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Wringing water from a flint

There is no room for a VAT increase

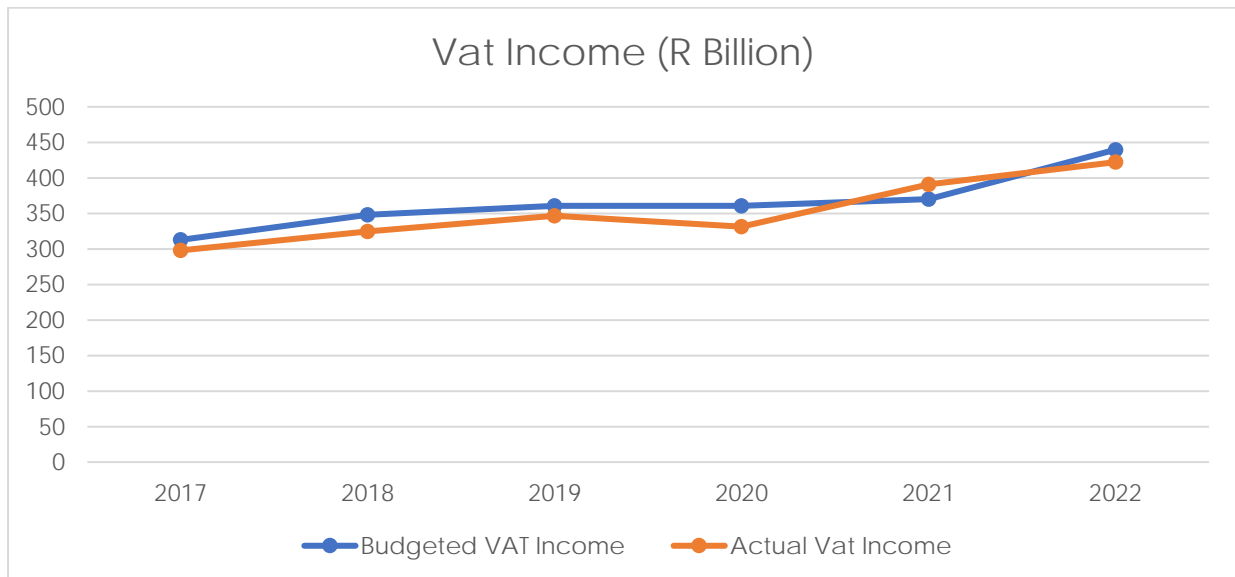
Introduction

It was recently reported¹ that the Treasury is considering an increase in value added tax (VAT), from 15% to 16% or 17%, to generate more revenue in order to make permanent the R350 allowance introduced as a result of the pandemic. According to the report, an increase in VAT will bring in an additional R24,5 billion or R49,4 billion, depending on the percentage increase decided upon. According to this year's National Budget, the payment of this specific allowance costs R44 billion per year.

Feasibility of a VAT increase

VAT was increased from 14% to 15% in 2018. As is the case now, the expectation in the 2018 National Budget was also that this increase would result in an income of R50,1 billion more than in the previous year. In reality, however, the increase in VAT revenue was only R26,8 billion, which was an increase of 8,3% compared to the previous year. The Consumer Price Index (CPI) for 2017 was 6,3% and for 2018 it was 4%². The increase in VAT income can therefore largely be attributed to higher prices, as it is a tax that is applied directly to consumer prices.

The following graph shows to what extent the Treasury overestimates the annual VAT income, compared to actual amounts received by SARS. The year 2021 is one exception, due to high inflation and the economic recovery after the pandemic.

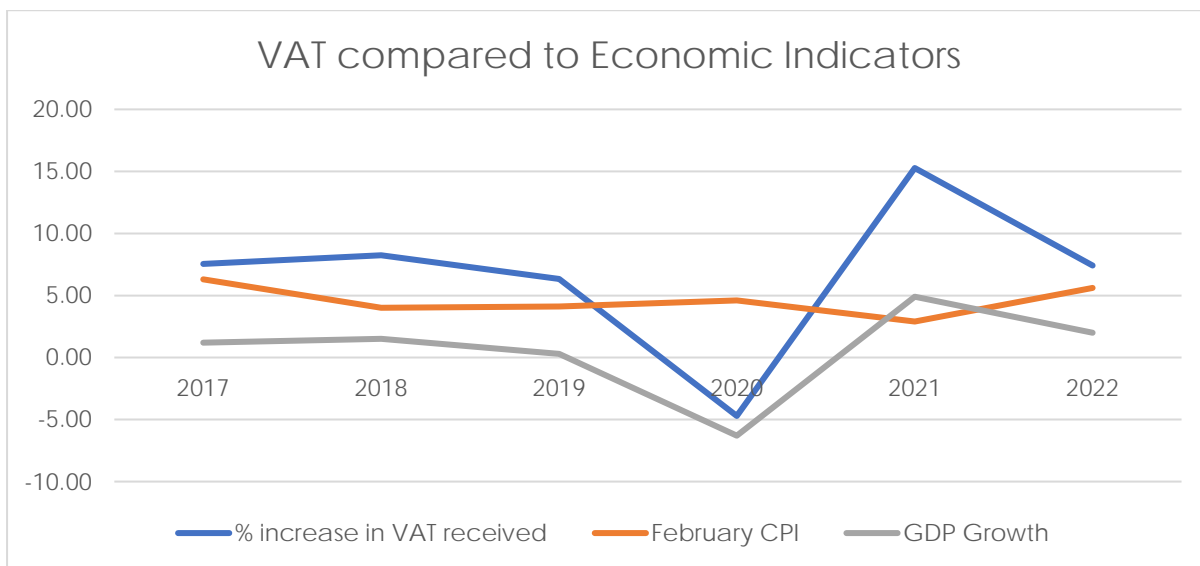


Therefore, increasing VAT has not had the desired effect, and further increases may encourage existing taxpayers to make greater efforts to evade VAT. Along with high rates of personal and corporate income tax, this will also remove even more productive money from the economy and further suppress already slow economic growth. In addition, high VAT does not align with the Treasury's progressive tax system where people with higher incomes pay higher tax rates. It is impossible for people with a low income to escape

¹ <https://mybroadband.co.za/news/government/508306-ramaphosa-warned-about-big-vat-increase-to-fund-grants.html>

² Februarie-syfers word gebruik om met die belastingjaar ooreen te stem.

paying VAT. Despite this reality, the 2018 increase in VAT proved that South Africans are already overtaxed to such an extent that an increase in any tax rate would not produce the expected revenue. The following graph indicates the percentage increases in VAT received, as well as the inflation rate and GDP growth rate. The expectation is that, should the VAT rate remain the same, revenue from VAT will largely be determined by economic growth and price increases.



Even when VAT is simply considered as a percentage of the total tax revenue, there has not been a significant increase, but rather the continuation of a trend where the tax composition is largely determined by other economic indicators.

VAT as % of total tax revenue	24,50	25,22	25,58	26,50	25,00	25,03
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Conclusion

The previous increase in VAT did not yield the expected return, and there is no reason to believe that any further increases will have a different outcome. The solution to the government's budget deficit does not lie in tax policy as the root causes of this problem are the lack of economic growth and indiscriminate spending. The solution to this problem rather lies in greater freedom for the private sector in order to grow the economy. For this, further pressure on consumers' disposable income will be disastrous.

The lack of return from the previous VAT increase indicates that South Africans are already overtaxed and that no increase in taxes will yield greater return; on the contrary, it will instead result in tax evasion and economic contraction. For the economy to thrive, as much private money as possible must remain in circulation, and any attempts to take it out of circulation by means of taxation will result in lower economic growth. The government's attempt to wring water from a flint will, as the proverb implies, bring them nothing. The only consequence we can expect is that it will be disastrous for our already fragile economy.

Sources

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- National Budgets
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