that this number has likely increased due to the fall in GDP per capita in the decade since 2015. Instead of addressing this reality, National Treasury's key priority remains debt stabilisation through a self-imposed fiscal anchor that is meant to "support responsible borrowing and spending" and a primary budget surplus (excluding interest payments) of 0.5% of GDP in 2025, which is expected to serve as one of the fiscal anchors.

National Treasury has, to date, largely approached debt stabilisation through expenditure cuts, with very limited tax increases. There has been no published assessment of the potential impact of these cuts on service delivery, nor the degree to which National Treasury perceives further cuts to be possible. The successive real cuts to spending since 2012 have almost certainly hampered GDP growth. The National Treasury's stated objective has been to stabilise the debt-to-GDP ratio. This is despite the fact that the real debt challenge is not the level of borrowing but its cost, something that should be immediately taken up (see below).

The fiscal strategy outlined in the now-scrapped 2025 National Budget is a worst-of-both-worlds middle-ground compromise that fails to chart a viable path. The adopted approach sought to limit further egregious budget cuts through the unpalatable proposal of increasing taxes on the poorest. At the same time, National Treasury failed to provide a robust positive vision for the transformative potential of public spending, thus making the pill of tax increases impossible to swallow. This is symptomatic of National Treasury's broader policy failings. What National Treasury should be offering is a thoughtful and ambitious programme for how public spending can transform lives and our economy, accompanying this with the mobilisation of the necessary revenue, secured progressively. The IEJ outlined six pillars for such an approach before the SONA. For this, we need a National Treasury that embraces the positive potential of a developmental fiscal policy, not one that is ideologically committed to shrinking the role of the state.

Opportunities and dangers

While the budget postponement offers the opportunity for a strategic reset, it also poses risks. The two percentage point VAT increase is not the only misguided decision. So too is the continued path of underinvestment. Equally problematic, is the Democratic Alliance's (DA) extremist position of 'no tax increases'. The inevitable consequences of this position would be draconian expenditure cuts that would harm the poorest. Similarly, the budget postponement should not be used as an opportunity to fast-track the implementation of the fiscal anchor, which the DA has ironically supported without considering its long-term implications on the resourcing of public services and the rigidity it will impose on fiscal policy. In what follows we unpack some of the risks and provide options for the way forward.

Tackling poverty and the high cost of living while investing in our future

There is scope to increase real spending on public services

Positively, the budget proposed a growth in consolidated government spending of an annual average of 1.16% (when adjusted for inflation with a base year of 2019/20). This is an improvement from the growth in the preceding three years, 2022/23 - 2024/25, where real consolidated government spending fell at an average rate of -0.88%. Between 2025/26 and 2027/28, inflation-adjusted non-interest spending (a proxy for spending on essential government functions) was proposed to increase by 1.04%. In addition, there is a welcome 2.1% proposed real increase in spending per person in 2025/26. However, reductions in the outer years still mean an overall *fall* of, on average, -0.7% between 2024 and 2028. There are also positive yet insufficient real increases to critical public services, such as basic education (1.3%), healthcare

(1.3%), and peace and security (0.3%), that are currently failing to provide adequately for the needs of those who rely on them.

Despite this, spending on critical social services remains woefully inadequate. In healthcare, these budget constraints have worsened the Department of Health's inability to hire more doctors, even as over 1800 remain unemployed, and despite a growing demand for their services. Health spending per user in 2025 is still R104 below 2019 pre-Covid-19 levels. For basic education, the government planned to spend an inflation-adjusted R19 482 per learner in 2027/28 compared to R19 250 in 2025/26. This needs to be increased significantly if the government is to reverse the long-term impacts of budget cuts and underfunding of schools in the townships and rural areas. Rather than seeing public spending as a cost, the government should increase and allocate growing investment expenditure in public services based on the understanding that investing in healthcare, education, and social services such as public childcare, and care for the ill, elderly, and disabled is a long-term investment.

Social Grants

Except for the Social Relief of Distress (SRD) grant, all social grants saw an above-inflation increase in the now-scrapped budget. This is welcome. However, in the context of a proposed two percentage point VAT increase, this is unlikely to result in a meaningful increase in beneficiaries' disposable income. In fact, the Pietermaritzburg Economic Justice and Dignity's analysis shows that the child support grant (CSG) increase of R50 would be eroded to just R6 as beneficiaries buying food from a standard basket would have to pay an additional R44 in VAT. It should also be noted that even with an increase, the CSG—proposed to increase to R580 from R530—remains far below the food poverty line of R796, the minimum amount an individual needs to meet their basic food requirements, and is thus still inadequate to meet children's most basic needs.

The SRD grant received no increase in allocation nor adjustment in its value to account for inflation. This a worrying development, especially given the recent judgment in the SRD grant court case that various procedural barriers led to the exclusion of millions who, under the criteria set by the Department of Social Development, should have been receiving the grant. A budget informed by the court ruling and committed to the progressive realisation of rights would have allowed for the expansion in the number of beneficiaries and an increase in the grant's value, rather than capping the allocation at R35 billion. Given that this allocation also covers grant administration costs, the actual average number of recipients is likely to be lower than 7.9 million beneficiaries per month which is a far cry from the up to 18.3 million people who should qualify and desperately need support. The allocation to this grant should reflect the President's continued commitment to the SRD grant being a stepping stone toward basic income support.

Job creation and employment programmes

In the context of poor economic growth and the lack of a clear job creation strategy, public employment programmes have been essential in supporting livelihoods and stimulating demand in local economies. The 2024 MTBPS and the 2024 and 2025 SONAs indicated that there is a need to streamline public employment programmes, including the Presidential Employment Stimulus (PES) and the Expanded Public Works Programme (EPWP). However, it is disappointing that not only have public employment programmes received a measly allocation of R21.5 billion amidst high unemployment, but this amount is even lower than the allocation in the previous fiscal year, which came in at R22.2 billion. These programs are not only important to alleviate unemployment but also support service delivery.

Public-led infrastructure development for shared prosperity

Increased focus on infrastructure investment is important given its positive impact on growth and current poor levels of gross fixed capital formation in South Africa. As of 2023, public and private sector capital investment combined sat at a paltry 15% of GDP, which is far from the National Development Plan's (NDP) target of 30% by 2030. Rather than increase public investment, the budget proposes a new credit guarantee vehicle to facilitate private sector participation. Such reforms fly in the face of evidence on the financial and environmental risks posed by private finance mechanisms such as Public-Private Partnerships (PPPs) and blended finance and the poor track record that such approaches have in actually mobilising the required levels of investment. Evidence shows that an annual investment of just 1% of the GDP in infrastructure could increase GDP by 1.3% immediately and by 2.4% for the five years that follow. Given these potential gains, it is important for the upcoming budget to massively scale public investment in rail, telecommunications, and other infrastructure. An allocation of only R400 billion to provinces and local governments over the medium term will not sufficiently contribute to reducing infrastructure backlogs nor 'crowd in' private sector investment in the long run.

Tax proposals ignore alternatives to raise revenue

The budget proposes additional tax revenue measures of only R58 billion. In addition to the 2 percentage point VAT hike, this is made up of partial adjustments to personal income tax (PIT) tables and no inflationary adjustments to medical aid tax credits, as well as increases in excise duties on alcohol and tobacco products. While we welcome the intent to raise more revenue, this amount is too little and is incongruent with the financing gaps faced by departments. It represents a failure to consider progressive measures to raise revenue, which we discuss below.

What would happen if the government increased VAT?

The increase in VAT would harm all households, especially poor households and low-income households. A VAT increase will reduce the buying power of consumers, and raise inflation levels. The proposed increase also needs to be viewed in the context of high real interest rates that continue to constrain demand in the economy. Despite the argument that zero-rating can work in tandem with a VAT increase as a way to simultaneously achieve higher revenues while protecting the most vulnerable people in society, previous efforts at zero-rating essentials such as food had mixed success as “suppliers did not pass on the benefit of the VAT relief to consumers as was intended,” as admitted by Deputy Minister of Finance David Masondo. Therefore, zero-rating of food items does not sufficiently lower prices for poor consumers, and it is likely to still leave poor households exposed to higher prices.

A VAT increase may not generate substantial revenue

VAT revenue generation depends on the level of spending by households, companies, and the government. In turn, expenditure by these actors depends on current and expected levels of economic growth. Thus, if economic growth underperforms expectations, then the growth in revenue tax intake due to changes in the VAT rate is likely to falter. This is precisely the problem the National Treasury faced with the VAT increase from 14% to 15% in 2018 where they ended up raising R22 billion less than was expected. The National Treasury attributed this to lower-than-expected economic growth and from changes in spending behaviour by buyers (understandable given the commensurate decrease in disposable income). The same behavioural responses may have occurred from this proposed VAT increase - a fall in spending and a fall in growth.

Alternative progressive tax measures to raise revenue

It appears that a revenue increase is required in the 2025 Budget. The policies to give effect to this increase must be carefully chosen to efficiently raise revenue while not hurting domestic expenditure, growth, and poor communities. Of course, wisely invested, the ‘harm’ to expenditure and growth can be outweighed by the benefit of additional public investment. Below we outline six approaches, all preferable to a VAT increase and some that can be implemented in tandem with each other. These, and other revenue-raising options, are outlined and costed in detail, in IEJ’s previous Policy Brief *Alternatives to Austerity: Revenue options to raise the maximum available resources.*

1. Most effective, least painful: build the state’s capacity to collect existing taxes

The South African Revenue Services (SARS) commissioner Edward Kieswetter, noted that part of the reason for the underwhelming revenue response of the last VAT increase was a decrease in tax compliance, making tax collection much harder for SARS. Instead, the Commissioner supported greater expenditure to improve the administration capacity of SARS, which he believes can improve revenue collection without increasing the tax burden. SARS has noted that there is grave danger in not closing the R17-R20 billion shortfall in their institution, arguing that the “underfunding experienced over the past years has seriously compromised SARS’ ability to effectively perform its compliance work that gives effect to its legal mandate, and in turn severely impacts the fiscal integrity of the Republic” thus as “the South African tax gap continues to grow, leaving significant tax revenues unrecovered”. The key tax losses are particularly in large and international businesses (through Base Erosion and Profit Shifting) and among individuals with high income and wealth, despite the new special unit dedicated to tackling their taxation.

2. Most effective, least painful: draw further funds from the Gold and Foreign Exchange Contingency Reserve Account

In 2024, the National Treasury, following the IEJ's proposals, drew down on the accrued funds sitting in the Gold and Foreign Exchange Contingency Reserve Account (GFECRA). Despite what has been drawn to date, the GFECRA currently holds over R300 billion, a further portion of which could be drawn on to finance key priorities. This accrues from both realised and unrealised gains on the country's gold and foreign exchange reserve holdings. It can be costlessly drawn on by the National Treasury, although it would be prudent to leave a small buffer in place.

3. Very effective, less painful: cut back on unnecessary tax breaks

The government loses R286.6 billion in preferential tax treatment according to the unpublished budget. This is equivalent to the government's spending on economic development in 2024/25, at R252 billion. The government should reconsider a number of tax breaks including:

- The removal of medical aid tax rebates - in 2022/23, medical aid-related subsidies cost the fiscus **R39 billion**.
- The removal of tax breaks linked to pension contributions, especially for high-earning individuals (> R750 000 per annum). In total for 2022/23, these deprived the public of **R82.6 billion**. This alone, even when limited to those earning above R1 million, could more than compensate for the 2 percentage point VAT increase.
- Cancelling the ineffective Employment Tax incentive in which the government lost **R4.7 billion** in 2022/23.
- Cancelling corporate tax incentives in which the government lost more than **R15 billion**.

These options are likely slightly more effective than increasing tax rates, particularly PIT rates, given the potential that higher rates may bring diminishing returns, although raising rates remains a viable option.

4. Very effective, less painful: a differentiated VAT system

Instead of an across-the-board VAT increase, the National Treasury could place a higher VAT rate on luxury items. In 2021, we estimated that a 25% luxury VAT rate would raise **R9 billion** annually, an amount that would likely be higher today.

5. Effective and targeted: raise rates on corporations and higher-income earners

The assertion - without the presentation of any accompanying evidence - that we have reached the limits of what can be gained from personal and corporate income tax rates (PIT and CIT rates respectively) is nonsense. South Africa, for instance, recently reduced the CIT rate from 28 to 27% without any benefit derived. Further, South African rates are not disproportionately high given our economic circumstances, with South Africa's corporate income effective marginal tax rate below the upper-middle income country median. In this context, the Government could consider:

- Suspending the upward movement of tax brackets that has traditionally been done to combat the effect of people moving into higher tax brackets due to annual salary increases. The AIDC estimates that if tax brackets had not been over-adjusted for inflation since 1995, the country would have raised an additional **R170-198 billion** in personal income tax revenue by 2024.
- Implementing a social security tax with the potential to raise **R64 billion.**
- Revise the CIT rate back to 28%, which has cost the country upwards of **R15 billion** annually.

6. Effective and targeted: tax wealth effectively

South Africa under taxes wealth and income from wealth. While not all of these could be implemented immediately, in 2021, we estimated the following could be raised:

- Implementing a net wealth tax which can raise **R70 to R160 billion** annually.
- Implementing a small financial transactions tax (0,1%) which has the potential to garner over **R40 billion** in revenue.
- Implementing a resource rent tax that can raise **R38 billion**.

Lowering the cost of borrowing

A more gradual and holistic approach should be taken to stabilising South Africa's debt, which at 75% (debt-to-GDP ratio) compares favourably to the upper-middle-income economy average of 73%. The challenge is the cost of our debt – South Africa pays around 5% on public debt interest payments as a share of GDP, while developing countries and upper-middle-income countries pay, on average, 2.2% and 1.8% respectively. Instead of slashing expenditure or raising VAT a broader debt management toolkit includes the prudent use of capital management techniques such as capital controls to stabilise short-term, speculative capital flows and provide room to reduce interest rates; capital allocation tools such as regulated lending by banks to steer credit to productive sectors of the economy at affordable rates, including through Reserve Bank lending; central bank intervention in the primary market to purchase government bonds; and using prescribed assets to make large pools of capital available at affordable rates.

Regarding prescribed assets, the Public Investment Corporation currently holds R2.3 trillion. Regrettably, these funds are not utilised to support development priorities but are overinvested in corporate equity. These funds can be redirected in part to support State-Owned Entities (SOEs) such as Eskom, of which the PIC holds an interest-bearing loan, or establish a Sovereign Wealth Fund (SWF) to support development priorities as shown by the AIDC.

A targeted approach to expenditure reduction

Finally, the state's current 'lawnmower' approach to expenditure cuts, in which cuts occur at similar levels across the board, must be firmly rejected. Rather, a consultative and transparent spending review process must be instituted. Such a process needs to carefully assess government programmes, aimed at scaling up successful programmes, while ineffective ones are revamped or closed if they no longer serve developmental goals. This process also has the potential to raise resources and improve efficiency.

What does this mean for the budget process going forward?

While some characterise the postponement of the budget as a triumph of democracy, we question why this budget was not tabled in Parliament so that its merits and shortcomings can be publicly debated, and rejected if Parliament deems it appropriate. For a long time, the budget was passed without sufficient debate by Parliamentary Committees due to National Treasury's inflated power, and the African National Congress's majority. The Parliamentary budget process should therefore be the site of legitimate contestation, and budget engagement should not be isolated to a few political parties and National Treasury technocrats. Civil society organisations now have the opportunity to mobilise behind an alternative human-rights-centered budget. The budget to be tabled in March needs to go beyond a reversal of the proposed 2 percentage point VAT increase and revise the fiscal framework to ensure it meets the priorities outlined in the MTDP. A budget that proposes allocations below inflation and population growth should be rejected. Ultimately, the budget should be seen as a tool for societal transformation and as such it must target unemployment, poverty, and inequality and steer economic investment to generate inclusive growth.

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Addendum: Possible revenue sources (2024)

The table below, from IEJ's 2024 Policy Brief *Alternatives to Austerity: Revenue options to raise the maximum available resources* gives a sense of the alternatives available, while certain figures have been updated in the analysis above.

SOURCE OF REVENUE	POTENTIAL REVENUE	NOTES ON STUDY
Remove retirement fund tax break for those earning above R500 000	R113 billion	IEJ calculations based on 2022/23 tax statistics. 2023 rands.
Remove retirement fund tax break for those earning above R750 000	R65 billion	IEJ calculations based on 2022/23 tax statistics. 2023 rands.
Remove medical aid tax benefit for the main member and one dependent for taxpayers earning above R500 000	R12 billion	DNA Economics study using 2020/21 tax statistics for the year 2023/24.
Remove the Employment Tax Incentive	R7 billion	IEJ calculations based on 2022/23 tax statistics. 2023 rands.
Net Wealth Tax levied at 3-7%	R70 - R160 billion	SCIS working paper calculations based on 2017 values. 2018 rands.
Increase Dividend Tax rate to 25%	R8 billion	DNA Economics study using 2020/21 tax statistics for the year 2023/24.
Align Estate Duty tax with PIT rates	R2 billion	DNA Economics study using 2020/21 tax statistics for the year 2023/24.
Increase Securities Transaction Tax to 0.3%	R1.5 billion	DNA Economics study using 2020/21 tax statistics for the year 2023/24.
Implement Financial Transaction Tax at 0.1%	> R40 billion	DNA Economics study using 2020/21 data, projected for 2021.
Implement a Currency Transaction Tax at 0.005%.	R4 billion	DNA Economics study using 2020/21 tax statistics for the year 2023/24.
Implement a Resource Rent Tax at 25%	R38 billion	DNA Economics study using World Bank 2021 estimate of 2019 resource rents, estimated for 2023/24 financial year.
Restore the CIT rate to 28%	R12 billion	IEJ calculations based on 2022/23 tax statistics. 2023 rands.
Implement a sliding-scale Social Security Tax	R64 billion	DNA Economics study using 2020/21 tax statistics for the year 2023/24.
Institute a luxury VAT rate of 25%	R9 billion	IEJ Working Paper updated in DNA Economics study using 2020/21 tax statistics for the year 2023/24.
Utilise the Gold and Foreign Exchange Contingency Reserve Account	R497 billion - A portion can be drawn down.	South African Reserve Bank Annual Report. 2023.
Leverage development financing for critical developmental priorities.		
Raise additional debt, including through prescribed assets.		