

# OPINION

## BUDGET LESSONS

# Now is the time to repurpose sin taxes as evidence-based health tax

Revenue may be raised successfully off goods with price-insensitive consumption, such as habit-forming goods

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Why do modern states tax their citizens? Apart from states needing revenue and taxes serving

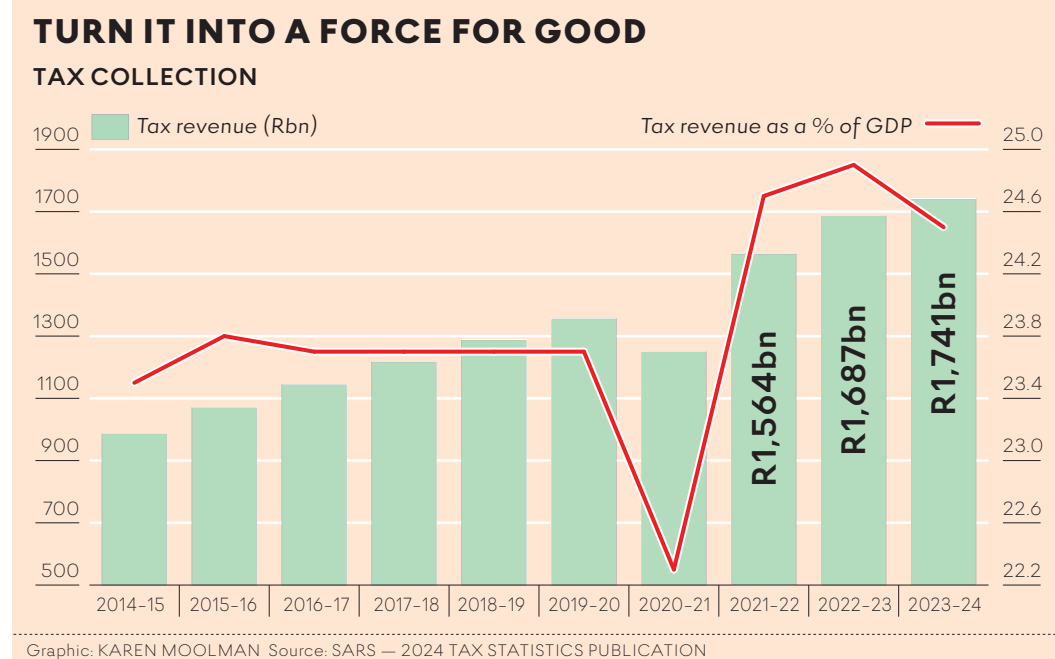
as a revenue tool, taxes have a far larger role in states characterised by participatory politics and constitutional rights. Taxes embody taxpayers' investment in an elected government to perform mandated functions and produce a social return.

In an ideal world the social return of taxes would be that they pay for a civilised society that looks after its poor, builds infrastructure and keeps its citizens safe from harm and injustice. Realistically, the precise form the expected return on taxes would take is highly context dependent. For instance, in high-tax Scandinavian jurisdictions taxpayers benefit directly from their taxes through lifetime access to public services and social protection, somewhat like state-enforced saving for taxpayers' future consumption.

The expected social return by taxpayers after 1994 was an inclusive and just society through a grand-scale tax and transfer mechanism. This return has not materialised. And not, as we are frequently told, because of inadequate tax revenue. We tax well – as well as prosperous countries such as Switzerland and Australia in terms of our tax-to-GDP ratio.

In fact, during budget season the outstanding performance of SA Revenue Service (Sars) commissioner Edward Kieswetter's team is hailed without exception. Sars competently raises the funding we need to invest in a more just society, but it is perhaps the only fiscal achievement we can claim. Beyond that, our taxes have proved to be an unproductive investment.

The reason is this: taxes are not primarily a revenue tool, the success of which may be claimed through high levels of tax collection. Taxes are a social tool. Tax success is measured by the social returns (such as quality healthcare and education, infrastructure, declining poverty, addressing inequality and economic growth and stability) that our taxes produce. Two fiscal truths stood stark amid the near-unanimous rejection of



the proposed two percentage-point hike in VAT on February 19. First, taxes should chase the progressive ideals a society has set for itself, not mere revenue targets. Second, taxpayers have much skin in the game and care deeply about the government's use of their hard-earned contributions. That is an interesting observation in the SA context.

Well-known attitudinal surveys (the World Values Survey and Afrobarometer Survey, for instance) contain questions that would indicate whether the social contract – and the fiscal aspects of the social contract relating to, for instance, tax-compliance behaviour – is norms driven or transactional in a particular society. This is an important empirical distinction.

In norms-driven societies tax compliance is largely unconditional and taxes are generally not leveraged when citizens attempt to bargain with the state for greater accountability. Rather, taxpayers comply with tax obligations based on a moral conviction that taxes work towards a better society.

This has the potential to produce harmonious state-society relations but depends on a high-trust environment in which all parties to the social contract deliver on their obligations. Tax

resistance is therefore not a typical mode of civic objection in norms-based societies but may emerge, paradoxically, not from low tax morale but because citizens' sense of morality becomes outraged.

In a transactional social contract taxpayers are more likely to demand a direct quid pro quo for their taxes, and compliance is conditional on taxpayer expectations being met. Events in the US – notably the demand for Ukraine's rare earth minerals in exchange for continued war assistance – would illustrate the workings of a transactional social contract; the Trump administration and its Department of Government Efficiency (Doge) annex are at pains to link every taxpayer dollar to direct benefit.

Survey responses for SA indicate a norms-driven social (fiscal) contract, yet on budget Wednesday the "no" to the proposed VAT increase came in unison. It may be time to recognise this as a society-wide moral objection to the socially unproductive use of taxes.

Taxes that are ripe to be remodelled from revenue-maximising tools into socially beneficial instruments are what we call our sin taxes. For instance, taxes on alcohol, tobacco and sugar-sweetened beverages are easy to justify as being

levied on unnecessary consumption that generates harm to the user and the rest of society.

In addition, tax policy advisers are aware of a tax rule – the Ramsey rule – predicting that revenue may be raised successfully off goods with price-insensitive consumption, such as habit-forming goods.

Hence, sin taxes are easy revenue and easy to justify, even on the poor.

As is often the case, the reality is significantly more complex. These excise taxes may be used in an evidence-based manner – specifically through linking the size of the tax on a harmful good to the extent of the harm it causes both to the consumer through loss of quality of life and earning capacity, and to society through the burgeoning cost of healthcare.

A harm-linked excise structure captures harmful goods accurately in its base and induces planned substitutions in consumption that would serve the health and wellbeing of society. Sin taxes then cease to be an easy-revenue instrument and become health taxes with a social return.

There is an inequality angle too. The consumption of tobacco, alcohol and sugar is associated with a rapid ("epidemiological") rise in noncommunicable diseases (NCDs) such as diabetes, chronic respiratory disease, cardiovascular disease and cancers, accounting for almost three-quarters of deaths globally. The poor are disproportionately affected by the rise in NCDs and the impact is severely regressive.

Health taxes are regressive too if they are paid by the poor, but they may be used to offset the regressive effects of rising NCDs, by inducing shifts in consumption and by earmarking health tax revenues for crucial health expenditure.

Unpopular as earmarking is among tax policymakers due to the funding rigours it may impose, possibly leading to underfunding in critical areas, the SA experience may well indicate that it is in fact discretion itself that leads to underfunding in critical areas such as public health.

Repurposing our sin taxes as evidence-based health taxes, prioritising public health in its design, and dedicating these revenues to support this objective, will constitute a shift towards the use of taxes as a force for good in society.

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## MORAL HAZARD

# Pension fund contribution holiday could imperil GEPF

On the surface, the proposal that the government should take a partial or full holiday from making payments to the Government Employees Pension Fund (GEPF) looks brilliant. But like all things that look good on the surface, it comes with risks.

At the time of writing it wasn't clear whether finance minister Enoch Godongwana will go along with the pension fund contribution holiday, a proposal that may suit him but could imperil the GEPF.

The risk is the demonstration effect – and the moral hazards it brings about – whereby politicians get comfortable with the idea that there are easy ways out of making tough decisions.

SA is where it is financially due to the failure by politicians to manage the country's financial affairs judiciously over the past 15 years. This is happening while the government's capacity and ability to run the country has weakened, a point made by Reserve Bank governor Lesetja Kganyago in 2022.

"Much as I wish we had a strong state that could deliver high-quality public goods at reasonable prices, the facts reflect otherwise. Relative to the 2000s we have a weaker state, spending a larger share of GDP," he said.

In this environment, the pension fund contribution holiday proposal has political appeal because it could save President Cyril Ramaphosa and his finance minister further political embarrassment. They were forced to postpone the tabling of the 2025 budget last month after failing to win cabinet approval for the proposed two percentage point VAT hike.

But shifting government contributions to the GEPF to other expenditures isn't without risk. To pay benefits to its members and their dependants, the GEPF relies on a combination of investment income and contributions (employee and employer). These benefits have been growing, in part because of years of above-inflation salary increases for public servants, reaching R141bn in financial 2024, up from R109bn five years earlier.

To fund the financial 2024 payments the GEPF used R109bn (net income) it earned from its investments managed by the Public Investment Corporation (PIC) and R92bn in contributions by employees and the employer. The biggest contribution – R59bn – came from the government.

"The fund receives sufficient cash flows from investment returns and contributions to ensure that all benefits are paid off without having to dispose of its investment assets," the GEPF noted in its 2023/24 annual report.

If the government takes a contribution holiday the GEPF



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will have to change its strategy. A holiday will leave the GEPF with a financial hole of R30bn-R60bn, depending on whether it is a full or partial holiday. Government contributions for 2025/26 and thereafter should be higher because of salary increases and new members joining.

The fund can plug the gap, at least temporarily. It can sell down some investments to generate the cash it needs to pay benefits. Or it can ask the PIC, its investment manager, to shift more funds to investments that generate more cash in the short term.

But the GEPF is a defined-benefit fund, with its members and dependants guaranteed a certain payout, irrespective of member or employer contributions. In short, as government guarantees those payouts, if it adopts the contribution holiday it will in effect be taking money from one of its pockets, money it will have to replace further down the line.

The ANC has landed itself in a vicious cycle whereby the more it has failed to run the country effectively the more it wants to extend the footprint of government through such ventures as National Health Insurance and the state-owned bank.

All of this has stoked sentiments against the size and role of government, which talks to how much of the country's economic resources the government should take and spend, and on what. These sentiments have also been incited by corruption, in the same way corruption did in 18th century Britain. "While laissez-faire was rooted in Enlightenment ideas, it was also viewed as an antidote to the more corrupt and venal system that characterised government in the 18th century," writes Walker Hanlon, an American economist, in *The Laissez-Faire Experiment. Why Britain Embraced and then Abandoned Small Government, 1800-1914*.

Hanlon notes that Britain's swing towards a small government was "a practical and sensible, but also flexible reaction to an older and more corrupt system of government", in which state intervention "often served primarily to reward favoured groups at the expense of the rest". SA now looks no different from 18th-century Britain.

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## AGRICULTURE

# Ignore noise and boost trade with Brics

Challenges that constrained SA's agricultural growth potential in recent years remain. These include poorly functioning municipalities, deteriorating roads and rail, the inefficiency of ports, the slow process of releasing government-owned land to beneficiaries with title deeds, rising crime and stock theft. These challenges must be resolved for the sector to grow robustly in coming years.

At the beginning of the year we expected the focus would primarily continue to be on a collaborative approach between government and private sector to tackle these challenges.

But much of the public discourse has been about international trade risks and misinformation about land reform policy in SA. While it is

important to address the misinformation and risks it presents to SA's participation in the African Growth & Opportunity Act, these two issues must not take all the focus and effort of stakeholders. The domestic challenges still matter more as they directly affect daily operations of farming businesses and agribusiness in many small towns across SA.

Significantly, given our environment of heightened uncertainty, the sector's approach should move from the reactive mode we observed since the beginning of the year to a proactive approach. This would entail SA refocusing on domestic plans and programmes such as the Agriculture & Agro-processing Master Plan and Operation Vulindlela. In trade matters, there should be increased effort

to widen export markets to new regions. The present environment, where all countries are uncertain about the direction of world trade, also presents an opportunity for SA to strengthen friendship and trade in various regions.

SA must use the geopolitical climate to firm up trade ties with the Brics bloc, addressing all tariffs and nontariff barriers that have long made SA agricultural products uncompetitive relative to those countries that have duty-free access to some Brics markets, such as China and India.

This approach would be in line with the aspirations of the master plan, which is intended to expand SA agricultural production through an export-orientated approach, in addition to gains that can be realised domestically with value addition. Opening up new



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markets would also refocus South Africans on the port issues and rural roads, which require significant improvements.

As things stand, the more attention given to global issues, on which various SA regions have limited influence, the more domestic challenges will continue to constrain the sector's growth.

This refocusing must start at government level. Directorates responsible for domestic matters in the departments of agriculture and trade, industry

& competition, among others, must refocus and rekindle conversations with stakeholders about the programmes under way.

Equally, a small and well-resourced team with senior government officials and the private sector must focus on widening trade with new markets. Given that we are in a noisy time in international trade, frequent stakeholder updates by government and private sector trade teams that would work on trade would provide comfort about the work under way.

This would also assure stakeholders that this team was directing the trade matters of the agricultural sector in the right direction. Allowing the geopolitical noise to drown out core issues constraining this sector's long-term growth and job creation will guarantee limited progress.

In other areas that require a release of government land with title deeds to beneficiaries, the government should march forward with that process and not open more discussion. The new beneficiaries would then partake in the programmes under the master plan, collaborating with commodity associations and many development organisations.

Ultimately, this is not an attempt to minimise the global risks, which could have profound implications on SA's agriculture. However, some balance and focus on domestic issues would help.

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## MIDDLE EAST

# What is Saudi Arabia really up to in its game of chess?

The Kingdom of Saudi Arabia has in the past been routinely pilloried for its misogynistic policies and practices, for its assassination of journalist Jamal Khashoggi, its ultraconservative interpretation of Islam and generally for being a repressive state.

Some of this seems to be changing in recent years. Its government, led by Crown Prince Mohammed bin Salman, has stripped the religious police of the right to arrest, allowed women to drive, lifted a ban on cinemas, sponsored music concerts and entertainment



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events and recently released dozens of political prisoners.

Joey Shea of Human Rights Watch captures the reasons for these changes as "sentencing people to decades-long terms for tweets is ultimately bad for business".

An example of Saudi Arabia's economic objectives can be

seen in the efforts around the Neom project, which aims to create a \$500bn futuristic urban industrial development on the Red Sea coast.

In pursuit of its pecuniary interests, Saudi Arabia, as recently as September 2023, indicated that it was on the brink of signing the 2020 Abraham Accords with Israel. The US president at the time, Donald Trump, celebrated the accords as the "deal of the century", initiating a new era of open diplomacy between Israel and four Arab nations.

But the kingdom had resisted signing and this was one of the reasons for Hamas' operation

on October 7 2023, throwing everything into one last, desperate effort to preserve the possibility of a Palestinian state.

Economic interests to some extent explain Saudi Arabia's change of heart. Others included the perceived Iran threat, and more importantly the crown prince wanting a secure path to the crown. In the obscure game of Saudi succession he has to secure the support of the kingdom's council. One sure way of achieving that is through leveraging off his relationship with the US.

Hence economic and political considerations explain the charm offensive in the US,

with US billionaires attending a Saudi investment conference on February 19 in Miami, addressed by Trump, who spoke of a new dawn of co-operation between the kingdom and the US.

In September 2023 the crown prince called for a more formal agreement with the US, saying it would "save effort from the Saudi side of not switching to other places", referring to its rapprochement with China and renewing of diplomatic relations with Iran.

Tom Stevenson, writing in the *London Review of Books*, points out that after October 7 a requirement that Israel make some concessions to the

Palestinians was bolted onto the understanding with the US. "The result was a proposed 'mega deal' consisting of a reformulated US-Saudi alliance, some face-saving in the form of Saudi-Israeli diplomatic normalisation and scraps for the Palestinians".

As for Israel, since the beginning of this year, and especially as the Israeli-Gaza ceasefire was taking shape, Prince Khalid Bandar, Saudi Arabia's ambassador to the UK, spoke of normalising ties that must "lead to the creation of a Palestinian state". In September 2024 the crown prince told the consultative Shura Council that

the kingdom would not recognise Israel without the establishment of an independent Palestinian state, including Gaza and the West Bank, with East Jerusalem as its capital.

The Saudis have been accused of blowing hot and cold over Palestinian sovereignty but it's clear the leadership is concerned about the rage the war in Gaza has fuelled among a generation of young Arabs, thus doubling down on Palestinian statehood. In this context, Trump shocked Arab states by saying not only that Gaza should be emptied of Palestinians but also that the US

should take over the strip. The Saudi foreign ministry made it clear that it was not budging from its call for a Palestinian state on the borders of 1967.

Lebanese journalist and author Kim Ghattas captures the state of play when she writes: "Enter the grand Middle East chessboard with the weak square of a devastated Gaza, an emboldened Israeli far right and an American president who sees everything as a real estate deal, even when it violates international law."

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