Economic Overview for Business Owners

March 2016

Budget 2016 and Small Business

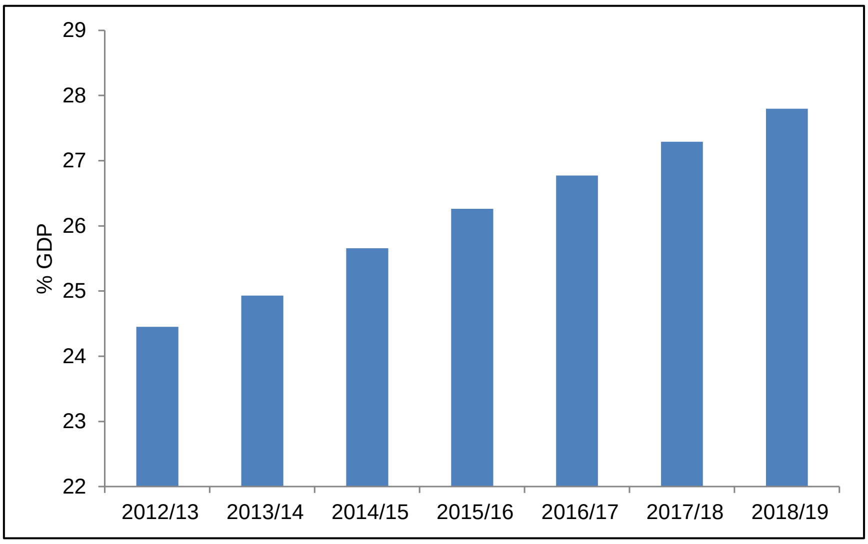
As far as the top-line numbers go, the decline in the main budget deficit from 4.2 per cent of Gross Domestic Product (GPD) in 2015/16 to a deficit of 2.9 per cent of GDP by 2018/19, is a positive development. The projected deficits for the next three years are significantly smaller than those projected a year ago, despite a weaker real GDP growth outlook. Moreover, main budget non-interest expenditure is expected to fall to 26.1 per cent of GDP by 2018/19, from 27.5 per cent in 2015/16, as Government constrains real expenditure growth by targeting the state's large wage bill. Equally encouraging is that the main budget's primary budget deficit (revenue less non-interest spending) improves to a surplus of 0.5 per cent of GDP by 2018/19, from a deficit of 1.1 per cent of GDP in 2015/16. Accordingly, Government's gross loan debt ratio is projected to stabilise at 51.0 per cent of GDP in 2017/18, before declining a notch to 50.5 per cent of GDP in 2018/19.

The detail does raise questions though. The Treasury's GDP growth numbers look optimistic. GDP in current prices expanded just 4.9 per cent in the year to 4Q2015. Although inflation is expected to lift, the National Treasury's projected nominal GDP growth of 7.8 per cent in calendar year 2016, followed by increases in excess of 8 per cent in the following two calendar years, are materially higher than the current trend. Government's revenue growth may, therefore, disappoint.

Also, although the focus on constraining expenditure falls on compensation, the jury is out, given Government's patchy track record on this expenditure category in recent years. Meanwhile, as regards National Health Insurance (NHI), Minister Gordhan indicated that the funding plan is still being considered. In illustration, the NHI White Paper, released in December 2015, includes a projection showing total NHI spending on healthcare by the public sector could increase from around 4 per cent of GDP currently, to around 6 per cent of GDP in 2025/26, but only if the economy grows at 3.5 per cent in real terms. Slower growth of, say, 2 per cent implies public sector spending on healthcare could increase to around 7 per cent of GDP over the period.

Gross tax revenue is budgeted to increase from 26.4 per cent of GDP in 2015/16 to 27.8 per cent of GDP by 2018/19. But, in tandem, poor economic growth and spending priorities, such as NHI, suggest the share of taxes in GDP could increase to a higher level than currently expected.

Gross tax revenue



Source: South African National Treasury

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Source: South African National Treasury, Budget Review

The Treasury's 2016 Budget Review suggests, however, that an increased focus on indirect taxes, including VAT, is likely. Concomitantly, the budget sets out to support business development generally, but also small businesses specifically. Some of these measures are discussed below.

South Africa's financial sector is one of the most developed in the world, yet it lags in the global competitiveness rankings as regards the provision of venture capital. The country needs to unlock the potential of its entrepreneurs by providing avenues for the commercialisation of ideas. Accordingly, to entice equity financiers to invest in small businesses, the venture capital company regime was introduced in 2008. The Review notes there are currently 31 registered venture capital companies. Government plans to seek measures to reduce the adverse impact which certain provisions imposed on these companies, has on investor participation. Further, the Treasury indicates that it is working with the Department of Small Business Development to explore the possibility of starting a "small business innovation fund".

The Treasury also indicated that the Department of Small Business Development is working with municipalities to cut red tape. The Review notes, for example, that nine of South Africa's largest municipalities intend reducing red tape in, for example, obtaining construction permits, registering property and securing electricity connections.

In addition, the Treasury proposes to amend the Special Economic Zones (SEZ) tax incentive legislation to make it clear that small business corporations in SEZs are subject to corporate income tax at either the applicable graduated rate, or 15 per cent, whichever is lower. The Budget Review notes, though, that small business corporations must still comply with the provisions of the Income Tax Act to be eligible for the 15 per cent rate.

Other measures, which may be beneficial to business more broadly, include easing visa requirements for visitors from abroad, accelerating broadband roll-out and adjusting immigration policy to reduce skills constraints. More broadly, if the recommendations of the Presidential Review Committee on State-Owned Enterprises (SOEs) are implemented as planned, the functioning of SOEs should improve, leading to enhanced infrastructure capacity and service delivery. This includes rationalising the number of entities, disposal of non-strategic assets, mobilising private sector co-investment and improving governance.

Overall, the Treasury's focus on support for and co-operation with private business enterprises is both welcome and essential. After all, without acceleration in economic growth over the medium term Government's fiscal maths do not add up.

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