

5 March 2018
Honourable Mr Yunus Carrim MP
Chairperson of the Standing Committee on Finance

RE: Considerations on expanding the zero-rated basket to mitigate the effect of VAT.

Thank you for the opportunity to engage with the committee on Wednesday, 28th February 2018. However, we think it is important to bring the following to your attention. These relate to the current debate to expand the list of foods in the zero-rated basket to mitigate the negative effect of the VAT increase on working class households. The current crisis require of us to think beyond the current hegemonic answers.

Expanding the basket of zero-rated foods has been contested on the basis of the following arguments:

- Expanding the basket may disproportionately benefit the rich (because rich or poor we share quite a few common foods).
- Selecting the new foods to be included in the zero-rated basket is incredibly complex as what foods are eaten, how foods are prepared and changing households purchasing patterns are all influenced by household specific and other complicated external variables. Even with the experience PACSA has around tracking food patterns and prices, there are just far too many variables in creating an expanded zero-rated basket that responds to the requirements of the working class and the impact on the larger economy. At best, we would be able to make an educated guess – but this hardly seems a sufficient response to the crisis we are in.
- Expanding the zero-rated basket still does not address the fundamental problem of food affordability. Already with a VAT rate of 14% we are seeing households underspending on food by 25%. So reversing the 1% or putting a few more foods in the zero-rated basket will not make life better for working class households.

Part of the problem is that proponents of an expanded zero-rated basket (regardless how well intentioned) are tinkering around with the foods in the zero-rated basket at the bottom of the system when instead we think the focus should be on taxing the top end of the system where we are sure that working class households do not buy those foods. The fact is that regardless of the size of the zero-rated basket; working class households will not be able to escape the impact of the VAT increase. So instead of adding more foods to exempt the majority of households in the hope that the harmful impact of the VAT might be partially mitigated; we should at least be looking at an upper bound basket where revenue can be gotten.

We have said that the zero-rated basket will not protect the working class nor will expanding the zero-rated basket. Expanding the basket will get us into more of a mess because the variables are far too complex and the impact on households and the broader economy are largely unknown.

It seems to us that the focus on expanding the zero-rated basket will not therefore fulfil its intended objective to protect the poor. Nor will it ensure that the rich pay their due.

We see food as a public good and therefore are of the mind that all food be exempted from tax. Removing VAT from all foods will go some way to address the fundamental question of food price affordability.

To remove VAT would be an important political statement that government considers food not just an ordinary commodity nor just a tradeable commodity but that food is the basic content for the primary right, which is the right to life. It would signal government awareness of the particular role food plays, not just in the body and for our health and human dignity but also the role food plays in the economy.

If we don't do this we will entrench poverty cycles: children who grow up in households where there is not sufficient nutritious food will not thrive, they will get sick more often and illnesses will be more severe. They will be less able to concentrate in school and their bodies and muscles will not grow as well. They will not be able to make use of educational investments. When they grow up they will be less able to perform in the workforce as adults, so their economic prospects and their earning potentials will diminish; the cycle will recur with their children. **This contributes to low economic productivity, low growth and low revenue.** We are already trapped in this cycle. South Africa has to find its way out of this cycle.

- In 2015 nearly two-thirds (64.2%) of Black South African households lived below the upper bound poverty line (R992 in 2015 and R1138 in 2017).ⁱ
- In 2015 a quarter (25.2%) or 13.8 million South Africans lived below the food poverty line (R441 in 2015 and R531 in 2017).ⁱⁱ
- In 2016 nearly a third (27%) of South African children under the age of 5 years were stunted: $\frac{1}{3}$ of boys and $\frac{1}{4}$ of girls were stunted.ⁱⁱⁱ
- South Africa is experiencing a major spike in Non-communicable diseases in women aged from 45 years and above (women bear the burden of the affordability crisis as they restrict their diets in order to prolong the period of better nutrition for their children; and they eat last and whatever is left in the pot); and local clinics are seeing an increase in the numbers of children

presenting with more severe and more prolonged childhood illnesses (diarrhoea, measles, pneumonia, colds, flu and rashes) which should be resisted on the plate if children were eating proper nutritious food.

- In 2017 approximately 7.06 million people were living with HIV, this is 12.6% of the population.^{iv}

This poverty cycle reinforces the low economic trajectory and the way out is to invest. We may not have a lot of time left – millions of South Africans seem already to be nearing the edge. In times of financial crisis the state should invest in its people in order to get greater social outcomes and economic benefits in the long term.

The only way to move out of this cycle and change our economic trajectory is to ensure sufficient and nutritious food for all South Africans and removing VAT from all foods is an important step towards this end. Insufficient food equals low productivity and is putting all our developmental outcomes at risk. Ensuring all people have access to food is important for an increased economic trajectory because it has direct consequences for economic productivity.

The revenue that we lose now by removing VAT off food will be recovered perhaps not in the first year, but over a period of years where we will see savings in terms of our health budget and greater outcomes in our education budget, policing and social security budget. The revenue that we lose in the short-term will be recovered from future savings in departmental budgets and importantly will further enable greater economic growth in the future and move people beyond the social security net. In this regard, the current budget needs to be looked at as a whole where we see how food plays a role in providing a basis for all our developmental and economic outcomes.

While removing VAT could be an important economic intervention it will also be an important political statement of government's intention to fulfil its constitutional obligation relating to the right to food and touch every single citizen in this country.

Suggestions on where the short-term loss of revenue from removing VAT from food can come from

No matter what the recommendations will be for how the deficit from the loss of VAT on food will be recovered, it will take time to project the impact on the fiscus, and it seems this process should not be rushed.

The budget deficit has largely been caused by an under recovery by SARS. We would argue that the deficit can be made up by ensuring that SARS is turned around and collects the proper tax revenue owed to it by corporate South Africa (that is the full 28% and not the 10% and 12% or with some sectors paying as little as between 4% and 7% as suggested might be happening by Judge Dennis Davis^v). Thereafter the balance can be made up by an increase in the CIT – raised above 28%. *Should this happen, we might even discover 6-8 months down the line that we do not have a budget deficit.*

We would also look at the corporate sector which is holding billions in their bank accounts and not investing it in useful economic activity – getting them to release this money usefully could contribute to economic growth and greater collection of revenue.

Lastly, if the fiscus requires some revenue from food, that an upper-bound luxury basket be introduced focusing on the foods which we are sure that working class households do not buy e.g. kiwi fruit and caviar, camembert and salmon steaks. In this way we can be sure that working class households will be protected from any VAT increases in the future and we will not have to come back to this debate on an annual basis on ways of expanding the zero-rated basket. Further, the focus will be on getting revenue from those who are in a position to contribute rather than exempting people from revenue obligations. The fiscus can be reasonably assured that it will be able to raise the revenue from those who are able to afford it. It would further ensure that the administrative system be simple and easy to apply.

We believe that there is sufficient political will to act on removing VAT on food and we would recommend to the committee to utilise this political will in the interests of our economic future for all South Africans. The political consequences of the VAT increase will have to be weighed.

Yours sincerely



MERVYN ABRAHAMS

PACSA Director

PACSA | Pietermaritzburg Agency for Community Social Action

Tel 033 342 0052 | Cel 079 398 9384

mervyna@pacsa.org.za | www.pacsa.org.za | www.facebook.com/PACSAPMB

ⁱ STATSSA (2017). **Poverty Trends in South Africa: An examination of absolute poverty between 2006 and 2015**. Report No. 03-10-06. Statistics South Africa, Pretoria, South Africa. P58.

See link: <http://www.statssa.gov.za/publications/Report-03-10-06/Report-03-10-062015.pdf>

ⁱⁱ STATSSA (2017). **Poverty Trends in South Africa: An examination of absolute poverty between 2006 and 2015**. Report No. 03-10-06. Statistics South Africa, Pretoria, South Africa. P14.

See link: <http://www.statssa.gov.za/publications/Report-03-10-06/Report-03-10-062015.pdf>

ⁱⁱⁱ Statistics South Africa (2017). **South Africa Demographic and Health Survey 2016: Key Indicator Report**. Statistics South Africa. Pretoria. P27-28. See link: <http://www.statssa.gov.za/publications/Report%2003-00-09/Report%2003-00-092016.pdf>

^{iv} Statistics South Africa (2017). **Mid-year population estimates, 2017**. Statistical Release P0302. Statistics South Africa. Pretoria. P7.

^v City Press (2017). Davis puzzled by low corporate taxes. 5 March 2017. Dewald Van Rensburg .

See link: <http://m.fin24.com/fin24/Economy/davis-puzzled-by-low-corporate-taxes-20170303>