

**A REVIEW OF THE POLICY ON INCENTIVES: TO WHAT EXTENT DO INCENTIVES  
ENHANCE THE POLICY OBJECTIVES OF SOUTH AFRICA?**

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## **Abstract**

The global trends show that developing countries and economies in transition such as South Africa are now primary foreign direct investment (FDI) destinations, and their importance as FDI recipients continues to increase.

This research paper evaluates the usefulness of incentives in driving the investment policy direction of South Africa, the role of stakeholders involved in incentive schemes, and the impact on the tax base. It contributes to the assessment of the usefulness of incentives in enabling the government to achieve its policy objectives. This research commends the government's approach to drafting its policy objectives in line with National Development Plan 2030. It is a plan that has consideration of global trends, and it is an appropriate panacea for the domestic policy framework that brings about foreign direct investment through initiatives such as incentives.

Tax incentives are not the primary determinant of the decision to invest. Most investors base their investment decisions not only on economic and commercial factors. Incentives function as a reward to investors who would invest without incentives rather than encouraging investors who would otherwise not invest or go elsewhere.

It is clear that non-tax incentive considerations outweigh tax incentive considerations, but it is also argued that tax incentives could effectively address environmental challenges and change consumer behaviour. However, these incentives are generally more effective in combination with other policy instruments.

Furthermore, this research finds that — because of the corruption or perception thereof — the deteriorating economic environment has exerted huge pressure on South Africa's public debt, due to the pressure placed on the government to finance its budget. The fiscal challenges that South Africa faces cannot be solved with 'more' incentives but rather a strategic balance with other measures.

The scale and variety of South Africa's investment incentives will continue to be a contested debate. However, while it is also clear that the revenue base is shrinking, it is difficult to envisage an investment policy strategy without incentive schemes. Incentives should be seen not as a problem and a drain on the fiscus but as an integral part of the solution.

## Table of Contents

CHAPTER 1: INTRODUCTION.....	8
1.1 Relevance of the topic.....	8
1.2 Research objectives .....	10
1.3 Research method.....	12
1.4 Research limitations .....	14
1.5 Structure of the research.....	15
CHAPTER 2: THE POLICY OBJECTIVES ASSOCIATED WITH INCENTIVES.....	17
2.1 Introduction.....	17
2.2 The constitution and legislative framework .....	18
2.2.1 Specific sections .....	19
2.2.2 Judicial systems.....	20
2.2.3 Investment context.....	21
2.3 The policy framework.....	23
2.3.1 The National Development Plan 2030.....	24
2.3.2 Fiscal policy as an instrument to achieve policy objectives .....	25
2.3.2.1 Brief history of fiscal policy in South Africa.....	26
2.3.2.2 Tax policy .....	28
2.4 Budget reforms since democracy.....	30
2.4.1 Katz commission .....	32
2.4.2 The motive for fiscal reforms.....	33
2.5 Distributional impact of fiscal policy .....	34
2.6 Conclusion.....	36
CHAPTER 3: ASSESSING THE INFLUENCE OF INCENTIVES.....	38
3.1 Introduction.....	38
3.2 A conceptual framework of Incentives in South Africa .....	38
3.2.1 Incentives defined .....	39

3.2.2 Investment incentives .....	40
3.2.3 Incentives as a policy instrument.....	41
3.3 Some examples of tax incentives .....	43
3.3.1 Industrial policy projects.....	43
3.3.2 Special Economic Zones (SEZs) .....	44
3.3.3 Energy efficiency savings.....	44
3.4 Is the design of incentives appropriate? .....	44
3.4.1 Cost and benefit analysis of tax incentives .....	46
3.4.2 Tax expenditure .....	47
3.5 The general impact of tax incentives.....	49
3.6 Conclusion.....	50
CHAPTER 4: BEHAVIORS ENCOURAGED BY INCENTIVES .....	51
4.1 Introduction.....	51
4.2 The stakeholders in incentive schemes.....	52
4.3 Who gets the incentive money?.....	53
4.4 Impact of incentives on the tax base .....	54
4.5 Investor confidence.....	55
4.6 Conclusion.....	57
CHAPTER 5: POSSIBLE ALTERNATIVES TO BALANCE FISCAL SUSTAINABILITY AND THE EFFICIENCY OF TAX INCENTIVES.....	58
5.1 Introduction.....	58
5.2 Can the objectives be achieved with more or with less incentives?.....	59
5.3 Are there alternatives to incentives? .....	61
5.4 Recommended alternatives .....	63
5.5 Conclusion.....	65
CHAPTER 6: SUMMARY AND CONCLUSION .....	66
6.1 Introduction.....	66

6.2 Summary of main findings.....66

6.3 Recommendations .....68

6.4 Limitations and suggestions for further research .....69

REFERENCES .....70

## CHAPTER 1: INTRODUCTION

### 1.1 Relevance of the topic

In one of the reports released by Statistics South Africa, it was highlighted that South Africa is viewed as one of the most unequal countries in the world, reporting a per-capita expenditure Gini coefficient of 0,67 in 2006, dropping to 0,65 in 2015.<sup>1</sup> Despite significant efforts by the government over the years to stimulate inclusive growth, the income gap between the rich and the poor has continued to widen in post-apartheid South Africa.<sup>2</sup>

It is an ancient phenomenon that the primary objective of taxation has been to collect revenue to finance the government's provision of essential public services. At the same time, enlightened by advances in public sector economics, taxation policies across the globe are designed to strike the difficult balance between achieving minimal disincentives to undertake productive activities and maximum social fairness.<sup>3</sup>

According to the Organisation for Economic Co-operation and Development (OECD), taxation presents a distinct opportunity to stimulate economic growth and investment and close the poverty gap in society. It is often the second-best policy instrument in achieving inclusive growth policy design.<sup>4</sup> Taxation is one of the measures through which governments seek to address certain social ills and bring about viable economic activities. This argument was advanced by *Steenekamp* in his study on '*The progressivity of personal income tax in South Africa since 1994 and directions for tax reform*'. While *Steenekamp's* study did not examine the entire taxation system, he found that direct taxes, as a percentage of total tax revenue had increased in

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<sup>1</sup> StatsSA 'Inequality Trends in South Africa' available at <http://www.statssa.gov.za/publications/Report-03-10-19/Report-03-10-192017.pdf>, accessed on 7 September 2023.

<sup>2</sup> Woolward, I 'Economists think South Africa's persistent inequality should be tackled with a wealth tax' available at <https://qz.com/africa/1610723/south-africas-inequality-can-be-fixed-with-a-wealth-tax/>, accessed on 7 September 2023.

<sup>3</sup> Bonucchi, M Ferrari, F Tomasini, S and Tsenova, T 'Tax policy, investment decisions and economic growth' available at <https://www.cairn.info/revue-de-l-ofce-2015-5-page-225.htm>, accessed on 7 September 2023. 1.

<sup>4</sup> Organisation for Economic Cooperation and Development 'Tax policies for inclusive growth in a changing world' available at <https://www.oecd.org/g20/Tax-policies-for-inclusive-growth-in-a-changing-world-OECD.pdf>, accessed on 7 September 2023. 10.

importance between 1993/94 and 2010/11 and that the personal income tax structure is progressive, but there was a declining trend in progressivity between 1994 and 2009. He contended that even the progressivity of taxation is one of the 'imperatives to reduce poverty levels'.<sup>5</sup>

It seems therefore that taxation is not only a revenue collection mechanism but is also one of the policy levers available to a government to deliberately address and redress certain social ills. The South African government recognised that to support a rapid economic rebound, it needs to focus on a few high-impact interventions and ensure they are executed swiftly and effectively.<sup>6</sup> Among many policy levers the government uses to effectively intervene in the economy is a range of tax and non-tax incentives.

Tax incentives can be defined as any deviations from the laws of the general tax system established by a country. They envisage a decrease of the tax burden or a more favourable tax treatment for a taxpayer (or a group of taxpayers) provided the taxpayer (or the taxpayer group) corresponds to certain statutory characteristics defined by the tax legislation.<sup>7</sup> National Treasury defined tax incentives in the *2012 Budget Review*<sup>8</sup> as specific provisions in the tax code that provide favourable tax treatment to individuals and businesses to encourage specific behaviours or activities.

In the last few years, the government has been posing questions as to whether incentive schemes, in general, achieve the government's intention to foster economic growth and investment.<sup>9</sup> This research paper aims to

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<sup>5</sup> Steenekamp, TJ 'The progressivity of personal income tax in South Africa since 1994 and directions for tax reform' (2012) 16 *Southern African Business Review* 39.

<sup>6</sup> Presidency 'The South African Economic Reconstruction and Recovery Plan' available at [https://www.gov.za/sites/default/files/gcis\\_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf](https://www.gov.za/sites/default/files/gcis_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf), accessed on 8 August 2023.

<sup>7</sup> Pule, B and Innuse, B 'The importance of defining corporate income tax incentive objectives in order to enhance their effectiveness' (2019) 4 *Littera Scripta* 54.

<sup>8</sup> National Treasury 'Budget Review 2012' available at <http://www.treasury.gov.za/documents/national%20budget/2012/review/FullReview.pdf>, accessed on 7 September 2023. 215.

<sup>9</sup> National Treasury 'Revenue trends and tax proposals' available at <http://www.treasury.gov.za/documents/national%20budget/2020/review/Chapter%204.pdf>, accessed on 7 September 2023.

evaluate the extent to which incentives provide any positive impact on policy objectives envisaged by the government in its policy objectives.

## 1.2 Research objectives

Following the comments above, it seems that the most pressing problem that South Africa has been facing over the years is the absence of faster and sustained inclusive economic growth. These are prerequisites for addressing the triple challenges of poverty, inequality and unemployment which are elements drawn from the Bill of Rights enshrined in the Constitution.<sup>10</sup> The government alluded to this admission in the 2019 Medium-Term Strategic Framework where it stated that 'additional interventions required to support priorities over the next five years require partnerships with social and private sectors to achieve better growth opportunities'.<sup>11</sup>

Through these private-sector partnerships, the government acknowledged that the private sector's contribution to jobs and investment will bring about accelerated inclusive growth as envisaged by the National Development Plan (NDP). It is stated that inclusive growth also ensures that the highly skewed distribution of productive assets, which is a source of inequality and social fragility, is more equitable,<sup>12</sup> and the investment climate is crucial, as are the right incentive structures, to guide the allocation of resources, and to encourage research and development.<sup>13</sup> At the launch of the NDP, the former Minister and chairperson of the National Planning Commission (NPC), Mr Trevor Manuel<sup>14</sup>, said that the approach to tackling poverty and inequality is premised on faster and more inclusive economic growth, higher public and

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<sup>10</sup> Constitution of the Republic of South Africa of 1996 Chapter 2.

<sup>11</sup> Department of Planning Monitoring & Evaluation 'Medium-term strategic framework 2019-2024' available at <https://www.poa.gov.za/Pages/MTSF.aspx>, accessed on 8 August 2023. 27.

<sup>12</sup> Ibid at 28.

<sup>13</sup> National Planning Commission 'National Development Plan Vision for 2030' available at [https://www.nationalplanningcommission.org.za/National\\_Development\\_Plan](https://www.nationalplanningcommission.org.za/National_Development_Plan), accessed on 7 September 2023. 94.

<sup>14</sup> Manuel, T 'National Development Plan launch speech' available at <https://www.gov.za/national-development-plan-launch-speech-trevor-manuel-minister-presidency-national-planning>, accessed on 5 August 2023.

private investment and that public investment complements private investment, which is a critical component for job creation and employment.

The policy objectives which the government has been trying to address are clearly stated in the 2030 vision document.<sup>15</sup> Whereas the NDP proposed fourteen policy objectives, this research paper will focus only on the following:

1. Remove the most pressing constraints on growth, investment, and job creation, including energy generation and distribution, urban planning etc.
2. Position South Africa to attract offshore business services, and build on the advantage provided by its telecommunications, banking and retail firms operating in other countries.
3. Offer a tax incentive to employers to reduce the initial cost of hiring young labour market entrants.

With these clear economic policy objectives, the key questions to be addressed in this research paper include the following:

- Whether incentives are enhancing the stated policy objectives, and, is the policy design appropriate to provide the desired impact? and,
- Whether the concept of incentives is a desirable policy instrument for South Africa, or whether other alternatives should be considered to support certain policy objectives?

To answer the research questions this research paper outlines the current policy design, and how it influences the investment behavioral patterns of the stakeholders associated with the industries to which certain incentives are targeted.

The research will briefly assess the cost-benefit of tax incentives to establish the real beneficiaries of money forgone and the value associated with tax incentives. This will help to evaluate whether the policy objectives can be

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<sup>15</sup> National Planning Commission 'National Development Plan Vision for 2030' available at [https://www.nationalplanningcommission.org.za/National\\_Development\\_Plan](https://www.nationalplanningcommission.org.za/National_Development_Plan), accessed on 7 September 2023. 66.

better achieved with consideration of other alternatives contemplated in the existing literature.

### 1.3 Research method

This research paper follows a non-doctrinal approach, although there are elements of doctrinal investigative research included, to evaluate the above-stated objectives. The study is therefore largely empirical and seeks to research whether incentives advance the countries stated economic objectives.

The study is based on a review of the literature. A clear understanding of the policy intent of the government is a starting point for understanding the concept of incentives, with a view to attempting to acquire a deeper understanding of the government's economic policy objectives.

Policy objectives are presumed to inform the policy interventions and tools which governments employ in attempting to achieve objectives. A literature review is a systematic, explicit, and reproducible method for identifying, evaluating, and synthesising the existing body of completed and recorded work produced by researchers, scholars, and practitioners. It is defined as an organised critical account of information that has been published on a specific topic and provides an organised synthesis of the information, ideas, and knowledge.<sup>16</sup>

In line with the qualitative approach, the research is focused on analyzing the publicly available literature from relevant stakeholders to assess whether a necessity exists to further strengthen the incentives regime to achieve the desired outcomes. Over the years, commentators such as *Hundenborn*<sup>17</sup> evaluated tax information to measure inequality. Similar data is used to examine the historical impact of certain incentives in South Africa. The research is conducted by accessing data from stakeholders such as Stats SA,

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<sup>16</sup> Ssenyonjo, P *A Comparative Study of Tax Incentives for Small Businesses in South Africa, Australia, India and the United Kingdom* (unpublished Master's dissertation, UNISA, 2019) 16.

<sup>17</sup> Hundenborn, J Woolard, I and Jellema, J 'The effect of top incomes on inequality in South Africa' available at <https://doi.org/10.1007/s10797-018-9529-9>, accessed on 7 September 2023.

tax statistics, government reports, and all other material relevant to the stated research topic, as further set out in the references list attached hereto.

The National Development Plan (NDP) recognises that faster, broad-based growth is needed to transform the economy, create jobs, and reduce poverty and inequality by 2030.<sup>18</sup> Beyond what the NDP envisaged, the government further outlined specific tax policy principles including the following:

- Consideration of the effects of taxes on economic growth, the behavioural response of taxpayers, inequality and fairness, and revenue administration capacity.<sup>19</sup>
- Seek to create an environment that is conducive to broad-based economic growth, and that avoids complicated incentives for specific sectors or groups of taxpayers. Progressivity will be enhanced by restricting deductions for the wealthy and increasing overall collections through improved administration.<sup>20</sup>
- Tax policy also needs to consider the tax regime in potential competitors and neighbouring countries.<sup>21</sup>
- Reviewing tax policy and strengthening regulation in the financial sector and supporting infrastructure development and economically integrated cities and communities.<sup>22</sup>

Consequently, the resources considered in this research paper include the legislation related to tax policy, government publications, Parliament reports, articles, journals, books, newspaper articles, and research papers, relating to incentives and government economic policy.

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<sup>18</sup> Presidency 'Economy and finance' available at <https://www.gov.za/about-sa/economy>, accessed on 8 August 2023.

<sup>19</sup> National Treasury 'Budget Review 2021' available at <http://www.treasury.gov.za/documents/National%20Budget/2021/review/FullBR.pdf>, accessed on 7 September 2023. 44.

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

<sup>22</sup> Presidency 'Economy and finance' available at <https://www.gov.za/about-sa/economy>, accessed on 8 August 2023.

#### 1.4 Research limitations

The scope of this research is based on the South African incentives' regime and societal circumstances. While a parallel comparison may be made to practices in other countries, the focus of this report is not on international incentives. Rather, given the unique circumstances in South Africa, this report will be focused on South Africa and the government's approach to addressing the inequality rife in society. Accordingly, any reference to international practices is mentioned merely to highlight differences or similarities.

The government offers a variety of incentives to attract investment into the economy. These include incentives for capital expenditure, competitive advantage incentives, incentives for a specific industry, and research and development incentives. This is not a conclusive list of incentive categories, and individual incentives are contained within these categories.

As stated above, there are several incentives offered by the South African government pursuant to its policy objectives. These range from tax allowances to support the automotive sector, from helping innovation and technology companies to film and television production. This research paper will be limited to these investment categories:

- Concept, research and development incentives – for private sector businesses that invest in the creation, design and improvement of new products and processes.
- Capital expenditure incentives – for companies that want to acquire or upgrade assets in order either to establish or expand their business' productive capacity.
- Competitiveness enhancement incentives – for investments that facilitate increased competitiveness, sustainable economic growth and development in a specific sector.

From these categories, one example from each will be selected and discussed to establish its impact and support the stated objectives.

### 1.5 Structure of the research

This research paper is divided into chapters relevant to addressing the research objective. All these chapters will have a brief introduction and concluding remarks on their specific themes. These are:

- **Chapter 1 – Introduction**

It is pertinent to understand the difficulties that lead to high levels of inequality and efforts by the government in redistribution and socioeconomic inclusion.

Chapter one provides the background which illustrates the rationale that brings about the importance, relevance and circumstances which created the problem being addressed by this research. In this background, a literature review which provides commentaries on government policy and incentives is also outlined. The first chapter seeks to navigate the route map through which this research is undertaken.

- **Chapter 2 – The Policy Objectives Associated with Incentives**

This chapter opens by outlining the legislative framework derived from the constitution with other tax and investment pieces of legislation. The historic evolution of policy instruments such as fiscal policy is examined in this chapter to assess their objectives and the extent of the distributional impact.

This chapter concludes by commenting on the importance of aligning policy instruments with stated objectives that are aimed at achieving specified goals.

- **Chapter 3 – Assessing the influence of incentives**

The concept of incentive schemes is a wide range across sectors of the economy. Therefore, it would be difficult to attempt an evaluation of all of them. This chapter shifts into the general incentive framework and tax incentives in particular.

The cost and benefit impact analysis of certain tax incentives will be explored based on the literature available which may demonstrate the extent to which the desired outcomes as stated in Chapter 2 are achieved or achievable.

- **Chapter 4 – Behaviors Encouraged by Incentives**

This chapter follows the examination of the reactions of market participants such as certain businesses to the tax incentives. It is important to evaluate whether these players would be reacting differently were these incentives not available to them.

The chapter draws a theory on effects (positive and negative), and whether that picture is desirable in the context of South Africa. This will include a look at the:

- revenue lost due to incentives,
- support and investment achieved, and
- who gets the funds lost through incentives? For example, can we trace the beneficiary of the money lost by the fiscus through incentives?

- **Chapter 5 - Possible Alternatives to Balance Fiscal Sustainability and the Efficiency of Tax Incentives**

This chapter looks at the objectives of tax incentives to evaluate other alternatives to achieving these objectives without employing tax incentives where other alternatives could provide the same or better results.

While incentives may or may not influence the behaviour of stakeholders in specific sectors of the economy, it remains a debatable proposition whether this can be achieved with more or fewer incentives. For this reason, this chapter outlines other possible alternatives to tax incentives contemplated in the available literature.

- **Chapter 6 - Summary and Conclusion**

The last chapter consolidates and makes clear all findings, conclusions and recommendations derived from the above chapters.

This section does not only provide additional recommendations but also looks at recommendations provided in the literature over the years and assesses the government's attitude towards them.

## CHAPTER 2: THE POLICY OBJECTIVES ASSOCIATED WITH INCENTIVES

### 2.1 Introduction

The global trends show that developing countries and economies in transition such as South Africa are now primary foreign direct investment (FDI) destinations, and their importance as FDI recipients continues to increase. According to the United Nations Conference on Trade and Development (UNCTAD), for the first time in 2010, developing countries received more than half (55 per cent) of global FDI flows. This increased opportunities for strategic investment targeting, promotion, and protection policies in developing countries. It indicates that the investment landscape is changing with increasing weight for developing countries.<sup>23</sup> In the case of South Africa, the NDP is viewed as the seminal policy document that brings about all government interventions.

However, a distinction should be drawn between a vision, and strategic plans to achieve the vision. While the NDP contains specific intervention tasks, it is a narrative of the vision for where South Africa should be in 2030. It does not provide clear policy intent specifically on tax incentives. According to the government, the 'vision as contained in the NDP is for a South Africa in which those who seek employment will be employed. We are striving for a society in which citizens will live healthy, long lives, a place where there is no fear of criminals and where all live safely and securely. We are building a country

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<sup>23</sup> UNCTAD 'Investment Policy Framework for Sustainable Development. United Nations Conference on Trade and Development' available at [https://unctad.org/system/files/official-document/diaepcb2015d5\\_en.pdf](https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf), accessed on 7 September 2023. 13.

with a capable state that supports citizens to fulfil their dreams and freely express their talents. It envisages a growing economy that is responsive to the demands of a fast-changing world, an economy that does benefit the few. It should be an economy where all share in the country's wealth'.<sup>24</sup>

South Africa's policy objectives are focussed on a range of areas such as learning and culture, health, social development, community development, peace and security, economic development, and public services. 'A range of policy decisions in each sector, including more efficient and cost-effective methods of implementation, is required to align spending with available resources.'<sup>25</sup>

This chapter examines the policy proposition in the economic development area and locates the legislative bases upon which this objective is founded. It looks at the policy instruments used to achieve these goals, how South Africa employed these instruments, and the potential impact on equitable wealth distribution envisaged in the constitution.

## 2.2 The constitution and legislative framework

South Africa is a constitutional democracy in that its legal system is subject to the *Constitution of the Republic of South Africa, 1996*. The Constitution declares that it is the supreme law of the judicial system which consists of independent courts, that any law or conduct inconsistent with it is invalid, and that the obligations imposed by the Constitution must be fulfilled.<sup>26</sup>

The Constitution<sup>27</sup> states that an Act of Parliament must provide, amongst others, for:

- the equitable division of revenue raised nationally among the national, provincial, and local spheres of government; and

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<sup>24</sup> Zuma, J G '5th anniversary of adoption of National Development Plan' available at <https://www.gov.za/speeches/president-jacob-zuma-5th-anniversary-adoption-national-development-plan-12-sep-2017-0000>, accessed on 15 July 2023.

<sup>25</sup> National Treasury 'Medium Term Budget Policy Statement' available at <http://www.treasury.gov.za/documents/mtbps/2020/mtbps/FullMTBPS.pdf>, accessed on 8 August 2023. 40.

<sup>26</sup> Constitution of the Republic of South Africa of 1996, s 2.

<sup>27</sup> Ibid at s 214(1).

- the determination of each province's equitable share of the provincial share of that revenue.

The legislative framework for the levying of a tax in South Africa is laid down in several statutes such as: the *Transfer Duty Act*, *Estate Duty Act*, *Income Tax Act*, *Customs and Excise Act*, *Value-Added Tax Act*, *Securities Transfer Tax Act* (which repealed the *Uncertificated Securities Tax Act*), *Unemployment Insurance Contributions Act*, *Skills Development Levy Act*, *Employment Tax Incentive Act*, *Carbon Tax Act*, *Diamond Export Levy Act*, and *Mineral and Petroleum Resources Royalty Act*.<sup>28</sup>

All these statutes are subordinate to the Constitution<sup>29</sup> and are therefore open to constitutional challenge. Such a challenge may be to the validity of the Act itself (or part of the Act) or regarding the conduct by any South African Revenue Service (SARS) official that is in breach of the Constitution in some respect, including administrative action taken in terms of the Act that is reviewable in terms of the *Promotion of Administrative Justice Act 3 of 2000* (PAJA).<sup>30</sup>

### 2.2.1 Specific sections

Section 213 of the Constitution provides for a National Revenue Fund into which all money received by the national government shall be paid, except money reasonably excluded by an Act of Parliament. The Public Finance Management Act 1 of 1999 (PFMA) gives effect to this provision and regulates financial management in the national government to ensure, amongst others, that all revenue, expenditure, assets, and liabilities of the national government are managed efficiently and effectively.

Section 228 confers on provincial legislatures the power to impose taxes, levies, and duties, other than income tax, value-added tax, general sales tax, rates on property or customs duties and flat rate surcharges on the tax bases of any tax, duty or levy that is imposed by national legislation other than the

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<sup>28</sup> de Koker, *A Silke on South African Income Tax* (2000) para 1.2

<sup>29</sup> Constitution of the Republic of South Africa of 1996

<sup>30</sup> de Koker para 1.2

tax bases of corporate income tax, value-added tax, rates on property or customs duties.

Section 229 regulates the power of a municipality to impose rates on property and surcharges on fees for services provided by or on behalf of the municipality and if authorised by national legislation, other taxes, levies, and duties appropriate to local government. This provision also provides that the taxing power of a municipality may not be exercised in a way that materially and unreasonably prejudices national economic policies, economic activities across municipal boundaries or the national mobility of goods, services, capital or labour.<sup>31</sup>

### 2.2.2 Judicial systems

The legislative provisions referred to above provide a constitutional base for the government to legitimately exercise authority over the resources of the state. This exercise of authority is however subject to judicial scrutiny.

Over the years, South African courts have been a judicial editor for serious disagreements about the certain exercise of power which might or might not infringe on the ambit of the Constitution.

The constitutionality of the exchange control exit levy imposed on funds that are remitted from South Africa was challenged in *Shuttleworth v South African Reserve Bank*.<sup>32</sup> In its judgment, the Supreme Court of Appeal said that 'A founding principle of Parliamentary democracy is that there should be no taxation without representation and that the executive branch of government should not itself be entitled to raise revenue but should rather be dependent on the taxing power of Parliament, which is democratically accountable to the country's tax-paying citizenry.'

The court pointed out that 'Our constitution is careful to ensure that the power of taxation is tightly controlled in that section 77(1) of the Constitution which

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<sup>31</sup> Ibidat para 22.2.

<sup>32</sup> *South African Reserve Bank and Another v Shuttleworth and Another* 2016 (78 SATC 23)

defines what constitutes a 'money bill' and section 73(2) provides that only the Minister of Finance may introduce a money bill in the National Assembly.'

Thus, 'the ordinary power of the National Assembly and the National Council of Provinces to initiate and prepare legislation does not extend to the initiation or preparation of money bills. All these constitutional provisions thus render it unconstitutional for taxes or levies to be raised by delegated legislation which is not specifically authorised in a money bill enacted by the money bill provisions of the Constitution.'

The court held that the process by which the 10% levy had been imposed, which was a tax, was unconstitutional. This decision was reversed on appeal by the Constitutional Court on the basis that the exit charge was not a tax since the raising of revenue was not its dominant purpose, and was merely incidental: however, the principles were not dissented from.<sup>33</sup>

The judicial system provides an assuring comfort to potential investors that South Africa's investment climate is based on legitimate legal systems.

### 2.2.3 Investment context

The regulatory authority of investment is specifically provided for in key legislative frameworks that govern foreign investment. To support the economic objectives, certain pieces of legislation are relevant. These are:

- **Protection of Investment Act 22 of 2015.** This Act provides a degree of protection to investors about their investments and aims to achieve a balance of rights and obligations that apply to all investors. 'The Act attempts, among other things, to codify standard bilateral investment treaty (BIT) provisions and provide domestic legislation that deals with investor-state relations'.<sup>34</sup>

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<sup>33</sup> de Koker

<sup>34</sup> Magubane, L 'Investment protection legislation in South Africa' available at <https://www.dlapiper.com/en/southafrica/insights/publications/2018/11/africa-connected-doing-business-in-africa/investment-protection-legislation-in-south-africa/> accessed on 7 September 2023.

- **Companies Act 71 of 2008 (Companies Act).** This law provides for the incorporation, registration, organisation and management of companies, the capitalisation of profit companies and the registration of offices of foreign companies carrying on business within South Africa.<sup>35</sup>
- **Broad-Based Black Economic Empowerment Act 53 of 2003.** This is a legislative framework for the promotion of black economic empowerment in South Africa.<sup>36</sup>

The Protection of Investment Act defines investment in a way that 'foreign investors may find it relatively easy to fall within its scope and enjoy the protection it offers.'<sup>37</sup> It outlines the definition as:

- Any lawful enterprise established, acquired, or expanded by an investor by the laws of South Africa, committing resources of economic value over a reasonable period, in anticipation of profit;<sup>38</sup>
- The holding or acquisition of shares, debentures, or other ownership instruments of such enterprise; or <sup>39</sup>
- The holding, acquisition, or merger by such an enterprise with another enterprise outside South Africa to the extent that such holding, acquisition, or merger with another enterprise outside South Africa influences investment in South Africa.<sup>40</sup>

In this regard, the UNCTAD introduced the term 'New generation' investment policies which place inclusive growth and sustainable development at the

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<sup>35</sup> Phalane, J and Hirschowitz, D 'Investing in South Africa' available at [https://uk.practicallaw.thomsonreuters.com/w-019-5868?transitionType=Default&contextData=\(sc.Default\)&firstPage=true#co\\_anchor\\_a344857](https://uk.practicallaw.thomsonreuters.com/w-019-5868?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a344857), accessed on 27 November 2022.

<sup>36</sup> Ibid.

<sup>37</sup> Magubane 'Investment protection legislation in South Africa' available at <https://www.dlapiper.com/en/southafrica/insights/publications/2018/11/africa-connected-doing-business-in-africa/investment-protection-legislation-in-south-africa/> accessed on 7 September 2023.

<sup>38</sup> Protection of Investment Act 22 of 2015 s 2(1)(a).

<sup>39</sup> Ibid s 2(1)(b)

<sup>40</sup> Ibid s 2(1)(c)

heart of efforts to attract and benefit from the investment.<sup>41</sup> This is broadly characterized by:

- a recognition of the role of investment as a primary driver of economic growth and development and the consequent realization that investment policies are a central part of development strategies; and
- a desire to pursue sustainable development through responsible investment, placing social and environmental goals on the same footing as economic growth and development objectives. Furthermore,
- a shared recognition of the need to improve the effectiveness of policies to promote and facilitate investment.

These three broad aspects of 'new generation' investment policies, *UNCTAD*<sup>42</sup> argued, translate into specific investment policy challenges at the national and international levels. It seems clear that the key investment policy challenge is to strike the right balance between regulations and openness which influence investment activities in the country's economy.

Therefore, it remains important for the investment policy framework to be grounded on the Constitution to firmly entrench the principle of certainty that investors often seek.

### 2.3 The policy framework

While South Africa's democracy is viewed as a peaceful transition from the previous regime, a lack of policy certainty is often argued as being a blemish on this achievement. A lack of progress towards a more balanced distribution of opportunities and income seems to raise difficult political and economic questions about the kinds of social, economic, or institutional change that

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<sup>41</sup> UNCTAD 'Investment Policy Framework for Sustainable Development. United Nations Conference on Trade and Development' available at [https://unctad.org/system/files/official-document/diaepcb2015d5\\_en.pdf](https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf), accessed on 7 September 2023. 17.

<sup>42</sup> Ibid at 17.

might contribute to the more rapid transformation of opportunities for the bottom half of the household income distribution.<sup>43</sup>

The lack of policy certainty remains one of several factors which cause an undesirable decline in economic growth and development.<sup>44</sup> The FFC also found that low investment and consumer confidence resulted from increased uncertainty regarding the direction of policies.<sup>45</sup> Such policy certainty would arguably provide a fertile environment for investment that would lead to distributional opportunities. This section evaluates policy development which seeks to address the desirability to invest in South Africa.

### 2.3.1 The National Development Plan 2030

The National Development Plan 2030 (NDP), as a policy guideline envisions the support of the government's intention to gradually shift state resources towards investments that reshape the economy, broaden opportunities, and enhance capabilities.<sup>46</sup> The Plan was adopted in 2011 by the government as a formative plan of the State which would inspire all government actions over twenty years. It covers a wide variety of areas, from the economy to security, from strengthening the capacity of the state to reducing the high levels of crime and corruption.

The NDP sets out a long-term vision for the country and provides a programme through which government can advance economic transformation through development planning. This plan was prominent in the Medium-Term Strategic Framework 2019-2024 (MTSF)<sup>47</sup>, which outlined the

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<sup>43</sup> SA-TIED 'Turning the tide on inequality' available at <https://sa-tied.wider.unu.edu/turning-tide-inequality>, accessed on 7 July 2023.

<sup>44</sup> Department of Planning Monitoring & Evaluation 'A strong and inclusive economy' available at [https://www.dpme.gov.za/keyfocusareas/outcomesSite/MTSF\\_2019\\_2024/2019-2024%20MTSF%20PRIORITY%202.pdf](https://www.dpme.gov.za/keyfocusareas/outcomesSite/MTSF_2019_2024/2019-2024%20MTSF%20PRIORITY%202.pdf), accessed on 8 August 2023. 49.

<sup>45</sup> Financial and Fiscal Commission 'Submission on the 2018 fiscal framework and revenue proposals' available at [file:///C:/Users/4649/Downloads/Final\\_Approved\\_Version\\_FFC\\_Submisison\\_on\\_2018\\_Fiscal\\_Framework\\_Revenue\\_Proposals-Update%20\(1\).pdf](file:///C:/Users/4649/Downloads/Final_Approved_Version_FFC_Submisison_on_2018_Fiscal_Framework_Revenue_Proposals-Update%20(1).pdf), accessed on 6 September 2023. 8.

<sup>46</sup> National Planning Commission 'National Development Plan 2030, Executive Summary' available at [https://www.nationalplanningcommission.org.za/National\\_Development\\_Plan](https://www.nationalplanningcommission.org.za/National_Development_Plan), accessed on 7 September 2023. 50.

<sup>47</sup> Department of Planning Monitoring & Evaluation 'Medium-term strategic framework 2019-2024' available at <https://www.poa.gov.za/Pages/MTSF.aspx>, accessed on 8 August 2023. 5.

framework for implementing the NDP. This MTSF outlines the priorities and interventions to be implemented across South Africa's national development pillars.

The foremost objective of the government is to address the challenges of unemployment, inequality, and poverty through three pillars of the NDP:

- achieving a more capable state,
- driving a strong and inclusive economy, and
- building and strengthening the capabilities of South Africa.<sup>48</sup>

The economic development function is aimed at supporting job creation, industrial development, and inclusive and sustainable economic growth. The spending in this function group is mainly driven by transfers and subsidies for incentive programmes, many of which are part of the economic recovery plan.<sup>49</sup>

These policy objectives flow into plans of relevant sectors such as tourism, Trade and Industry, and thereby inform the policy instruments which attract investment.

### 2.3.2 Fiscal policy as an instrument to achieve policy objectives

Appropriate tools are the cornerstone for overcoming challenges and achieving developmental objectives such as job creation, industrial development, and inclusive and sustainable economic growth.

The South African government noted that growing the economy in an inclusive manner is the fundamental challenge it is confronted with, which is the principal goal that is identified in the NDP. For this reason, the government committed to 'utilise all the levers of power at our disposal to significantly enhance the level of ownership', which would entail 'deploying the regulatory power of the state as well as targeted incentives to induce

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<sup>48</sup> Ibid at 13.

<sup>49</sup> National Treasury 'Medium Term Budget Policy Statement' available at <http://www.treasury.gov.za/documents/mtbps/2020/mtbps/FullMTBPS.pdf>, accessed on 8 August 2023. 42.

appropriate change. We will use the budget to pursue the goal of inclusive economic growth.'<sup>50</sup>

Globally, fiscal policy is viewed as a crucial part of the economic framework. 'The central theme of fiscal policy includes development activities like expenditure on railways, infrastructure, etc. Non-development activities include spending on subsidies, salaries, pensions, etc. It gives incentives to the private sector to expand its activities.'<sup>51</sup> This is also the case in the South African context.

Effectively, the fiscal policy is expected to expand investment and divert resources from less desirable activities to more desirable investment channels. According to the NDP aspirations, fiscal policy must maintain the condition of full employment, and economic stability and stabilize the rate of growth. *Pragyandeepa* also agrees that 'fiscal policy should try to remove the bottlenecks and structural rigidities which can use imbalance in various sectors of the economy. Moreover, it should strengthen physical controls of essential commodities, granting of concessions, subsidies, and protection in the economy.'<sup>52</sup> However, this remains a hot debate as to whether South Africa has been effective in this task.

### 2.3.2.1 Brief history of fiscal policy in South Africa

The history of fiscal policy in South Africa dates back many decades and has been a bitter-sweet story since 1994. Commentators such as *Stan du Plessis and Wimpie Boshoff*<sup>53</sup> have referred to the first half of the last two decades as 'a remarkable story', adding that the fiscal situation had deteriorated sharply in the run-up to the 1994 elections. However, in his *Journal of the Helen Suzman Foundation*, Donaldson argues that the 'broadly expansionary fiscal

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<sup>50</sup> Zuma '5th anniversary of adoption of National Development Plan' available at <https://www.gov.za/speeches/president-jacob-zuma-5th-anniversary-adoption-national-development-plan-12-sep-2017-0000>, accessed on 15 July 2023.

<sup>51</sup> Business Standards 'What is fiscal policy' available at <https://www.business-standard.com/about/what-is-fiscal-policy>, accessed on 25 August 2021.

<sup>52</sup> Pragyandeepa 'Top 8 objectives of fiscal policy' available at <https://www.economicdiscussion.net/fiscal-policy/top-8-objectives-of-fiscal-policy/4694>, accessed on 7 June 2023.

<sup>53</sup> du Plessis, S and Boshoff, W 'A fiscal rule to produce counter-cyclical fiscal policy in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 7 September 2023.

stance continued until 2012. However, growth and revenue outcomes continued to lag well behind budget projections. By 2013, the budget deficit was still over 4 per cent of GDP, net debt had increased to 36 per cent of GDP and the Budget Review signalled that there was no further room for fiscal stimulus.<sup>54</sup>

One of the important milestones of fiscal reform was the PFMA<sup>55</sup>, which legislated the need for regular financial reporting, sound expenditure controls and a strengthened system of supervision and audit. In addition, the Money Bills Amendment Procedure and Related Matters Act<sup>56</sup> was promulgated to give Parliament powers to amend the budget and other money bills before it.

In 2013, the fiscal framework in the Budget Review introduced a shift in policy aimed at stabilising debt by containing future expenditure within pre-announced ceilings and phasing in a higher revenue-GDP target.<sup>57</sup> 'Introducing a debt ceiling is a credibility-building mechanism, that is, should the government succeed in limiting the debt/GDP ratio to below the ceiling, it demonstrates the government's commitment to fiscal discipline.'<sup>58</sup> By 2017, weak economic growth, the upward drift of the debt-GDP ratio, and a crisis of confidence in economic policy had led to credit rating downgrades to below investment grade.<sup>59</sup>

There are critical measures and interventions that fiscal policy and the public finances can make to both a growth recovery and its distributional impact. For example, a well-designed employment subsidy provided added the advantage of encouraging formalisation of earnings and employment,

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<sup>54</sup> Donaldson, A 'Fiscal policy since the Great Recession' available at <https://hsf.org.za/publications/focus/focus-82-the-economy/5-a-donaldson.pdf>, accessed on 7 September 2023.

<sup>55</sup> Public Finance Management Act of 1999

<sup>56</sup> Money Bills Amendment Procedure and Related Matters Act of 2009

<sup>57</sup> National Treasury 'Budget Review 2013' available at <http://www.treasury.gov.za/documents/national%20budget/2013/review/FullReview.pdf>, accessed on 7 September 2023.

<sup>58</sup> P and Calitz Burger, E 'Covid-19, economic growth and South African Fiscal Policy' (2020) 89 *South African Journal of Economics*

<sup>59</sup> Donaldson 'Fiscal policy since the Great Recession' available at <https://hsf.org.za/publications/focus/focus-82-the-economy/5-a-donaldson.pdf>, accessed on 7 September 2023. 27.

compliance with labour standards and tax obligations, and participation in social security arrangements.<sup>60</sup>

The government's fiscal consolidation commitment was firmly reinforced in the 2018 Budget, which introduced substantial spending reductions across most functions together with the value-added tax (VAT) increase in over twenty years.<sup>61</sup> However, some commentators argue that fiscal policy in South Africa has seen successful consolidation over time, but it was not effectively used as an active component of stabilisation policy over this period.<sup>62</sup>

### 2.3.2.2 Tax policy

A country's tax policy 'is not only an expression of national sovereignty, but it is at the core of this sovereignty, and each country is free to devise its tax system in the way it considers most appropriate.'<sup>63</sup> According to the International Monetary Fund (IMF)<sup>64</sup>, taxation is the only practical means of raising revenue to finance government spending on the goods and services that most of us demand. This demonstrates the significance of taxation as one of the policy instruments to stimulate the economy.

The IMF maintained that the ideal tax system for developing countries should raise essential revenue without excessive government borrowing and should do so without discouraging economic activities, and without deviating too much from tax systems in other countries.<sup>65</sup> Such decisions form the basis of tax policy formulation.

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<sup>60</sup> Ibid at 29.

<sup>61</sup> National Treasury 'Budget Review 2018' available at <http://www.treasury.gov.za/documents/national%20budget/2018/review/FullBR.pdf>, accessed on 7 September 2023.

<sup>62</sup> du Plessis 'A fiscal rule to produce counter-cyclical fiscal policy in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 7 September 2023. 8.

<sup>63</sup> Organisation for Economic Cooperation and Development 'Addressing base erosion and profit shifting' available at [https://www.oecd-ilibrary.org/taxation/addressing-base-erosion-and-profit-shifting\\_9789264192744-en](https://www.oecd-ilibrary.org/taxation/addressing-base-erosion-and-profit-shifting_9789264192744-en), accessed on 7 September 2023. 28.

<sup>64</sup> Tanzi, V. and Zee, H. 'Tax policy for developing countries' available at <https://www.imf.org/external/pubs/ft/issues/issues27/>, accessed on 8 September 2023. 1.

<sup>65</sup> Ibid.

While every jurisdiction is free to establish its corporate tax system as is suitable to its objectives, in South Africa specific tax policy principles include the following:

- the Davis Committee sighted an important challenge to 'ensure that tax does not produce unintended and distortive effects on cross-border trade and investment or that it distorts competition and investment within each country by disadvantaging domestic players.'<sup>66</sup>
- As an instrument of fiscal policy to increase the rate of investment, 'tax policies must discourage unproductive and speculative investment, be used to curb excessive consumption, and must encourage an inflow of foreign capital.'<sup>67</sup>

Fiscal policy is consistently a hotly contested topic as the economy meets politics, but more importantly, ratings agencies often take a very long hard look at South Africa's fiscal policy. The government also concedes that its 'fiscal position is a risk to growth'<sup>68</sup> and that urgent reforms are important for investor confidence.

Like many other economies, the SA government is a major player in economic activities, it is 'responsible for 18% of total activity in the South African economy. This makes government the second biggest industry after finance and business services.'<sup>69</sup> This is done through the development of large-scale infrastructural projects or the provision of resources to the poor in the form of social grants.

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<sup>66</sup> Davis, D. 'Second interim report on Base Erosion and Profit Shifting (BEPS) in South Africa' available at <https://www.taxcom.org.za>, accessed on 7 September 2023. p. 23

<sup>67</sup> S Chand 'Role of fiscal policy in developing countries' available at <https://www.yourarticlelibrary.com/policies/role-of-fiscal-policy-in-developing-countries/26320>, accessed on 9 September 2023.

<sup>68</sup> National Treasury 'Medium Term Budget Policy Statement' available at <http://www.treasury.gov.za/documents/mtbps/2020/mtbps/FullMTBPS.pdf>, accessed on 8 August 2023. 14.

<sup>69</sup> South African Market Insights 'Fiscal policy, taxes and government spending' available at <https://www.southafricanmi.com/south-africas-fiscal-policy.html>, accessed on 18 August 2022.

The National Treasury (NT) is 'central to macroeconomic policy in South Africa and holds a key role in maintaining macroeconomic stability around an achievable path of growing output capacity.'<sup>70</sup> Several reforms have been proposed and some implemented over time since the beginning of the democratic government of South Africa.

It seems that, with these policy interventions, the government has been hoping for a Social Compact that would develop in two-fold in its mandate and manifestation.

- A compact between all the social partners in the South African ecosystem, to establish shared values and a unified vision for the reconstruction and recovery of South Africa's economy.
- That together the collective forces of labour, business, and communities rural and urban alike, harness the full capacity and potential of resources.

This united front will also be entering a compact with the investor community to establish a win-win approach to driving new growth, jobs and innovation that will put us back on track towards Vision 2030 as set out in the NDP.<sup>71</sup> In this regard, the government is tasked with designing tax instruments that can optimally fulfil a revenue-raising function. Moreover, these tax instruments must be reformed to align with the government's economic and social policy objectives.<sup>72</sup>

## 2.4 Budget reforms since democracy

The Budget is an important policy, planning and monitoring instrument that can be used by Parliament to oversee the alignment of the proposed expenditure with government policy priorities and more broadly alignment to

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<sup>70</sup> SA-TIED 'Macroeconomic modelling for policy formulation' available at <https://sa-tied.wider.unu.edu/macroeconomics>, accessed on 7 July 2023.

<sup>71</sup> Presidency 'The South African Economic Reconstruction and Recovery Plan' available at [https://www.gov.za/sites/default/files/gcis\\_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf](https://www.gov.za/sites/default/files/gcis_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf), accessed on 8 August 2023. 29.

<sup>72</sup> Presidency 'Economy and finance' available at <https://www.gov.za/about-sa/economy>, accessed on 8 August 2023.

the National Development Plan (NDP) goals as well as other short-term goals such as dealing with the Covid-19 pandemic. The Budget can also be used as an oversight tool for monitoring the implementation and achievement of priority service delivery outputs toward the realisation of the NDP goals.<sup>73</sup> What remains questionable is the element of review and monitoring.

In this regard, a 25 Year Review<sup>74</sup> was conducted by the government which analysed the challenges and achievements of the democratic government and has been used as a reference for this Medium-Term Strategic Framework (MTSF). The Review recommended that South Africa must build a 'national compact on economic transformation', that addresses economic exclusion, inequality, and unemployment through the creation of more jobs; sustained land reform and an agrarian revolution; deconcentrate the economy and promote growth; develops an industrial plan for localisation and innovation; development and maintenance of infrastructure; all driven by a democratic developmental state.<sup>75</sup>

By its admission, the government states, in the 25 Year Review and MTSF,<sup>76</sup> that 'none of these measures are new. South Africa, therefore, requires a pragmatic and realistic implementation plan based on appropriate economic development strategies.' It is the strategies such as the fiscal framework which seek to achieve these objectives through measures such as incentive programs to attract investment. This is a global phenomenon as many countries target tax incentives to a specific industry to develop new industries or revive older industries.<sup>77</sup>

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<sup>73</sup> Lings, K and Mphaphuli, V 'Budget 2021: setting a path towards economic recovery by stabilising public finances' available at <https://stanlib.com/2021/02/24/budget-2021-setting-the-economy-on-the-road-to-recovery/>, accessed on 7 September 2023. 1.

<sup>74</sup> Presidency 'Towards a 25 year review 1994-2019' available at [https://www.gov.za/sites/default/files/gcis\\_document/201911/towards25yearreview.pdf](https://www.gov.za/sites/default/files/gcis_document/201911/towards25yearreview.pdf), accessed on 8 August 2023.

<sup>75</sup> Ibid at 241.

<sup>76</sup> Department of Planning Monitoring & Evaluation 'Medium-term strategic framework 2019-2024' available at <https://www.poa.gov.za/Pages/MTSF.aspx>, accessed on 8 August 2023. 17.

<sup>77</sup> Calitz, E Wallace, S and Le Roux, B 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 6.

### 2.4.1 Katz commission

It seems that due regard and credit should be attributed to the Katz Commission in the efforts to transform the tax system in South Africa. The central challenge which faced the new democratic government was to 'build a modern, vibrant economy that could assume its rightful place in the global economic community while addressing the massive backlogs in access to vital social and economic services, which was manifest in the extreme inequality of income and wealth.'<sup>78</sup>

The Katz Commission was announced in June 1994 with a broad mandate to investigate virtually every aspect of the South African tax regime inherited from the previous government against the backdrop of the political, social and economic goals of the incumbent government.<sup>79</sup> Among the major recommendations under the theme of 'tax base broadening initiative' were the:

- introduction of Capital Gains Tax (CGT) in 2001 with the two broad principles of 'fairness and economic efficiency and 'International competitiveness'.
- taxation of Worldwide Income. In 2001, South Africa began taxing its residents on a worldwide basis. South African individuals and companies are now taxed on foreign source income as a general matter.
- shift from harmful tax practices to internationally acceptable investment incentives. The government took steps to move away from harmful tax practices (whereby a country attracts foreign investment by offering tax holidays and other 'ring-fenced' incentives not available to local companies). South Africa instead

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<sup>78</sup> Manuel, T 'The South African tax reform experience since 1994' available at [http://www.treasury.gov.za/comm\\_media/speeches/2002/2002102501.pdf](http://www.treasury.gov.za/comm_media/speeches/2002/2002102501.pdf), accessed on 31 January 2023. 1.

<sup>79</sup> Ibid at 2.

seeks to incentivise local investment by using more effective and internationally acceptable means.<sup>80</sup>

The Katz Commission faced the difficult task of recommending immediate reforms which would be introduced in the 1995 Budget while establishing a framework for medium and long-term tax reform.<sup>81</sup> Recommendations reforming the administrative machinery dominated the early work of the Commission and were an important consideration throughout the Commission's reports.<sup>82</sup> The first interim report set out the guiding principles of tax reform that should underpin all proposals to restructure the tax regime.<sup>83</sup>

The fiscal policies applied during the early years responded to economic challenges through tax cuts and growth in spending. The budget framework overtime progressed in key fiscal indicators, and government consumption expenditure had stabilised.<sup>84</sup>

#### 2.4.2 The motive for fiscal reforms

Tanzi and Zee summed up as they evaluated the Tax Policy for Developing Countries that 'the best strategy for sustained investment promotion is to provide a stable and transparent legal and regulatory framework and to put in place a tax system in line with international norms.'<sup>85</sup> The emerging markets would therefore be well advised to align their policy priorities with international trends and implement necessary reforms.

South Africa's case is no different, Industrial policy takes place in a highly fiscally contested space. With multiple pressing concerns (education, health, etc.), a tightly constrained budget, and divisions within government about the

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<sup>80</sup> Ibid at 8.

<sup>81</sup> Ibid.

<sup>82</sup> Parliament 'Final Draft Report of the Joint Standing Committee on Finance on the Third Interim Report of the Katz Commission of Inquiry Into Taxation' available at <http://www.treasury.gov.za/publications/other/katz/3.pdf>, accessed on 7 September 2023.

<sup>83</sup> Manuel 'The South African tax reform experience since 1994' available at [http://www.treasury.gov.za/comm\\_media/speeches/2002/2002102501.pdf](http://www.treasury.gov.za/comm_media/speeches/2002/2002102501.pdf), accessed on 31 January 2023.

<sup>84</sup> National Treasury 'Medium term budget policy statement' available at <http://www.treasury.gov.za/documents/mtbps/2001/3.pdf>, accessed on 8 August 2023. 29.

<sup>85</sup> Tanzi 'Tax policy for developing countries' available at <https://www.imf.org/external/pubs/ft/issues/issues27/>, accessed on 8 September 2023. 12.

scale and allocation of spending, industrial policy cannot be used to transform every aspect of the economy all at once. For example, as early as 2003, Barnes<sup>86</sup> found that the distinctive feature of the industrial policy affecting the South African auto industry is the effective array of selective policies which were adopted.

Other reasons for fiscal reforms include the context of a need for increased revenue. Most countries implemented tax reforms with the stated objectives of improving efficiency, equity, neutrality, and administrative simplicity of tax systems.<sup>87</sup> The IMF found these countries to have experienced an increase in tax-to-GDP ratios.

There are signs around the globe, particularly in Africa, that the investment competition is gaining momentum. Other economies on the continent are 'steadily catching up with South Africa'. 'The reality in SA is that we are operating in a zero-sum game.' Stimulating growth is a clear solution, and rebalancing the incentives programmes to attain growth is expected to be the government's top priority.<sup>88</sup> This would go a long way to achieve the distributional objectives of fiscal policy. Further discussion on incentives follows in the next chapter.

## 2.5 Distributional impact of fiscal policy

The fiscal policy in developing countries should be conducive to rapid economic development. In a poor country, fiscal policy can no longer remain a compensatory fiscal policy. It has a tough role to play in a developing economy and must face the problem of growth-cum-stability. This is the view shared by Chand.<sup>89</sup> Chand argues that the effectiveness of fiscal measures in

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<sup>86</sup> Barnes, J Kaplinsky, R and Morris, M 'Industrial policy in developing economies: developing dynamic comparative advantage in the south african automobile sector' available at <http://www.ids.ac.uk/ids/global/pdfs/RJ&JB03.pdf>, accessed on 6 September 2023. 20.

<sup>87</sup> Shome, P 'Tax Policy Handbook' available at <https://www.elibrary.imf.org/view/books/071/06719-9781557754905-en/06719-9781557754905-en-book.xml>, accessed on 8 August 2023. 3.

<sup>88</sup> KPMG 'Incentivise your investment strategy: a guide to South African government and tax incentives' available at <https://home.kpmg/content/dam/kpmg/za/pdf/2021>, accessed on 7 September 2023. 3.

<sup>89</sup> Chand 'Role of fiscal policy in developing countries' available at <https://www.yourarticlelibrary.com/policies/role-of-fiscal-policy-in-developing-countries/26320>, accessed on 9 September 2023.

promoting development depends on the incentives administered to the strategic points in the productive set-up by the consequences of taxation and public spending.

'To reduce inequalities and to do distributive justice, the government should invest in those productive channels which incur benefit to low-income groups and help raise their productivity and technology.'<sup>90</sup> The question is how South Africa has used fiscal policy instruments like taxation and government expenditure to reduce inequalities in income and wealth distribution.

While many commentators agree that the government has done much to improve livelihood over time, no consensus is evident for 'reduced poverty nor increased growth'. Fiscal policies also do not seem to be specific enough to be able to measure the desired impact as envisaged by Fraser Sherman in her article on *Advantages & Disadvantages of Fiscal Policy*.<sup>91</sup>

Whereas in recent years the fiscal space has become more limited, over time, the government 'has progressively expanded its fiscal programs to help address poverty and inequality while maintaining sound fiscal indicators. It broadened the tax base and built an efficient tax administration to generate the resources it needed to progressively expand the social safety net for the poor.'<sup>92</sup>

*Inchauste et al.* found that 'results show that South Africa uses its fiscal instruments to effectively reduce market income poverty and inequality through a slightly progressive tax system and highly progressive social spending but despite this, the levels of inequality and poverty remain unacceptably high'.<sup>93</sup>

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<sup>90</sup> Pragyandeepa 'Top 8 objectives of fiscal policy' available at <https://www.economicdiscussion.net/fiscal-policy/top-8-objectives-of-fiscal-policy/4694>, accessed on 7 June 2023.

<sup>91</sup> Sherman, F 'Advantages & Disadvantages of Fiscal Policy' available at <https://smallbusiness.chron.com/pros-cons-contractionary-monetary-policy-3871.html>, accessed on 8 August 2023.

<sup>92</sup> Inchauste, G Lustig, N Maboche, M Purfield, C and Woolard, I 'The distributional impact of fiscal policy in South Africa' available at <https://documents1.worldbank.org/curated/en/502441468299632287/pdf/WPS7194.pdf>, accessed on 7 September 2023. 3.

<sup>93</sup> Ibid at 35.

Notwithstanding, like many governments, South Africa is not without limitations on fiscal policy. The government does not always have the option to use fiscal policy to shape the economy or handle problems, 'they don't occupy a good fiscal space' envisaged by Sherman. Government activities such as borrowing often worry potential investors that such 'stimulus spending will do the economy more harm than good or that the government won't spend any added funds wisely.'<sup>94</sup>

These limits are however not without possible solutions. The IMF proposes measures to avoid the cons of fiscal policy:

- The stimulus shouldn't have a permanent effect on deficits.
- The government should commit to getting the spending back to normal once conditions improve.
- The government should look for structural reforms it can make that will boost growth.<sup>95</sup>

Some of these measures such as 'structural reforms'<sup>96</sup> have been well-ventilated by the government in recent Budget announcements. It remains 'addressing the twin challenges of poverty and inequality in a way that is consistent with fiscal sustainability requires higher and more inclusive economic growth to support fiscal policy'.<sup>97</sup>

## 2.6 Conclusion

Whereas global trends inevitably influence domestic policy, a sovereign state must recognise that the importance of establishing evidence for policies such as tax incentives cannot be overstated. It has been argued that 'too often

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<sup>94</sup> Sherman 'Advantages & Disadvantages of Fiscal Policy' available at <https://smallbusiness.chron.com/pros-cons-contractionary-monetary-policy-3871.html>, accessed on 8 August 2023.

<sup>95</sup> Ibid.

<sup>96</sup> National Treasury 'Budget Review 2021' available at <http://www.treasury.gov.za/documents/National%20Budget/2021/review/FullBR.pdf>, accessed on 7 September 2023.

<sup>97</sup> Inchauste 'The distributional impact of fiscal policy in South Africa' available at <https://documents1.worldbank.org/curated/en/502441468299632287/pdf/WPS7194.pdf>, accessed on 7 September 2023. 36.

policies march forward with little consideration of the cost-benefit and opportunity cost of specific policy interventions.<sup>198</sup>

The interventions that are aimed at mitigating these challenges should be taken within a supportive macroeconomic framework, which balances the need to restore fiscal sustainability with economic growth that attracts investment.<sup>99</sup> Given South Africa's relatively high revenue burden compared to other Emerging Market economies, there is little scope for South Africa to increase tax rates in future if it is to remain competitive with other Emerging Markets. Doing so will serve as a disincentive for individuals and companies to earn their income and be taxed in South Africa.<sup>100</sup>

The Financial and Fiscal Commission (FFC) has found that one of the challenges for South Africa is that 'policies and programmes that have been introduced at the various levels of government lack completeness and integration in their implementation.'<sup>101</sup>

Policy certainty or lack thereof has a serious impact on investor confidence. Currently, South Africa remains confronted with many unresolved fiscal pressures in the broader public sector such as; state-owned companies, municipalities, etc.<sup>102</sup> Such fiscal trajectory is a major source of uncertainty – a serious factor for investment.

To succeed in policy objectives, a greater focus of policy instruments will have to go on economic investment, trade, skills, and enterprise development.

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<sup>98</sup> Calitz 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 4.

<sup>99</sup> Government Communication and Information System 'Highlights of the economic reconstruction and recovery plan' available at [https://www.gov.za/sites/default/files/gcis\\_documents/Economic%20Recovery%20Plan%20Publication\\_highlights.pdf](https://www.gov.za/sites/default/files/gcis_documents/Economic%20Recovery%20Plan%20Publication_highlights.pdf), accessed on 7 September 2023.

<sup>100</sup> Burger 'Covid-19, economic growth and South African Fiscal Policy' (2020) 89 *South African Journal of Economics*

<sup>101</sup> Financial and Fiscal Commission 'Funding and policy framework for supporting urban informal employment' available at [https://ffc.co.za/wp-content/uploads/2021/04/2017\\_Policy\\_Brief\\_9\\_Funding\\_And\\_Policy\\_Framework\\_For\\_Supporting\\_Urba\\_Informal\\_Employment.pdf](https://ffc.co.za/wp-content/uploads/2021/04/2017_Policy_Brief_9_Funding_And_Policy_Framework_For_Supporting_Urba_Informal_Employment.pdf), accessed on 6 September 2023.

<sup>102</sup> National Treasury 'Medium Term Budget Policy Statement' available at <http://www.treasury.gov.za/documents/mtbps/2020/mtbps/FullMTBPS.pdf>, accessed on 8 August 2023. 21.

Cities should be developed to be places of work opportunity, with the ease of doing business as a key indicator of progress.<sup>103</sup>

## CHAPTER 3: ASSESSING THE INFLUENCE OF INCENTIVES

### 3.1 Introduction

This chapter assesses the influence of incentives in the financial system, and whether they effectively support the policy framework discussed in chapter 2 above. This is done by evaluating the concept of incentives framework in South Africa, and whether the design is appropriately aligned with the objectives. The chapter will conclude by evaluating what the literature offers as an assessment of the costs and benefits of incentives, and whether they provide the desired tax expenditure which brings about the desired outcomes.

### 3.2 A conceptual framework of Incentives in South Africa

While this research does not attempt to advance the politics of taxation, admittedly, the role of a 'tax system cannot be divorced from the broader fiscal and macro-economic policy, or from more general conceptualisation of the role of the state itself within a particular political system.'<sup>104</sup>

The South African government acknowledged in the early years of democracy that 'it is imperative that the tax regime is supportive of private investment' and proceeded to implement these 'tax reforms with the distinct purpose of aggressively broadening the tax base, thereby affording significant rate reduction in line with international trends'.<sup>105</sup> Such efforts come

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<sup>103</sup> Donaldson 'Fiscal policy since the Great Recession' available at <https://hsf.org.za/publications/focus/focus-82-the-economy/5-a-donaldson.pdf>, accessed on 7 September 2023. 2.

<sup>104</sup> Davis, D 'Tax system and inclusive growth in south africa - Interim report' available at <https://www.taxcom.org.za/>, accessed on 7 September 2023.

<sup>105</sup> Manuel 'The South African tax reform experience since 1994' available at [http://www.treasury.gov.za/comm\\_media/speeches/2002/2002102501.pdf](http://www.treasury.gov.za/comm_media/speeches/2002/2002102501.pdf), accessed on 31 January 2023. 5.

a long way and can be traced back to the Katz Commission<sup>106</sup>, which provided a report with proposals on the comprehensive review of the country's tax systems and structure.

### 3.2.1 Incentives defined

The Katz Commission stated that tax incentives 'are a form of special pleading, a preferential treatment to a particular group' and as such they should be treated as a subsidy provided by the government. It noted that incentives often lead to lobbying by groups whose aim is to retain their vested interest. The Commission stated that 'the range of incentives should be narrowed as far as possible'. The Davis Tax Committee has proposed a detailed review of corporate tax incentives and the removal of inefficient subsidies.<sup>107</sup>

According to *Calitz*, Incentives may relieve tax liabilities completely, or partially, provide preferred rates, deductions, and exemptions and may fall under one tax or many. Incentives are given by central governments as well as subnational governments. Incentives may be very localized with the expectation of generating investment in one region of a country or may be developed with the expectation of increasing investment at large.<sup>108</sup> Incentives in a broader sense can be viewed as one of the key enablers that government can put in place to ensure successful implementation of their objectives to enhance investor and public confidence, and create a supportive policy environment and enabling conditions for ease of doing business.<sup>109</sup>

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<sup>106</sup> Parliament 'Final Draft Report of the Joint Standing Committee on Finance on the Third Interim Report of the Katz Commission of Inquiry Into Taxation' available at <http://www.treasury.gov.za/publications/other/katz/3.pdf>, accessed on 7 September 2023. 28-30.

<sup>107</sup> National Treasury 'Budget Review 2020' available at <http://www.treasury.gov.za/documents/national%20budget/2020/review/FullBR.pdf>, accessed on 7 September 2023.

<sup>108</sup> *Calitz* 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 5.

<sup>109</sup> Presidency 'The South African Economic Reconstruction and Recovery Plan' available at [https://www.gov.za/sites/default/files/gcis\\_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf](https://www.gov.za/sites/default/files/gcis_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf), accessed on 8 August 2023. 4.

Based on this definition, it is important to discuss the investment brought about by the implementation of incentives.

### 3.2.2 Investment incentives

The general aim of investment incentives is to influence the locational decisions of investors and thus reap the positive effects of foreign direct investment (FDI). Investment incentives may also be provided to shape the benefits of FDI by stimulating foreign affiliates to operate in desired ways or to direct them into regions or industries considered in need of investment. For example, investment incentives may refer to grants to locally based companies for investing in advanced technologies or to subsidies to foreign firms investing in the locality.<sup>110</sup>

There are three main categories of investment incentives, which can be implemented on local, regional, national, and supranational levels: financial incentives, such as various grants and loans; fiscal incentives, such as tax holidays and reduced tax rates; and other incentives, such as subsidized infrastructure, market preferences, and regulatory concessions. The incentives may be selective and discriminate based on the size of the investment or its origin. Generally, developed countries and economies in transition frequently employ financial incentives, whereas developing countries prefer fiscal measures. Many developing countries have established free-trade zones, where normal domestic regulatory requirements do not apply.<sup>111</sup>

Investment incentives, however, seem to play a rather limited role in determining the locational pattern of FDI. Nevertheless, they may play an important role in an investor's decision on the margin — for instance, if a corporation must decide between a similar location as an alternative for investment.<sup>112</sup> With the increasing integration of production on a global scale,

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<sup>110</sup> Drahokoupil, J. 'Investment incentive government policy. *Britannica*' available at <https://www.britannica.com/topic/investment-incentive>, accessed on 7 September 2023.

<sup>111</sup> *Ibid.*

<sup>112</sup> *Ibid.*

FDI expanded enormously from the second half of the 1980s. This was accompanied by a change of attitude toward FDI. Most countries liberalized their policies to attract all kinds of investment from multinational corporations.

The increasingly competitive orientation of states blurred the distinction between investment incentives and other policies as the concern for attracting or retaining capital became primary in framing different policies and regulations. As the neoliberal environment of low regulation and taxation is often perceived as crucial for attracting capital, critics argue that the competition resulting from these incentives may lead to a regulatory 'race toward the bottom.' Thus, a need to regulate investment incentive policies on the global level is often discussed.<sup>113</sup>

The increase in different investment incentives is well documented, and it reflects more intense competition, especially between similar and geographically proximate locations. In this context, a transformation toward the competition state, which aims to secure competitive advantages for capital based inside its borders, is often discussed.<sup>114</sup>

### 3.2.3 Incentives as a policy instrument

The state needs considerable revenue to expand social spending and infrastructure to raise growth and investment. The unresolved challenge is to 'generate these revenues without penalising growth or exacerbating inequality.'<sup>115</sup> For this reason, it is important to view the incentives with due consideration to the economic growth plans envisaged by the state.

While the SA government acknowledged the need to accelerate economic growth more inclusively, it needed clear and tangible tools such as the New Growth Path which aimed at creating five million jobs by 2020. The government sought to do this by 'providing a supportive environment for

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<sup>113</sup> Ibid.

<sup>114</sup> Ibid.

<sup>115</sup> Lewis, C and Alton T 'How can South Africa's tax system meet revenue raising challenges?' available at <https://www.oecd-ilibrary.org/docserver/5jrp1g0xztbr-en.pdf?expires=1694072836&id=id&accname=oid010569&checksum=CAE3A478387D5BADB39E6D0A1E251C36>, accessed on 7 September 2023.

growth and development while promoting a more labour-absorbing economy.' The NPC believed this could be done (among other proposals) by:

- Improving economic policy coordination and implementation
- Building partnerships between the public sector, business, and labour to facilitate, direct and promote investment in labour-intensive areas.
- Raising competitiveness and export earnings through better infrastructure and public services, lowering the costs of doing business, improving skills and innovation, and targeting state support to specific sectors
- A higher rate of investment, with public sector investment crowding in private investment.<sup>116</sup>

Responding to the policy directive derived from the NDP, which required South Africa to develop fiscal and economic policies that encourage foreign direct investment (FDI) to foster economic growth, the Davis Committee proposed fiscal tools which promote the economic vision. These included:

- The fiscal policy should not work in a vacuum. It must be crafted in the context of the country's economic policy, the NDP and the Constitutional objectives.
- The tax policy should not prevent economic growth. It should foster an increase in tax revenues, an increase in tax base and the creation of jobs in South Africa.
- The tax policy should not adversely affect South Africa as a suitable foreign investor destination.
- Measures adopted to counter base erosion and profit shifting (BEPS) should therefore not be counterproductive to the Constitutional and economic objectives of the government.<sup>117</sup>

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<sup>116</sup> National Planning Commission 'National Development Plan 2030, Executive Summary' available at [https://www.nationalplanningcommission.org.za/National\\_Development\\_Plan](https://www.nationalplanningcommission.org.za/National_Development_Plan), accessed on 7 September 2023. 28.

<sup>117</sup> Davis 'Second interim report on Base Erosion and Profit Shifting (BEPS) in South Africa' available at <https://www.taxcom.org.za>, accessed on 7 September 2023. 26.

The South African government prefers the use of tax incentives, rather than disincentives, to promote certain market behaviours. *Dippenaar*<sup>118</sup> found this practice to be in line with what the literature suggested about developing countries generally avoiding tax disincentives when promoting environmentally friendly behaviour.

The importance of establishing evidence for policies such as tax incentives cannot be overstated, 'too often policies march forward with little consideration of the cost-benefit and opportunity cost of specific policy interventions.'<sup>119</sup> *Calitz, Wallace and Burrows*<sup>120</sup> found that no matter the evidence for or to the contrary, 'tax incentives continue to drive much of the tax policy in developing and developed countries', and some examples are outlined in this study.

### 3.3 Some examples of tax incentives

In a highly competitive global economy, incentive support for local and foreign investment is paramount for achieving business and economic growth.<sup>121</sup> South African government offers a range of incentive schemes in departments such as the Department of Trade, Industry and Competition (DTIC) either through cash grant funding or tax relief, all targeted at stimulating the growth of the economy, creating and sustaining jobs, improving competitiveness and encouraging investment.<sup>122</sup> Some of these examples include the following:

#### 3.3.1 Industrial policy projects

In 2008, a ZAR 20 billion incentive package for investors in energy-efficient projects was announced. The incentive is available for industrial projects

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<sup>118</sup> Dippenaar, M 'The role of tax incentives in encouraging energy efficiency in the largest listed South African Businesses' (2018) 21 *South African Journal of Economic and Management Sciences* 21.

<sup>119</sup> Calitz 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 4.

<sup>120</sup> *Ibid* at 3.

<sup>121</sup> KPMG 'Government and tax incentives' available at <https://home.kpmg/za/en/home/services/tax/global-r-and-d-incentives.html>, accessed on 19 July 2021.

<sup>122</sup> KPMG 'Incentivise your investment strategy: a guide to South African government and tax incentives' available at <https://home.kpmg/content/dam/kpmg/za/pdf/2021>, accessed on 7 September 2023. 3.

participating in the manufacturing sector (other than alcohol or alcohol-related products, tobacco or tobacco-related products, arms and ammunition, and biofuels, which harm food security). Companies are divided into those with a qualifying status and those with a preferred status. The status is determined in terms of a point system.<sup>123</sup>

### 3.3.2 Special Economic Zones (SEZs)

An SEZ incentive has been introduced for companies carrying on business in an SEZ comprising of a reduced corporate tax rate of 15 per cent as well as a 10 per cent allowance in respect of the cost of new and unused buildings owned by a qualifying company or any new or unused improvements to any building owned by a qualifying company.<sup>124</sup>

### 3.3.3 Energy efficiency savings

The energy efficiency savings incentive provides an income tax deduction to qualifying taxpayers. The deduction equates to ZAR 0.95 for each kilowatt hour (or equivalent) saved by the taxpayer during the relevant year of assessment against a baseline from the beginning of the year. The incentive has been extended to 31 December 2025.<sup>125</sup>

## 3.4 Is the design of incentives appropriate?

Assessing the effectiveness of tax incentives is not a simple task devoid of subjectivity. However, various scholars attempted this exercise and evaluated the extent to which incentives attract investment.

According to *Ssenyonjo*, tax incentives have their shortcomings and have been criticised by many scholars while others have questioned whether tax incentives yield the desired results. South Africa should pursue tax incentives bearing in mind that it has limited resources and therefore there is a need to assess the impact of those tax relief measures timeously. This could enable the government to discontinue any tax incentives that are not contributing to the

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<sup>123</sup> PwC 'Corporate - Tax credits and incentives' available at <https://taxsummaries.pwc.com/south-africa/corporate/tax-credits-and-incentives>, accessed on 29 July 2023.

<sup>124</sup> Ibid.

<sup>125</sup> Ibid.

required output. The incentive programs that are implemented in South Africa are not reviewed to determine their success.<sup>126</sup>

As stated earlier, economic theory is that tax incentives function as a tool for encouraging foreign investments. However, it has been observed that tax incentives distort resource allocation leading to some sub-optimal investment decisions and are therefore harmful to long-term growth, since the country loses out on revenue foregone. It is also argued that tax incentives are not the primary determinant of the decision to invest. Most investors base their investment decisions not only on economic and commercial factors but also on institutional and regulatory factors. Despite these concerns, internationally there has not been enough attention given to developing guidelines on tax incentives.<sup>127</sup>

According to UNCTAD, the foreign direct investment incentives schemes should be designed and structured in such a way that they do not provide additional avenues for tax avoidance. The general corporate income tax regime should be the norm and not the exception and the proliferation of tax incentives should be avoided as they quickly lead to distortions, including harmful tax competition between countries and a 'race to the bottom', generate unintended tax avoidance opportunities, become difficult to monitor, create administrative costs and may end up protecting special interests at the expense of the general public.<sup>128</sup>

It seems clear that the appropriateness of the design of incentives remains a contested idea which necessitates an assessment of the cost and benefits of incentive schemes.

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<sup>126</sup> Ssennyonjo *A Comparative Study of Tax Incentives for Small Businesses in South Africa, Australia, India and the United Kingdom* (unpublished Master's dissertation, UNISA, 2019) 4.

<sup>127</sup> Davis 'Second interim report on Base Erosion and Profit Shifting (BEPS) in South Africa' available at <https://www.taxcom.org.za>, accessed on 7 September 2023.

<sup>128</sup> UNCTAD 'Investment Policy Framework for Sustainable Development. United Nations Conference on Trade and Development' available at [https://unctad.org/system/files/official-document/diaepcb2015d5\\_en.pdf](https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf), accessed on 7 September 2023. 64.

### 3.4.1 Cost and benefit analysis of tax incentives

An analysis is necessary to consider the distributional implications of tax incentives to ponder on questions such as who wins and who loses as the outcomes of incentives. The 'cost' of the tax incentive in the short run is a matter of debate.

The Davis Tax Committee explored the cost of incentives to the fiscus in relation to what they have produced for the benefit of the country. This was done 'to measure the alternative use of the money foregone or opportunity cost. The World Bank also assisted the Committee with an analysis of the efficacy of certain tax incentives in South Africa in the promotion of developmental objectives. Unfortunately, the analysis did not live up to expectations due to a lack of relevant data.'<sup>129</sup>

The *UNCTAD* conference referred to principles of investment promotion and facilitation which contain two key components:

- 'First, it stipulates that in their efforts to improve the investment climate, countries should not compromise sustainable development goals, for instance by lowering regulatory standards on social or environmental issues, or by offering incentives that annul a large part of the economic benefit of the investment for the host country.'<sup>130</sup>
- 'Second, the principle acknowledges that, as more and more countries seek to boost investment and target specific types of investment, the risk of harmful competition for investment increases, i.e., a race to the regulatory bottom or a race to the top of incentives (with negative social and environmental consequences or escalating commitments of public funds). Investment policies should be designed to minimize this risk.'<sup>131</sup>

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<sup>129</sup> Davis, D 'Closing report on the work done by the Davis Tax Committee' available at <https://www.taxcom.org.za/>, accessed on 7 September 2023.

<sup>130</sup> UNCTAD 'Investment Policy Framework for Sustainable Development. United Nations Conference on Trade and Development' available at [https://unctad.org/system/files/official-document/diaepcb2015d5\\_en.pdf](https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf), accessed on 7 September 2023. 35.

<sup>131</sup> *Ibid* at 35.

If a government operated under a balanced budget of sorts, the tax incentive would have to be financed through higher other taxes (general funds) or via lower expenditures. The resulting net fiscal burden could be regressive or progressive. It would also be useful to analyse the subsidy side of the incentives game. The same tools of public finance can be used to demonstrate the effectiveness, efficiency, and equity of using direct subsidies (versus tax expenditures) to incentivize certain industries. In some countries, expenditure subsidies may be more politically acceptable in that they are viewed as short-term expenditures that can be eliminated in the future. Subsidies should also reach the regular expenditure budget of governments and thereby be more transparent than tax incentives.<sup>132</sup>

### 3.4.2 Tax expenditure

From the above discussion, it seems reasonable to view the impact of incentives as some form of expenditure on the system that would otherwise generate income for society. Tax expenditure is by itself a defined concept in the context of direct government expenditure.

As early as 2011, the Budget Review<sup>133</sup> defined it 'as deviations from the benchmark of a current standard tax legislative framework. A benchmark is a reference point against which the nature and extent of a concession can be identified – it is the standard taxation treatment that should apply to similar taxpayers or types of economic activities.' Once tax expenditures have been identified, one of the three methods below can be used to measure the estimated loss to the fiscus:

- The **revenue foregone** method estimates tax expenditures by calculating the amount of tax revenue that would have been collected in the absence of the tax expenditure and assumes that the behavioural response of taxpayers remains unchanged. This is the most

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<sup>132</sup> Calitz 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 21.

<sup>133</sup> National Treasury 'Budget Review 2011' available at <http://www.treasury.gov.za/documents/national%20budget/2011/review/Budget%20Review.pdf>, accessed on 7 September 2023. 181.

used method to measure tax expenditures because of its relative simplicity, and it was used in this draft report.

- The **revenue gain** method measures tax expenditures by calculating tax revenue that would have been collected in the absence of the tax expenditure, considering behavioural responses associated with the removal of a tax expenditure provision. However, modelling taxpayer behaviour is quite complex.
- With the **outlay equivalence** method, tax expenditures are measured by estimating the number of direct government expenditures that would be required to provide the same benefit to taxpayers. This approach allows for a comparative analysis with direct expenditures to provide the same level of benefits.<sup>134</sup>

The National Treasury has evaluated the benefits of some of the incentive schemes over time. It found that about 'half of the total R&D tax expenditure has supported the manufacturing sector over this period. The large share of support directed towards manufacturing, and to a lesser extent to the agricultural sector, shows that this incentive encourages R&D within sectors that are important for creating jobs.'<sup>135</sup>

It found that 'the financial sector benefits the most from this exemption, with a significant increase in 2018/19. An average of 1 147 taxpayers received the benefit of the participation exemption for the first three fiscal years presented (the latest year has a low level of assessment).'<sup>136</sup>

'The primary aim of the tax system is to raise sufficient revenue for government spending. It can also promote socioeconomic objectives through targeted tax exemptions, deductions, or credits. Tax expenditures are estimates of the total revenue foregone because of this preferential tax treatment.'<sup>137</sup> Such

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<sup>134</sup> Ibid at 181.

<sup>135</sup> National Treasury 'Budget Review 2022' available at <http://www.treasury.gov.za/documents/national%20budget/2022/review/FullBR.pdf>, accessed on 18 August 2023. 121.

<sup>136</sup> Ibid.

<sup>137</sup> Ibid at 119.

expenditure data exists to help the government assess the costs, benefits, and effectiveness of this expenditure.

### 3.5 The general impact of tax incentives

The 2022 Budget Review illustrated clear data comparing the actual revenue collections with the revenue that would have been collected without incentives in place. In the same breath, it is conceded that 'the revenue foregone approach assumes that taxpayers do not change their behaviour in response to a tax expenditure being withdrawn. In reality, behaviour is likely to change if an incentive is withdrawn, so the additional revenue collected may be less than estimated.'<sup>138</sup>

Several other views tend to support the view that changes in incentive structures have had a positive impact on market practices. It is however also suggested that the few cases of market abuse recorded by the FSCA have weakened the impact. It is noted that following the global financial crisis, most excesses have been removed from incentives; however, it is also suggested that skills shortages in specialised areas may result in the over-compensation of certain specialists.<sup>139</sup>

While these estimates are relatively crude regarding the price and output effects, they illustrate the differences in incentives across sectors. The net impact to incentive ratios is large for incentives aimed at the agriculture, motor vehicles, electricity and transport sectors and relatively small impacts for trade, mining, finance, and community services. These results come from the number and magnitude of the interactions among industries. If the government's objective is to increase total output (and employment), this analysis provides some evidence that the impacts are very different depending on the incentivised industry.<sup>140</sup>

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<sup>138</sup> Ibid.

<sup>139</sup> National Treasury 'Financial markets review final report' available at <http://www.treasury.gov.za/publications/other/FMR%202020.pdf>, accessed on 7 September 2023.

<sup>140</sup> Calitz 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 20.

### 3.6 Conclusion

This chapter attempted to raise questions about whether the investment policy instrument such as incentives is appropriate to adequately address the stated objectives, and whether the instruments applied to address the intended outcomes.

Dippenaar<sup>141</sup> evaluated the literature and noted propositions that tax incentives could effectively address environmental challenges and change consumer behaviour, although tax incentives are generally more effective in combination with other policy instruments. However, it is also acknowledged in his study that some argue that tax incentives are ineffective because non-tax considerations have a larger impact on investment decisions and many factors besides tax incentives or disincentives drive investment decisions.

The UNCTAD<sup>142</sup> conference found that academic literature exists on methodologies for evaluating policy effectiveness. They found, three objective difficulties around investment policy associated with the measurement of policy effectiveness:

- It is often difficult to assess the effectiveness of discrete investment policy measures, such as the provision of incentives, let alone the effects of the overall investment policy framework.<sup>143</sup>
- It is often difficult to find solid evidence for the discrete impact on various dimensions of investment, let alone for the impact of the policies that led to that investment or that guide the behaviour of investors.<sup>144</sup>
- Much of the impact of investment policies and thus their effectiveness depends on the way such policies are applied, and

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<sup>141</sup> Dippenaar 'The role of tax incentives in encouraging energy efficiency in the largest listed South African Businesses' (2018) 21 *South African Journal of Economic and Management Sciences*

<sup>142</sup> UNCTAD 'Investment Policy Framework for Sustainable Development.

United Nations Conference on Trade and Development' available at [https://unctad.org/system/files/official-document/diaepcb2015d5\\_en.pdf](https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf), accessed on 7 September 2023. 51.

<sup>143</sup> *Ibid* at 51.

<sup>144</sup> *Ibid* at 52.

on the capabilities of institutions charged with the implementation and enforcement of policies and measures, rules, and regulations.<sup>145</sup>

Given these objective difficulties in measuring the effectiveness of investment policies, and to ensure that potentially important policy changes are not delayed by complex analyses of the impact of individual measures, Investment policy should be based on a set of explicitly formulated policy objectives with clear priorities, a time frame for achieving them, and the principal measures intended to support the objectives. These objectives should be the principal yardstick for measuring policy effectiveness.<sup>146</sup>

## CHAPTER 4: BEHAVIORS ENCOURAGED BY INCENTIVES

### 4.1 Introduction

Literature suggests that tax incentives could effectively address environmental challenges and change consumer behaviour, although tax incentives are generally more effective in combination with other policy instruments. Some argue, however, that tax incentives are ineffective because non-tax considerations have a larger impact on investment decisions, and many factors besides tax incentives or disincentives drive investment decisions. Empirical evidence on the cost-effectiveness of tax incentives also appears to be inconclusive. Although there are varied opinions about the use and effectiveness of tax incentives, they remain an integral part of the tax policies of countries, and it is expected that they will continue to be used globally.<sup>147</sup>

To fully comprehend the behavioural patterns resulting from incentives, this research investigates the stakeholders often involved in incentive schemes,

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<sup>145</sup> Ibid at 52.

<sup>146</sup> Ibid at 52.

<sup>147</sup> Dippenaar 'The role of tax incentives in encouraging energy efficiency in the largest listed South African Businesses' (2018) 21 *South African Journal of Economic and Management Sciences*

the question of incentive beneficiaries, the impact on the tax base and what the investor confidence invokes on the market.

#### 4.2 The stakeholders in incentive schemes

Understandably, the views of interested stakeholders are critically important in shaping the behaviors in the incentives market. Understanding the opportunities and constraints to private sector development and productivity growth is key for the design of effective policies that deliver on job creation and economic growth more broadly.<sup>148</sup>

*Calitz* argues that tax incentives are usually redundant and ineffective: they reduce and complicate the fiscal system without achieving their stated objectives. Even to the limited extent that some incentives are effective in inducing investors to behave differently than they would have done in response to market signals, the result is often inefficient, diverting scarce resources into less-than-optimal uses.<sup>149</sup> This seems to suggest the importance of a coordinated policy framework that directs market participants towards strategic partnerships with the government.

In the RSA Medium-Term Strategic Framework 2019-2024, several stakeholders are responsible for the implementation of the incentive policy objectives and interventions. The policy focuses government development planning on implementation at a strategic and operational level and provides for strategic focus on resourcing, partnerships, coordination of all state entities, and social compacts with social partners including defining clear commitments for labour and private sector investment. The Public Private Growth Initiative (PPGI), a partnership between the government and the private sector has committed to several projects that include manufacturing and job creation over the five years.<sup>150</sup>

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<sup>148</sup> SA-TIED 'Enterprise development for job creation and growth' available at <https://sa-tied.wider.unu.edu/enterprise-development>, accessed on 7 July 2023.

<sup>149</sup> *Calitz* 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 3.

<sup>150</sup> Department of Planning Monitoring & Evaluation 'Medium-term strategic framework 2019-2024' available at <https://www.poa.gov.za/Pages/MTSF.aspx>, accessed on 8 August 2023. 20.

These varied opinions about the use and effectiveness of tax incentives<sup>151</sup> also indicate the varied nature of stakeholders associated with incentive schemes, and the apparent different interests all those stakeholders would hold. Furthermore, the role of the government as the regulator through tools such as PPGI cannot be over-emphasised.

#### 4.3 Who gets the incentive money?

A question must be asked about the real beneficiary of these incentives. For example, do workers benefit from incentive schemes taken up by their employing company?

A study was conducted in France on company incentives and the extent of benefits enjoyed by employees. It found, among others that, 'although tax incentives target mid- and low-wage workers, the surplus generated by the policy does not 'trickle down' to low-wage workers. Compared to tax cuts, tax credits allow policymakers to create a link between tax benefits and desired outcomes.'<sup>152</sup>

Generally, incentives differ in several ways, in terms of the types of companies and activities that are likely to benefit from them, the time profile of the revenue impact on the government for any given level of incentive, the difficulty of administration, and the possibility of tax avoidance.<sup>153</sup> For example, the author alludes that tax holidays offer the greatest value to firms and projects that make substantial profits in the early years of operation.

However, investment allowances, tax credits, and accelerated depreciation, in contrast, are specifically targeted at capital investment. Their revenue cost is constrained by the amount of capital that the firm is willing to put at risk. As

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<sup>151</sup> Dippenaar 'The role of tax incentives in encouraging energy efficiency in the largest listed South African Businesses' (2018) 21 *South African Journal of Economic and Management Sciences*

<sup>152</sup> C Carbonnier, Malgouyres C, Py L, and Urvoy, C 'Who benefits from tax incentives? the heterogeneous wage incidence of a tax credit' available at <https://docs.iza.org/dp14683.pdf>, accessed on 6 September 2023. 31.

<sup>153</sup> Holland, D 'Income tax incentives for investment' available at <https://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch23.pdf>, accessed on 7 September 2023. 10.

such, they are of little benefit to the quick-profit types of firms that can take the best advantage of tax holidays.<sup>154</sup>

A serious disadvantage of offering tax incentives to attract investment is that, to the extent that enterprises that would have invested in any event claim them<sup>155</sup>, tax revenue is lost without any corresponding benefit to the host country.

General tax rate reductions differ from the other incentives in that they are not specifically directed toward new activity. Income from both existing and new operations is eligible for the incentive. Thus, when rate reductions are viewed as an incentive, they are less likely to be cost-effective than incentives that are related to the amount of new investment.<sup>156</sup>

As argued above, it is logical to conclude that finding the true beneficiary of incentives is harder than it is counting the resultant impact on the tax base.

#### 4.4 Impact of incentives on the tax base

The impact on incentives on a country's tax base should involve tedious administrative scrutiny. Such administrative processes should inform policy makers about the desirability of more or fewer incentive schemes.

Auditing incentives provides an extra challenge to tax administrators, who must first verify that the incentive has been applied correctly. Verification can be difficult if complex calculations are involved. Second, administrators must ensure that the activity or firm qualifies for the incentive. This process can be complicated if concepts and definitions are vague or ambiguous or, as for foreign-owned firms, the records establishing the eligibility of the firm are in another country.<sup>157</sup>

Tax incentives which are directed at business activities are aimed at real investment in productive activities rather than investment in financial assets

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<sup>154</sup> Ibid.

<sup>155</sup> Ibid at 17.

<sup>156</sup> Ibid.

<sup>157</sup> Ibid at 12.

and often directed to foreign investors. They are supposed to supplement insufficient domestic capital for the desired level of economic development in specific sectors or across the board.<sup>158</sup>

Incentives should not create an additional low-tax location for multinational corporate structures. Governments should consider options to design and administer fiscal incentive schemes in such a way that they remove the motivation to shift profits and erode the tax base, e.g., by providing tax breaks for earnings reinvested in productive assets, or focusing tax incentives on capital goods (e.g., rollover relief). Incentives could also be made conditional upon pre-defined or agreed tax behaviour and on disclosure criteria.<sup>159</sup>

According to the IMF, tax incentives have 'efficiency costs since they distort the allocation of resources. They tend to erode the tax base, create an opportunity for 'tax planning,' and tend to benefit short-term investments and those that are already profitable. They also make monitoring and, therefore, tax administration more difficult.'<sup>160</sup>

The overwhelming experience of transition countries and, to a lesser extent, of developing countries with tax holidays has been that they are particularly susceptible to tax avoidance and have been ineffective in attracting FDI.<sup>161</sup>

#### 4.5 Investor confidence

Investment cannot be fully comprehended without the understanding of investor confidence. *Jeremy*<sup>162</sup> defined investor confidence as the investors' willingness to engage in the investment opportunities and associated

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<sup>158</sup> Calitz 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 7.

<sup>159</sup> UNCTAD 'Investment Policy Framework for Sustainable Development. United Nations Conference on Trade and Development' available at [https://unctad.org/system/files/official-document/diaepcb2015d5\\_en.pdf](https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf), accessed on 7 September 2023. 64.

<sup>160</sup> Shome 'Tax Policy Handbook' available at <https://www.elibrary.imf.org/view/books/071/06719-9781557754905-en/06719-9781557754905-en-book.xml>, accessed on 8 August 2023. 10.

<sup>161</sup> Holland 'Income tax incentives for investment' available at <https://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch23.pdf>, accessed on 7 September 2023. 14.

<sup>162</sup> Jeremy, K 'Economics note: investor confidence' available at [https://www.sec.gov/files/investor\\_confidence\\_noteOct2017.pdf](https://www.sec.gov/files/investor_confidence_noteOct2017.pdf), accessed on 7 September 2023. 2.

intermediation channels available to them based on their perception of risk and return.

It has been argued that it relates to confidence in the financial system and the economy at large which is a critical driver of economic and financial instabilities. This is because business confidence affects the forces that drive the economy. If there is low confidence about the economy, consumers, the business sector, existing, potential local and foreign investors adopt the 'wait and see' attitude due to fear of the unknown. Consequently, expenditures intended for the present period are postponed into the future. Similarly, an increase in the confidence by economic agents implies that consumers and firms are confident to spend in the prevailing economic conditions.<sup>163</sup> These conditions become the economic drivers which enhance the investment inflows into the economy.

The Business confidence index (BCI) in South Africa is monitored and reported by the Bureau for Economic Research (BER) and the South African Chamber of Commerce and Industry (SACCI). There is historical data on the BCI which has been used over time to measure business confidence. The SACCI's index noted that 'during the economic sanctions period of the 1980s, the 1985 BCI measured the second-lowest average of 91.5, followed by an average of 92.6 in 2019. The highest annual average for the BCI was recorded in 2006 at 137.5'.<sup>164</sup>

Despite 2020 being an exceptional year because of the Covid-19 pandemic — when global confidence indices were driven into the ground — '2019 now stands as the third-worst average reading of the index, while 2006 was the peak of confidence.'<sup>165</sup> According to Stoddard, this average had been the

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<sup>163</sup> Maredza, A and Nyamazunzu, Z 'Business confidence in South Africa: identifying key domestic drivers and the nature of their impact. 6th Economics & Finance Conference' available at <https://www.researchgate.net/publication/>, accessed on 7 September 2023.

<sup>164</sup> SACCI 'The South African Chamber of Commerce and Industry' available at <https://sacci.org.za/sacci-business-confidence-index/>, accessed on 22 July 2021

<sup>165</sup> Ed Stoddard 'Business confidence in South Africa at all-time low in 2020. *Daily Maverick* 2 October' available at <https://www.dailymaverick.co.za/article/2021-02-10-business-confidence-in-south-africa-at-all-time-low-in-2020/>, accessed on 7 September 2023.

'previous worst since 1985. The year 2019 was marked by recession, Stage 6 load shedding, and already declining levels of investment'<sup>166</sup>, and this has not inspired confidence in the business world.

The government regulatory framework has far-reaching implications on fiscal and investment policies which directly impact investor confidence.<sup>167</sup> It seems therefore that the extent to which a country practically values its constitution and regulatory framework is important for economic growth. This deliberate attitude towards this legislative framework should inform policy formulation which provides support to economic objectives.

#### 4.6 Conclusion

Although the 'empirical evidence on the cost-effectiveness of tax incentives also appears to be inconclusive', and although there are 'varied opinions about the use and effectiveness'<sup>168</sup>, governments remain chief among stakeholders involved and partaking in the incentive schemes. Driven by its policy objectives, the government uses incentives as policy tools to regulate the market in favor of certain areas and functions identified by the government.

Other interested stakeholders and analysts such as *Calitz* argue that these incentives are usually redundant and ineffective: they reduce and complicate the fiscal system without achieving their stated objectives. It seems evident that incentives are not an obvious benefit to the fiscus.

This chapter does not find that incentives are not necessary, and neither does this section find any specific benefit to certain sectors of society. As stated by Davis, 'Tax incentives are not the primary determinants of the decision to invest. Most investors base their investment decisions not only on economic and commercial factors but also on institutional and regulatory factorsThe

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<sup>166</sup> Ibid.

<sup>167</sup> C Bisseker 'Investor confidence may never fully recover from SA's week of anarchy' *Business Day* 19 July 2021 available at <https://www.businesslive.co.za/bd/opinion/columnists/2021-07-19-claire-bisseker-investor-confidence-may-never-fully-recover-from-sas-week-of-anarchy/>, accessed on 6 September 2023.

<sup>168</sup> Dippenaar 'The role of tax incentives in encouraging energy efficiency in the largest listed South African Businesses' (2018) 21 *South African Journal of Economic and Management Sciences*

general aim of investment incentives is to influence the locational decisions of investors.<sup>169</sup> What becomes clear is the need to have a coordinated relationship with stakeholders in the incentives market.

## CHAPTER 5: POSSIBLE ALTERNATIVES TO BALANCE FISCAL SUSTAINABILITY AND THE EFFICIENCY OF TAX INCENTIVES

### 5.1 Introduction

Why do countries persist with incentives despite their drawbacks? The need to attract investment seems abundantly clear from the above chapters, but it seems difficult to address the chief reasons that discourage investment. 'Tax incentives are at least something over which they have control and which they can enact relatively easily and quickly, precisely because the full cost is not always visible or disclosed.'<sup>170</sup>

The government seems alive to the need to keep a balance between attracting investment and protecting the tax base. 'Over the past three years, government has focused on measures to protect the tax base and reforms aimed at improving equity, efficiency, certainty, and simplicity. The review of tax incentives, following the advice of the Davis Tax Committee, has led to several incentives being discontinued because there was little evidence of any additional benefit.'<sup>171</sup> However, it remains unclear whether incentives are measures which empower this balance – a question canvassed in this chapter. Therefore, should the country add more, reduce incentives, or establish a measured balance of factors necessary to achieve the policy objectives?

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<sup>169</sup> Davis 'Second interim report on Base Erosion and Profit Shifting (BEPS) in South Africa' available at <https://www.taxcom.org.za>, accessed on 7 September 2023.

<sup>170</sup> Calitz 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 8.

<sup>171</sup> National Treasury 'Budget Review 2023' available at <https://www.treasury.gov.za/documents/national%20budget/2023/review/FullBR.pdf>, accessed on 18 August 2023. 45.

## 5.2 Can the objectives be achieved with more or with less incentives?

Some commentators such as Bisseker are not optimistic about the growth trajectory of South Africa and point to 'the government's gross incompetence and incapacity laid bare, the challenge of reigniting growth — let alone overcoming unemployment, inequality and poverty — looks, frankly, insurmountable.'<sup>172</sup>

The government also admitted that the inability of the economy to create jobs coupled with the high-level entry requirements and the skills mismatch are some of the reasons advanced for the persisting structural unemployment. Although the economy grew by 2.8 per cent on average from 1994 to 2018, it has not been able to absorb the number of people needing employment.<sup>173</sup> It also said that the increasing pace of inclusive growth is a central policy challenge for the government to manage the systemic risks identified in the *Budget Review 2023*.<sup>174</sup> This admission however, does not equate to increasing incentives without due consideration of the balance between fiscal sustainability and efficiency of incentives.

These costs can, in theory, be reduced if means can be found to target the incentives to desirable activities or to projects that would not have occurred without the incentive.<sup>175</sup>

Alternatives to tax incentives may also involve direct expenditure of funds, and tax incentives may be seen as a politically easier alternative, since subsidies involving direct expenditure may undergo closer scrutiny than tax

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<sup>172</sup> Bisseker 'Investor confidence may never fully recover from SA's week of anarchy' *Business Day* 19 July 2021 available at <https://www.businesslive.co.za/bd/opinion/columnists/2021-07-19-claire-bisseker-investor-confidence-may-never-fully-recover-from-sas-week-of-anarchy/>, accessed on 6 September 2023.

<sup>173</sup> Presidency 'Towards a 25 year review 1994-2019' available at [https://www.gov.za/sites/default/files/gcis\\_document/201911/towards25yearreview.pdf](https://www.gov.za/sites/default/files/gcis_document/201911/towards25yearreview.pdf), accessed on 8 August 2023. 28.

<sup>174</sup> National Treasury 'Budget Review 2017' available at <https://www.treasury.gov.za/documents/national%20budget/2017/review/BR3.%20Fiscal%20policy.pdf>, accessed on 1 September 2023. 4.

<sup>175</sup> Holland 'Income tax incentives for investment' available at <https://www.imf.org/external/pubs/nft/1998/tlaw/eng/ch23.pdf>, accessed on 7 September 2023. 17.

expenditures aimed at attracting investment.<sup>176</sup> The most common approach is to consider the corporate tax reduction which an abolishment of all investment tax incentives would make possible. Another approach to analysis of tax incentives is to consider the opportunity cost of tax incentives with reference to other government programmes which could be financed, particularly those of a pro-poor nature. Another alternative to tax incentives is cooperation among countries. Such cooperation is notoriously difficult but interest in cooperation has grown as competition has become more and more fierce.<sup>177</sup>

Furthermore, there are policy guidelines offered by the UNCTAD which are focused on fiscal incentives for corporate taxation and preventing tax avoidance. These include:

- A periodic review of corporate taxation (and fiscal incentives) for effectiveness, costs and benefits should be an integral part of investment policy.<sup>178</sup>
- Undue complexity of income tax law and regulations should be avoided, and they should be accompanied by clear guidelines, as transparency, predictability and impartiality of the tax regime are essential for all investors, foreign and national alike.<sup>179</sup>
- The tax system should tend to neutrality in its treatment of domestic and foreign investors.<sup>180</sup>
- An increasing role for foreign investment in national economies requires increased technical capabilities on the part of tax authorities to manage international taxation and transfer pricing issues.<sup>181</sup>

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<sup>176</sup> Calitz 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 8.

<sup>177</sup> Ibid at 21.

<sup>178</sup> UNCTAD 'Investment Policy Framework for Sustainable Development. United Nations Conference on Trade and Development' available at [https://unctad.org/system/files/official-document/diaepcb2015d5\\_en.pdf](https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf), accessed on 7 September 2023. para 3.2.1.

<sup>179</sup> Ibid para 3.2.2.

<sup>180</sup> Ibid para 3.2.3.

<sup>181</sup> Ibid para 3.2.4.

- Tolerance or facilitation of tax avoidance should not be considered an instrument either to attract inward investment or to support the competitiveness of multinational enterprises abroad.<sup>182</sup>
- Where governments choose to provide fiscal incentives for investors, these should be provided on a nondiscretionary basis and should not by nature seek to compensate for an unattractive or inappropriate general tax regime. As much as possible, fiscal incentives should have sunset clauses after which the investor should follow the general fiscal rules.<sup>183</sup>

Effectively, the policy design and its implementation are a continuous process of fine-tuning and adapting to changing needs and circumstances. Therefore, regular review of performance against objectives should take place – UNCTAD suggests every 3-4 years. The objectives for investment policy should be the yard stick for measurement of policy effectiveness.<sup>184</sup>

From the above argument, it seems logical to conclude that neither the increase, nor the decrease in the number of incentives would enhance the achievement of investment policy objectives. Thus, a government should rather have keen interest in adapting to changing needs and social circumstances and consistently fine-tune incentive schemes for effectiveness.

### 5.3 Are there alternatives to incentives?

The Small Business Institute of South Africa (SBI)<sup>185</sup> — which considers itself as a big voice for small business — submitted a research paper to Parliament. It argued that government cannot afford to keep spinning its wheels on cutting red tape for small businesses in South Africa, and that the government spent many years introducing new projects, regulations, and plans to make doing

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<sup>182</sup> Ibid para 3.2.5.

<sup>183</sup> Ibid para 3.2.8.

<sup>184</sup> Ibid at 70.

<sup>185</sup> Small Business Institute 'Tackling the "disabling environment" to boost economic growth, small business and jobs' available at <https://www.smallbusinessinstitute.co.za/wp-content/uploads/2019/02/TacklingTheDisablingEnvironmentToBoostEconomicGrowthSmallBusinessAndJobs.pdf>, accessed on 7 September 2022.

business easier in South Africa, but all of that remained the same pain for small businesses.

It is well known that the government has implemented several policies and plans to remedy obvious social ills. Some of the interventions include incentives such as the Employment Tax Incentive (ETI). In addition, South Africa's industrial policy put employment at the centre of any industry support by government with 30 per cent of procurement set aside for youth owned and managed enterprises.<sup>186</sup>

However, these interventions have not had the envisaged impact; as can be observed on persistent high levels of unemployment over time.<sup>187</sup>

Ensuring inclusive growth will also require addressing the vast amounts of money South Africa loses to the illicit economy each year — estimated at 10 percent of GDP. This has mainly been in the form of illicit exports, concealment of wealth abroad, and illicit financial flows — which have a well-established link to corruption, while reducing the tax base. Other activities include smuggling tobacco products, counterfeit textiles, drug trade, illicit mining of gold, diamonds and other minerals, ivory smuggling, and the poaching of endangered species like abalone and rhino.<sup>188</sup>

Whereas this research paper is considering incentives, other measures to achieve policy objectives cannot be ignored. Ngewana<sup>189</sup> argues that strong institutions such as SARS are important for sustained economic growth, and a large part of the increase in South Africa's public debt is attributed to continued low growth.

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<sup>186</sup> Presidency 'Towards a 25 year review 1994-2019' available at [https://www.gov.za/sites/default/files/gcis\\_document/201911/towards25yearreview.pdf](https://www.gov.za/sites/default/files/gcis_document/201911/towards25yearreview.pdf), accessed on 8 August 2023. 26.

<sup>187</sup> StatsSA 'Quarterly Labour Force Survey' available at <https://www.statssa.gov.za/publications/P0211/P02111stQuarter2018.pdf>, accessed on 7 September 2023.

<sup>188</sup> Department of Planning Monitoring & Evaluation 'A strong and inclusive economy' available at [https://www.dpme.gov.za/keyfocusareas/outcomesSite/MTSF\\_2019\\_2024/2019-2024%20MTSF%20PRIORITY%202.pdf](https://www.dpme.gov.za/keyfocusareas/outcomesSite/MTSF_2019_2024/2019-2024%20MTSF%20PRIORITY%202.pdf), accessed on 8 August 2023. 49.

<sup>189</sup> Ngewana, A A *Critical Assessment of the Sustainability of South Africa's Fiscal Policy and Related Institutional Frameworks* 2019) 33.

## 5.4 Recommended alternatives

After decades of acknowledging the legislative and regulatory burden as excessive for small businesses to thrive, and that policy uncertainty negatively affects investment in the economy, it is more accurate to say that 'South Africa's tragedy and farce cannot be distinguished'.<sup>190</sup> From the above sections, it seems that not all is doom and gloom in the case of South Africa. However, there remains a need to refocus some of the existing initiatives and balanced them with nuanced approaches to achieve policy objectives.

There are initiatives that the government could maintain – albeit with greater focus on outcomes. These include:

- Operation Vulindlela which has been tasked with making long-promised priority reforms happen. This project pledged to focus on reforms related to electricity generation, the spectrum auction, ports, and resolving a new water framework.<sup>191</sup> Whereas reforms in these areas are critical, the regulatory burden choking the economy seems to go much deeper.
- Small Business Institute proposed that businesses should adopt a 'red tape challenge' — a web-based tool will provide for a dynamic interface with business owners battling red tape to have their say on regulations affecting their everyday lives; whether to speak up for well-designed rules that protect, or challenge those badly designed or badly thought-through regulations that are an unnecessary burden.<sup>192</sup>

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<sup>190</sup> Small Business Institute 'Tackling the “disabling environment” to boost economic growth, small business and jobs' available at <https://www.smallbusinessinstitute.co.za/wp-content/uploads/2019/02/TacklingTheDisablingEnvironmentToBoostEconomicGrowthSmallBusinessAndJobs.pdf>, accessed on 7 September 2023. 8.

<sup>191</sup> Presidency 'Operation Vulindlela, Summary Booklet' available at <http://www.treasury.gov.za/Operation%20Vulindlela%20Summary%20Booklet%20March%202021.pdf>, accessed on 7 September 2023.

<sup>192</sup> Small Business Institute 'Tackling the “disabling environment” to boost economic growth, small business and jobs' available at <https://www.smallbusinessinstitute.co.za/wp-content/uploads/2019/02/TacklingTheDisablingEnvironmentToBoostEconomicGrowthSmallBusinessAndJobs.pdf>, accessed on 7 September 2022.

- A review of the PFMA and the MFMA to facilitate Public Private Partnerships (PPP). More efforts will need to be strengthened to attract private sector investment in the delivery of infrastructure as part of building broad-based PPP.<sup>193</sup>

UNCTAD also made a range of policy proposals for the promotion of investment in priority sectors for sustainable development. Among which is transforming investment incentive schemes from purely 'location-based' incentives towards 'sustainability-based' incentives, aiming to promote investment in relevant sectors and conditional upon their sustainable development contribution.<sup>194</sup>

Other alternatives are policy in nature and include due consideration of how widely to offer tax and financial benefits, if these incentives are necessary to attract investment, and if their costs — in terms of revenue forgone and economic distortions — outweigh their benefits. Cost-benefit analysis prior to introducing incentives, and monitoring ex-post, would help the government assess the extent to which, and at what cost, incentives meet their intended objectives.<sup>195</sup>

Another alternative to tax incentives is cooperation among countries. Such cooperation is notoriously difficult but interest in cooperation has grown as competition has become more and more fierce. Cooperation can be of many forms.<sup>196</sup>

*SA-TIED*, in its research brief proposed an optimal fiscal consolidation strategy such as 'reducing government consumption spending to bring the least

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<sup>193</sup> Presidency 'The South African Economic Reconstruction and Recovery Plan' available at [https://www.gov.za/sites/default/files/gcis\\_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf](https://www.gov.za/sites/default/files/gcis_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf), accessed on 8 August 2023. 10.

<sup>194</sup> UNCTAD 'Investment Policy Framework for Sustainable Development. United Nations Conference on Trade and Development' available at [https://unctad.org/system/files/official-document/diaepcb2015d5\\_en.pdf](https://unctad.org/system/files/official-document/diaepcb2015d5_en.pdf), accessed on 7 September 2023. 9.

<sup>195</sup> OECD 'Towards smarter use of investment incentives' available at <https://www.oecd-ilibrary.org/sites/813bef22-en/index.html?itemId=/content/component/813bef22-en#section-d1e10154>, accessed on 7 July 2023.

<sup>196</sup> Calitz 'The impact of tax incentives to stimulate investment in South Africa' available at <https://www.ekon.sun.ac.za>, accessed on 6 September 2023. 22.

painful fiscal adjustment and increasing government investment spending to support an improvement in the fiscal position by being growth-enhancing — especially if targeted toward constraints such as electricity supply'.<sup>197</sup>

Furthermore, there is not much evidence done to analyse the opportunity cost of incentives with reference to other government programmes which could be financed, particularly of a pro-poor nature.

The government itself had long intimated the establishment of a central government agency responsible for coordinating and driving the infrastructure investment programme.<sup>198</sup> Therefore, it's clear that a new course of action is needed. However, it remains unclear whether the government sincerely acknowledges that government is not the proximate cause of growth without the private sector playing a role in responding to market force.

## 5.5 Conclusion

It is apparent that the cost of tax incentives is wide-ranging and goes beyond any immediate revenue loss. They include distortions to the economy because of preferential treatment of investment qualifying for incentives, administrative costs from running and preventing fraudulent use of incentives schemes, and social costs of rent-seeking behavior — including possibly an increase in corruption. Even the pure revenue costs of incentives are difficult to quantify. The benefits of tax incentives are even harder to assess.<sup>199</sup>

Tax incentives may subsidise firms that would have invested without favourable treatment and can constitute a significant cost for governments in terms of revenue forgone. However, carefully designed, and targeted incentives may help correct market failures and advance certain

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<sup>197</sup> SA-TIED 'Fiscal Sustainability in South Africa' available at [https://sa-tied-archive.wider.unu.edu/sites/default/files/SA-TIED-research-brief-012022\\_0.pdf](https://sa-tied-archive.wider.unu.edu/sites/default/files/SA-TIED-research-brief-012022_0.pdf), accessed on 21 August

<sup>198</sup> Presidency 'The South African Economic Reconstruction and Recovery Plan' available at [https://www.gov.za/sites/default/files/gcis\\_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf](https://www.gov.za/sites/default/files/gcis_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf), accessed on 8 August 2023. 11.

<sup>199</sup> Klemm, A 'Causes, benefits, and risks of business tax incentives' available at <https://www.imf.org/external/pubs/ft/wp/2009/wp0921.pdf>, accessed on 7 September 2023. 11.

development goals, such as supporting renewable energy or skills and technology upgrades, enhancing the positive impact of investment.<sup>200</sup>

The government needs to focus on a long-term investment framework that encourages private investment in areas that are critical for growth.

## CHAPTER 6: SUMMARY AND CONCLUSION

### 6.1 Introduction

This research paper evaluates the usefulness of incentives in driving the investment policy direction of South Africa, the role of stakeholders often involved in incentive schemes, and the impact on the tax base. It attempts to contribute to the assessment of the usefulness of incentives in enabling the government to achieve its policy objectives.

This chapter summarises the conclusions related to the major findings and provides some policy recommendations based on the results discussed in the preceding chapters. It is structured in the following manner: section 6.2 summarises the main findings of the research paper, section 6.3 outlines policy recommendations; and section 6.4 concludes with limitations of the research paper and some suggestions for further research on related fields.

### 6.2 Summary of main findings

The NDP was drafted with the preamble of the constitution, and it commits the state into the future with clear developmental goals. This research commends the government's approach to drafting its policy objectives in line with this plan. It is a plan that has consideration of global trends and is an appropriate panacea for domestic policy framework which brings about foreign direct investment through initiatives such as incentives.

This study supports other studies in the empirical literature that suggests that incentives matter less for private investment and economic growth. Tax

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<sup>200</sup> OECD 'Towards smarter use of investment incentives' available at <https://www.oecd-ilibrary.org/sites/813bef22-en/index.html?itemId=/content/component/813bef22-en#section-d1e10154>, accessed on 7 July 2023.

incentives may subsidise firms that would have invested without favourable treatment and can constitute a significant cost for governments in terms of revenue forgone. Therefore, consideration must be given to obvious leakages such as shadow economic activities that erode the tax base.

Tax incentives are not the primary determinants of the decision to invest. Most investors base their investment decisions not only on economic and commercial factors. Incentives function as a reward to investors who would invest without incentives rather than encouraging investors who would otherwise not invest or go elsewhere.

This research agrees with Financial and Fiscal Commission on its finding that one of the challenges for South Africa is that 'policies and programmes that have been introduced at the various levels of government lack completeness and integration in their implementation,'<sup>201</sup> and adds that policy certainty or lack thereof has a serious impact on investor confidence which these incentives seek to attract.

Whereas non-tax incentive considerations outweigh tax incentive considerations, it is also argued that tax incentives could effectively address environmental challenges and change consumer behaviour. However, these incentives are generally more effective in combination with other policy instruments.

Furthermore, this research finds that — because of the corruption or perception thereof — the deteriorating economic environment has exerted huge pressure on South Africa's public debt, due to the pressure placed on the government to finance its budget.<sup>202</sup> It is clear that fiscal challenges that South Africa faces cannot be solved with 'more' incentives but rather a strategic balance with other measures.

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<sup>201</sup> Financial and Fiscal Commission 'Funding and policy framework for supporting urban informal employment' available at [https://ffc.co.za/wp-content/uploads/2021/04/2017\\_Policy\\_Brief\\_9\\_Funding\\_And\\_Policy\\_Framework\\_For\\_Supporting\\_Urba\\_Informal\\_Employment.pdf](https://ffc.co.za/wp-content/uploads/2021/04/2017_Policy_Brief_9_Funding_And_Policy_Framework_For_Supporting_Urba_Informal_Employment.pdf), accessed on 6 September 2023.

<sup>202</sup> Ngewana A *Critical Assessment of the Sustainability of South Africa's Fiscal Policy and Related Institutional Frameworks* 2019) 34.

The scale and variety of South Africa's investment incentives will continue to be a contested debate. However, while it is also clear that the revenue base is shrinking, it is difficult to envisage an investment policy strategy without incentive schemes. Incentives 'should be seen not as a problem and a drain on the fiscus but as an integral part of the solution.'<sup>203</sup>

### 6.3 Recommendations

Fiscal authorities have a responsibility to strike a balance between the expenditure and revenue side of the budget. Moreover, *Jiboa* found that 'the structure of the system seems to matter less for private and economic growth, and government should continue identifying possible leakages that erode the tax base'<sup>204</sup> Over the years, tax incentives have continued to be part of development policy in South Africa, the same can be argued globally. However, the evidence of the impact of targeted incentives remains unclear.

The major findings of this research suggest that fiscal policy makers should consider the following in their policy formulation:

- The interventions that are aimed at mitigating these challenges should be taken within a supportive macroeconomic framework, which balances the need to restore fiscal sustainability with economic growth that attracts investment.
- Investment policy should be based on a set of explicitly formulated policy objectives with clear priorities, a time frame for achieving them, and the principal measures intended to support the objectives. These objectives should be the principal yardstick for measuring policy effectiveness.
- Targeted incentives may help correct market failures and advance certain development goals, such as supporting renewable energy or skills and technology upgrades and enhancing the positive impact of

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<sup>203</sup> Chipfupa, T 'Incentives: policy, benefits and risks' available at <https://www.thesait.org.za/news/540310/Incentives-Policy-Benefits-and-Risks.htm>, accessed on 7 September 2023.

<sup>204</sup> Jibao, *SS Enhancing Sustainable Fiscal Policy in South Africa* (PhD(Economics), University of Pretoria, 2013) 177.

investment. Therefore, the government needs to focus on a long-term investment framework that encourages private investment in areas that are critical for growth.

- Greater attention should be given to legislative processes to address the leakages such as shadow economic activities that erode the tax base. Cooperation with institutions such as the Financial Intelligence Centre must be at the centre of this approach.

These recommendations may be useful in addressing the policy objectives which the current incentives approach sought to address. It must be reiterated though that, while they may not seek to replace existing incentives, these may escalate the realisation of NDP goals.

#### 6.4 Limitations and suggestions for further research

Although this research paper is conducted through a review of literature already researched on the topic, the question on new and latest information cannot be certain as this subject is a moving target. This study should not be a once-off and have policy formulation relying on it. Therefore, periodic assessment in this regard should be undertaken.

The focus of this research investigates the concept of the incentives framework in totality, and its impact on the policy objectives. However, it became clear that a thorough assessment of each incentive program could make a meaningful contribution to assessing their impact on the policy direction of the country.

This study assessed the impact of tax incentives interchangeable with general incentives as a policy tool to achieve policy objectives, it became clear that a distinction can be drawn between tax and non-tax incentives. It would, therefore, be interesting to find whether their respective impact is distinctly dissimilar.

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