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FEDUSA SUBMISSION ON THE 2007 BUDGET

FEDUSA Submission to

The Portfolio Committee on Finance

Cape Town

Presented by:
FEDUSA Parliamentary Office
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FEDUSA COMMENTS ON THE 2007 BUDGET

FEDUSA noted, following the State of the Nation address in 2007, that notable progress has been made in our country in different areas, including.

- High levels of confidence, certainty and stability;
- Lower government debt and inflation;
- Substantial growth in exports of manufactured goods, and generally rising productivity and various initiatives towards improved skills such as JIPSA and ASGISA led Government initiatives;
- A sharper regional and continental focus;
- Increased empowerment opportunities for black people, women and the poor.
- An increase awareness and realization that crime is requiring drastic measures to address the situation.

However, FEDUSA and our affiliate unions would like to request Government to address the following issues affecting the budget:

- Workers within South Africa should be protected in terms of legislation such as immigration rules and regulations. We need a greater effort by the South African government to indicate the numbers, types of skills of illegal immigrants that compete with South Africans for jobs;
- FEDUSA does not want our members to work in a labour market where people are forced to accept lower wages due to desperate poverty,
- Government should consider reviewing its policy on silent diplomacy in Zimbabwe. It is estimated that currently not less than 1,2 million Zimbabweans have employment in South Africa. This has a major impact on the competition within South Africa for employment;

FEDUSA would be calling on Government to exercise caution on proposed bilateral trade agreements. Trade agreements should enhance the creation of local jobs and not result in massive job shedding.

Those are serious issues for FEDUSA. Although those matters are the responsibility of different state departments, they also have fiscal implications.

1. MACRO-ECONOMIC PERSPECTIVE

FEDUSA as a socially responsible trade union federation recognises that there should be a fine balance between efficiency - the effect of budget proposals on the ability and propensity of businesses and individuals to work and save, and equity - the way the budget affects the distribution of income. If the focus of fiscal policy is too much on the redistributitive side, this could hamper economic growth creation, while on the other hand the neglecting of the redistribution aspect, could also have serious consequences.

FEDUSA, as a social partner believes that it is imperative that all recognize key policy directions aimed at creating growth and employment. The rate of job creation has been bolstered by the implementation of ASGISA. However the progress made is slow. The challenge in the policy lies with the process of implementation and the state's capacity to deliver as organ of delivery. South Africa needs a greater awareness of the realization that we all should make a concerted effort by educating the nation on policy directives. Criticism needs to be positive and contributing to creating a better life for all. A better life will not be realized without educating our nation and providing jobs to the youth and unemployed sections of our society.

2. MACRO-ECONOMIC PROJECTIONS

The table below shows that the South African economy is in an even healthier condition than was envisaged at the presentation of the mini budget in October 2006, with an economic growth rate of more than 5 per cent over the MTEF period. Government expects investment by the private and government sector to increase by a satisfactorily rate of almost 11 per cent.

Inflation, as measured by the GDP deflator, will be lower than the October 2006 projections. Government also expects that CPIX inflation (excluding interest on bond payments) will be lower than projected in October and that it will fall within the 3-6 per cent margin set by the monetary authorities.

Table 1 Macroeconomic projections (2006 MTEF in brackets)

	2006 Estimate	2007 Forecast	2008 Forecast	2009 Forecast
Real GDP growth	4,9 (4,4)	4,8 (4,4)	5,1 (4,8)	5,4 (5,3)
Gross fixed capital formation	12,0 (9,5)	10,7 (9,0)	10,9 (9,3)	11,1 (10,0)
Final household consumption	7,0 (6,6)	5,7 (4,4)	4,8 (4,5)	5,0 (4,7)
GDP deflator	5,8 (6,5)	5,8 (6,6)	4,9 (4,8)	5,4 (4,5)
CPIX (Average for year)	4,6 (4,6)	5,1 (5,5)	4,7 (4,4)	4,5 (4,5)
Current account balance (% of GDP)	-5,5 (-5,7)	-5,3 (-5,3)	-5,7 (-5,6)	-5,9 (-5,8)

If the inflation actually turn out to be what is now expected, it is unlikely that we will see any interest rate increases. FEDUSA want to reiterate our concerns expressed in our comments last year on the mini budget. The high consumption expenditure, together with the higher level of investment by both government and the private sector, result in a large current account deficit of our balance of payments. The level of the current account balance is such that it affects the exchange rate. This development does not only affect production price inflation but eventually also for consumer inflation. The relatively large current account is financed by capital inflows. Although this is normal and acceptable for developing countries, Government should always be mindful that the largest part of that capital inflow consists of short-term investments, sometimes also called "hot money. Although developing countries are today no longer being regarded for investment purposes to be all alike, the risk remains real that these funds may be withdrawn on short notice. The only viable policy options to avoid this risk, is to increase our exports and to attract longer-term real investment. The Minister in this year's budget admits this.

3. BUDGET FRAMEWORK

The table below shows that South Africa will in fact have a surplus on its budget for the first time. For 2006/07 it is expected to be 0,3 percent and 0,6 percent in this fiscal year. This would be a welcome domestic contribution to our scarce pool of savings and will without doubt contribute to investments.

The table also shows that our total tax burden, in other words the tax/ GDP ratio increased from 24,3 per cent in 2004/05 to a relatively high expected 28,1 per cent in this fiscal year, where after it will fall to 27 per cent in 2009/10. If the tax revenue/GDP instead of total revenue is taken, the increase is 24,8 percent in 2004/05 to almost 29 percent in 2007/08.

Table 2. Main budget framework, 2003/04 – 2009/10 (Selection)

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Tax revenue	354980	417334	489662	556562	606870	659820
% GDP	24,8	26,4	27,9	28,7	28,3	27,7
Total revenue	347854	411748	475836	544602	591166	641515
% GDP	24,3	26,1	27,1	28,1	27,6	27,0
State debt cost	48851	50912	52178	52916	52967	50915
% GDP	3,4	3,2	3,0	2,7	2,5	2,1
Total expenditure	368541	416760	470614	533873	594198	650301
% GDP	25,8	26,4	26,8	27,5	27,7	27,3
Budget balance	-20687	-5012	5221	10728	-3032	-8787
% GDP	-1,4	-0,3	0,3	0,6	-0,1	-0,4

Source: National Treasury.

Table 3 shows that tax revenue increases much faster than the inflation rate as measured by the GDP deflator.

Table 3. Percentage increase in tax revenue (After tax proposals)

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Nominal increase	17,3	17,6	17,3	13,7	9,0	8,7
Real increase	11,8	13,0	11,4	8,3	4,0	3,2

Those relative large increases in the tax revenue burden made it possible for government to increase its expenditure from just under 26 per cent in 2004/05 to a budgeted almost 28 per cent in 2008/09, while also to move the budget in a surplus or a very small deficit.

FEDUSA is not convinced that this high tax burden with the resultant budget surplus is the appropriate fiscal stance at this stage of South Africa's development. Although a budget surplus contributes to savings and lower debt service cost, a somewhat higher budget deficit and a lower tax burden may also affect the economy favorably. Lower tax rates will have favorable affects on the ability and propensity to work and save and therefore on our economic growth. Comparing those two options could only be verified econometrically and Government is urged to undertake this exercise.

4. FEDUSA VIEWS ON GOVERNMENT EXPENDITURE AND TRANSFERS

FEDUSA noted that public spending has increased by over 9,2 percent in real terms over the past three years and that it will increase by a further 7,7 per cent over the next three years. It is also noted that total infrastructure expenditure will increase by an estimated R415, 8 billion over the medium term. Those are large amounts, which together with private consumption and investment could put South Africa on the road to 6% growth.

Expenditure increases by consolidated government for a few functions is shown below.

Table 4. Percentage increase 2006/07 – 2009/10 in selected consolidated expenditure functions

	Police	Prisons	Justice	Education	Health	Housing
Nominal increase	10,3	10,0	14,9	11,0	10,5	25,2
Real increase	4,9	4,6	9,5	5,6	5,0	19.7

According to the table, all the functions are expected to increase at relatively high levels in real terms. Justice and housing will receive special attention.

In the following section, FEDUSA comment on a few categories of spending, which is not according a specific classification system:

- **Infrastructure**

Over many years FEDUSA urged Government to increase its infrastructure expenditure, because we are convinced that effective government infrastructure is a pre-requisite for faster economic growth. It is noted with satisfaction that many infrastructure projects will be targeted to create jobs. The type of infrastructure projects that create jobs and opportunities are roads, housing, dams, forest plantations etc. Government is urged to implement these projects with speed and to involve as much workers as possible. A pre-requisite is that these infrastructure projects must also bring longer term opportunities to get goods and services to markets, children to school and workers to places of study or work. The Minister mentioned that many projects in the building environment are labour-intensive and would form part of the Expanded Public Works Program, aimed at drawing in marginalized communities in the economy.

The Budget review states that housing, rail and road infrastructure as well as the World Cup 2010 will be targeted as priorities. Labour – based employment should be the preferred method of construction.

- **Housing**

FEDUSA fully supports Government with the high priority given to Housing over the next MTEF period (Table 4). Although much has already being achieved, we need more houses built. The rate of delivery is still slow. Low cost housing access is still difficult to the poorest of the poor and FEDUSA would like to see a situation where a policy is rolled out and at least 500 000 houses are built in a single year. The problems pertaining to bureaucratic red tape needs to be addressed. We cannot have a repetition of the N2 gateway housing project in 2006. We need a firm commitment from Department of Housing on grappling with the crisis in housing delivery.

Slow delivery on land reform and the "land grab" issues are creating an unstable and breeding ground for revolt by the poor and destitute. FEDUSA would like to appeal to Government to address land reform and related issues as matters of priority. If the South African agricultural industry is to remain viable and poverty be addressed we need a revitalization of key policy directions. Money and land are the key obstacles to low-income housing.

- **World Cup 2010**

FEDUSA supports government' increased infrastructure spending as it not only creates jobs but also brings long-term opportunities. FEDUSA however wishes to see these funds managed and hope that the private sector can also be involved in more infrastructure projects. FEDUSA calls on Government to ensure that the envisaged Public Service reform and the creation of a Single Public Service is a fully negotiated process. A dictative process by Government will result in possible collapse of service delivery. FEDUSA would like to send out a stern warning that Service delivery in 2010 is dependent on public service and local government cooperation.

- **Industrial Development And Economic Transformation**

Currently the Government agenda is driven by ASGISA. FEDUSA supports ASGISA but the constraints relating to education and skills shortage needs to be removed and the focus should be directed towards accelerated policy and programme implementation. Increased policy directives to address the backlogs in education and skills advancement are required. The backlog between the have's and have not's getting wider and the nation needs to be educated. SETA's service delivery should be addressed and intervention by Cabinet on this policy direction is a matter of priority. The current skills development strategy does not produce enough people with required skills to ensure growth of the economy. For ASGISA to be successful Government needs to engage together with the other social partners on getting the support and participation of all levels of our nation.

FEDUSA noted that this year's budget contains programs to support ASGISA that promote sustained investment in productive capacity and undoing barriers to growth embedded in the post-apartheid land-scape.

- **Health Services**

FEDUSA is of opinion that average spending on health was too low over the last two financial years. This situation is rectified this year as Health is receiving particular attention in the budget. Health services receive an additional provision of R4, 6 billion to be phased in over the next 3 years. This amount will be used to step up salaries and also to increase the number of health workers.

However, in light of the very low life expectancy of South Africans, the lack of skilled medical personnel, and the HIV and TB prevalence (appears to be escalating) FEDUSA suggests that serious government intervention is required in Health and the impact it have on the economy. There is also an indication that the Department lacks competence and planning efficiency to deal with the economic impact of health issues.

HIV/Aids is still a disease surrounded by ignorance, prejudice, discrimination and stigma. FEDUSA calls on Government to reconsider a clear policy aimed at effective ways to reduce and manage the disease that is killing our societies and leaving families disposed and young children orphaned. Prevention and Treatment strategies should be removed from party politics and managed in a coherent strategy that is all encompassing.

- **Justice & Protection Services**

FEDUSA is pleased to note that police, prisons and justice will receive relatively high real increases in their allocation. Especially the increase of 9,5 percent in real terms is applauded (Table 4). However the fight against crime would not be easy. Recognition by Government that crime is out of control and drastic measures to address the issue would be the first bold step. As FEDUSA we would like to urge Government to bring the matter within the domain of NEDLAC as it is a crucial matter of Socio-economic concerns. The level of crime constitutes a real social issue in need of an urgent intervention. We need the Government to fulfill its obligations to all the people of South Africa. The recent spate of high-jackings and violence against women and children, the elderly and vulnerable needs a revised policy direction to deal with crime.

The reported crime figures for 2005/06 remain very high[1] with rape and attempted rape, murder and aggravated robbery topping the list. As SA was rated 3rd highest amongst 63 countries (behind Swaziland and Columbia) with regard to crime it should be a top priority. Violent crime has affected 8 out of 10 businesses and its workers in South Africa[2].

- **Governance & Administration**

Effective public sector administration and infrastructure are pre-requisites for faster economic growth and employment creation. FEDUSA want to commend Government on the steps announced in this year's budget to improve public service delivery and capacity constraints in local government and home affairs. It is hoped that these steps will go some distance to improve the situation. FEDUSA is very concerned with the fact that in 2005/06 only 12% of state departments received clean audit reports. As a large part of the number of qualified audits (32%) fell into the category of a lack of basic financial control and the state's capacity to deliver on priorities is questioned.

6. GOVERNMENT'S TAX PRPOSALS

In this year's budget the tax relief to individuals was less than in the past years. The Minister indicated that a large increase would stimulate the already buoyant rate of consumption expenditure. In economic policy terms this means that the dove tailing of monetary and fiscal policy requires that the stance of fiscal policy should also be more restrictive. As promised by the Minister in his MTBPS of last year, the Minister used the surplus revenue to increase expenditure, especially in infrastructure, to provide tax relief and to improve savings. FEDUSA agrees with this approach. As mentioned above, the large current account balance of our balance of payments remains a risk.

Personal income tax relief amounted to R8, 4 billion, and in line with FEDUSA's comments on last year's MTBPS; the relief was not only given to the lower income brackets, but also over a wide range of income brackets. Thresholds for the different income brackets, was increased to R4300 and R6900 for individuals under 65 and over 65 relatively . The implication of this is that not only consumption expenditure is affected, but also savings. This is in line with the priority given by Government to improve our economic growth rate by increasing savings.

The tax revenue over run was also used in other ways to bolster savings. Not all was used to give tax relief, but a part thereof used to obtain a budget surplus, which boils down to government savings. A further measure is that the interest and dividend income tax-free threshold was increased to R18000 for individuals younger than 65 and R2600 for people older than 65. The abolishment of the retirement fund tax could also be favourable for savings.

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[1] Source: Institute for Security Studies (issafrica.org)/ saps.gov.za

[2] Survey of 200 businesses as sources from Grant Thornton Accountants: International Business Report for 2007. Business Day 1 February 2007

FEDUSA would support measures to stimulate savings. An important way to stimulate savings is to lower the maximum marginal income tax rate (PIT) on individuals from the current 40 percent to a rate nearer to company tax. With the phasing out of STC on companies, company tax effectively come down to about 29 percent. The large difference between company and personal income tax rates creates an anomaly where funds can move between individuals companies. The lowering of PIT will not only rectify this remedy, but would also lead to an increase in savings. FEDUSA would therefore request Government to consider this option.

7. <u>INDIVIDUAL TAX ISSUES IN THE 2007 BUDGET</u>

7.1 Medical schemes contributions – more equitable dispensation

While FEDUSA agrees that the main aim of the medical schemes contribution changes is to obtain a more equitable dispensation for employees, the fact is that the average contribution per member per month is around R693.

While tax free monthly contributions have been capped at R530 for member and 1st beneficiary and R320 for other beneficiaries further limits have been set as follows:

- Threshold for deductibility of medical expenses increased to 7.5%; and
- Only certain medical treatment paid for by employer is regarded as a tax-free benefit for employee.

This means that while the current two thirds medical scheme contribution by employers would have meant a tax-free contribution of R1848 per month for a working family of four. This has now been reduced to R1600 leaving the employee with an extra taxable salary of R248 per month. Even at the lowest tax rate this means an extra tax of R45 per month for the family for example. With medical inflation currently around 7% this extra employee tax could come close to R50 per month even for the lowest taxed workers! Workers in the top marginal tax brackets will pay more than R105 per month more, which is equal to over R1260 in extra tax payment for this tax-paying employee.

With public health leaving a lot to be desired FEDUSA wants to suggest that the Minister should increase the medical scheme allowance up to R800 per family individual, or to give a much bigger tax relief.

Employees are taxed at a very high rate for the services that they receive and government should recognize that employees could also expect government to give them something back.

7.2 FEDUSA's recommendations on Tax on Retirement Funds.

With the extra taxes on vehicles and medical aids the Minister must give workers a better chance to save for retirement. In most countries government funds pensions but in South Africa government taxes retirement funds and workers are forced to save their own hard earned money. Government cannot tax all social benefits of workers as these in other countries are included in the tax rate or are actually tax deductible.

Furthermore the government expects pension funds to also contribute to social projects where funds are not really getting a fair risk reward proposal at all. Workers cannot be expected to see their savings go into both taxes and social projects as both dilute the after tax returns.

An urgent intervention is required on the way forward of the retirement reform process. The reform is stalled by the outstanding 2nd white paper on Pension Fund Reform. We have been patiently waiting for years to get a revised draft on pension fund reform on the table. The recent Fidentia debacle affecting destitute woman and children urges the seriousness of this policy directive to be finalized and for Government to stop bureaucratic red tape in delaying the process of reform.

FEDUSA welcomes the abolishment of the tax. On retirement funds.

7.3 Motor vehicle allowances

Taking fuel consumption and increases in fuel prices into consideration FEDUSA would like to propose that the first 18 000km currently regarded as private consumption be capped and not increased to 20 000km; and the business allocation be kept at 14000km and not decreased to 12 000km. This is one of the reasons why individual tax collections have increased dramatically over the last two financial years. The implication of this on the individual is that are taxed at a higher rate.

8. COLLECTIVE BARGAINING

It is worth mentioning that in terms of the provisions of Section 1 of the Labour Relations Act, 1995, as amended, in as far as it relates to collective bargaining, the purpose of the Labour Relations Act is to provide a framework within which employees and their trade unions, employers and employers' organizations can collectively bargain to determine wages, terms and conditions of employment and other matters of mutual interest, and formulate industrial policy, and to promote the following:

a) Orderly collective bargaining; and
b) Collective bargaining at sectoral level.

However, collective bargaining in the public service is virtually non-existent. The Minister of Finance has announced in October 2006 his Medium Term Budget Policy Statement, which outlines the expenditure estimates for the next 4 years, without any inputs from organized labour. This has been the case over the past years and makes a mockery of the collective bargaining process in the public service. The trade unions are compelled to accept what is offered or embark on an indefinite strike.

FEDUSA is of the view that there should be serious social dialogue taking place at both Parliament and NEDLAC prior to the announcement of the Budget for the year or Medium Term Budget Policy Statement by the Minister of Finance. This will go a long way in accommodating the public servants in terms of decent salary increments.

9. SOCIAL SECURITY TAX

The intention of Government is to introduce a social security tax to basic retirement savings, death, disability and unemployment benefits. The system should however be the subject of an open and inclusive system involving all sectors of the society.

The announcement of the introduction of a comprehensive social security system aimed at addressing poverty and assisting those living under the poverty line. Various discussions had taken place in the last decade on social security but a lack of implementation and bureaucratic measures seem to delay the process. Poverty alleviation measures in rural areas needs to be stepped up and prioritised. Agrarian reform should be a national priority in 2007-2009. The surpluses of Treasury should be given back to citizens by stepping up service delivery rollouts.

The average developing level of poverty seems to be deteriorating. Various studies seem to indicate that almost 30% of the population is living in poverty. In 2006 almost 7million children were recipients of child support grants. Health problems such as the rate of HIV/Aids infections and tuberculosis (The Human Development Report (UNDP) of 2006 shows a clear increase of people ages 15-49 infected with HIV and the number of cumulative HIV deaths as well as the prevalence of TB prevalence in Southern Africa), impact of crime is increasing on a daily basis the number of orphans dependant on social assistance in one form or another. The dependency on the state is on the increase.

In the Social Development retirement proposals it is suggested that no tax incentives need be given to encourage you to save for retirement via private sector vehicles. If this is the case it means for the workers out there that it is the last year in which you may claim private retirement provision against taxable income. (Taxable income is income that is subject to tax after you have deducted the exemptions from your taxable gross income).

FEDUSA would like to call on the Minister not to penalise hardworking South Africans who makes provision for retirement via private provision but to allow the benefit under the current tax system to continue in the light of a new system for social insurance.

10. FURTHER FEDUSA BUDGET RECOMMENDATIONS

While FEDUSA is a trade union federation and rarely makes tax proposal on company taxes, FEDUSA does feel that ASGISA needs to succeed. As skills are broadly described as lacking in many fields in the SA economy and many young people are struggling to enter the job market.

FEDUSA Congress in September 2005 resolved the following with regard to taxes and fiscal issues:

- FEDUSA supports the notion of tax-free retrenchment payouts for workers who get retrenched.
- FEDUSA supports the training of retrenched workers using SETA's so that these workers can either retrain into other sectors or receive some business training if they wish to participate in small business.

- FEDUSA calls on government to fill the current vacant posts within the public service which government has not filled as quickly as possible.
- FEDUSA will support a lower tax rate on employers who consistently create sustainable long-term jobs.
- FEDUSA also supports lower taxes for workers and small business to help establish faster growth.
- Congress also supports the reduction of barriers, which impede the movement of South African skills within South Africa.
- Investment in infrastructure is encouraged, in that it contributes to development, structural adjustment and the creation and maintenance of sustainable jobs. Such investment may also target the development of trans-Southern African networks in the areas of transport, telecommunications and energy;
- Faster liberalisation of exchange controls.
- Lowering domestic real interest rates through prudent fiscal policy, encouraging savings, making progress in reducing the cost of utility services and encouraging competitiveness in the economy.

11. CONCLUSION

FEDUSA will support strategies, which reduce the cost of capital, and give tax credits to business who employ labour intensive production methods. FEDUSA also supports a stable but competitive currency aimed at raising investment and exports.

FEDUSA supports tax relief for job creation and training. FEDUSA as a progressive and socially responsible trade union Federation wants to make it easier to employ and train people. We believe that government has the room and the will to make these proposals a reality, which will greatly enhance growth and employment in SA.

FEDUSA hopes that our budget proposals will help enhance the Budget of 2008/2009.