



Budget 2025

Responsible growth for a sustainable future

20 March 2025



Table of contents

Executive summary	3
Introduction	4
Collecting taxes, fairly	5
Growing the economy to create more tax revenue	8
Towards climate-resilient infrastructure	10
Contacts	12

Executive summary

This year, PwC South Africa's theme for the Budget Speech season is 'Responsible growth for a sustainable future'. It emphasises the need to make the right fiscal choices today in the interest of South Africa's tomorrow. In this report, we reflect on the broader context of South Africa's tax increase choices, levers to improve economic growth and the need for climate-resilient infrastructure.

Budget Speech 2025 announced that the Value-Added Tax (VAT) rate will increase by 0.5 percentage points to 15.5% in May 2025 and another 0.5 percentage points in April 2026. This is expected to generate R43.3bn in tax revenues in the next two fiscal years. We believe that there are other options available for the National Treasury to also consider as it looks for additional tax revenues. One option would be to invest in narrowing the tax gap (the difference between taxes legally owed and taxes collected), currently estimated at more than R400bn. Another option is revising the Southern African Customs Union (SACU) revenue sharing formula, which in 2025/2026 will see R73.5bn paid over to some of our neighbouring countries.

Plans to increase tax rates might be less of a focal point if South Africa's economy was growing at a healthier pace —there is a strong positive relationship between economic growth and tax revenue growth. One of the ways that to economy can grow faster is through productivity gains. Productivity is a catalyst for economic development, enabling nations to produce more with the same scarce resources. The levers that can be pulled to accelerate South Africa's productivity and economic growth centre on energy, logistics and infrastructure.

Frequent references in the Budget Review 2025 document to infrastructure spending are not accompanied by discussions about the impact of climate and weather on infrastructure. While South Africa wants to increase funding for climate-resilient infrastructure, the fiscus cannot afford to financially support the amount of investment that is required. There are, however, some key steps that could improve traditional infrastructure delivery processes to increase the climate resilience of fixed capital. These include incorporating climate risk assessments into project planning; harnessing nature as a buffer against extreme weather; using community knowledge and volunteers; updating building codes and standards; and attracting private sector investment.

Introduction

Last week, the finance minister Enoch Godongwana delivered his Budget 2025 to Parliament.

The address was later than initially expected. As the time neared last month for the minister to present the nation with the government's fiscal plan, members of the cabinet returned to the drawing board on some key issues impacting the fiscus. Parties belonging to the Government of National Unity (GNU) embraced their mandate to work together to find common ground on difficult decisions that needed to be made.

This year, PwC South Africa's theme for the Budget Speech season is 'Responsible growth for a sustainable future'. It emphasises the need to make the right fiscal choices today in the interest of South Africa's tomorrow. It carries the same spirit that the GNU harnessed to work together towards finalising the country's fiscal plans for dissemination today.

Collectively, we need to focus on creating a more prosperous South Africa. The fiscal budget is key to this endeavour: collecting taxes and spending this money on the socio-economic needs of our people are core responsibilities of the state.

Through our **Ubuntu Bethu (Our Humanity) strategy**, PwC leverages our community of solvers to build trust and deliver sustained outcomes towards creating a more prosperous South Africa.

To this end, we have asked a group of our brightest minds to consider how we, as a society, can improve upon some of the pertinent factors influencing the fiscal balance: how and where does tax money come from and how and where is it spent.

In this report, we reflect on the broader context of South Africa's tax increase choices, levers to improve economic growth and the need for climate-resilient infrastructure.



Collecting taxes, fairly

South Africa has seen large fiscal deficits over the past decade, resulting in substantial increases in the public debt burden and the amount of money spent on debt servicing. This year, around 22c of each rand that the state collects will go towards servicing debt.

As such, South Africa is in search of ways to shore up its revenues towards reducing the fiscal deficit today and, over time, reduce its debt burden. There are, of course, a myriad of ways that this can be achieved, both from a theoretical and practical perspective. We consider three options available over the medium term.

3.1 Raising Value-Added Tax (VAT)

The finance minister is proposing that VAT will increase by 0.5 percentage points to 15.5% on 1 May 2025 and another 0.5 percentage points in April 2026, in a compromise to the original proposal to increase the VAT rate by two percentage points. It is envisioned that the 0.5 percentage points adjustments would generate an extra R13.5 bn in tax revenues in the 2025 fiscal year and R43bn over the next two years.

We agree with the Budget Review 2025 (page 39) that increasing taxes on consumption through a higher VAT rate will have the least detrimental effect on economic and employment growth over the medium term, relative to increases in personal income tax (PIT) and corporate income tax (CIT). Consumption taxes such as VAT do not distort savings and investment and are consequently less damaging for economic growth.

A higher VAT rate will have the least detrimental effect on economic and employment growth over the medium term, relative to increases in personal income tax (PIT) and corporate income tax (CIT).

As noted by the Budget Review 2025 (page 39), South Africa's PIT and CIT are relatively high compared to its peers whereas the VAT burden is relatively low. We estimate that, across upper-middle income countries, VAT rates average around 18%.

Since the 2008 global financial crisis, the individual contributions of different taxes to South Africa's tax mix have changed significantly. The contribution of PIT has increased substantially, the contribution of CIT has decreased, while the contribution of VAT has remained relatively constant.

Increasing PIT—especially at the higher income brackets—has been proposed as an alternative to increasing VAT. At present, the PIT burden (the largest single contributor to the tax mix) is equal to nearly 10% of GDP, the highest of any middle-income country and towards the high end for even high-income countries. Various studies have shown that PIT is amongst the most damaging taxes for economic growth.

In the local context, while South Africa has implemented substantial PIT increases in each of the five fiscal years until 2018/2019, these increases did not translate into the expected increased revenue collections. Moreover, these tax increases have had an adverse effect on levels of tax compliance and other behavioural responses.



3.2 Closing the tax gap

Various concerns have been raised about the country’s tax gap: the difference between taxes legally owed and taxes collected. PwC estimates that this gap is somewhere between R400bn and R450bn per annum. Our estimate is based on an extrapolation from various tax gap studies undertaken on portions of the tax base, the estimated size of the illicit economy in various sectors and corroborated by SARS statements on its estimate of the tax gap.

Put differently, if this money was collected in the current (2024/2025) fiscal year, tax revenues would have been more than 20% higher than the actual revenues.

PwC estimates that the tax gap—the difference between taxes legally owed and taxes collected—is up to R450bn per annum.

While it is unrealistic to expect that there would be no tax gap, a gap of around 20% of theoretical revenues is high. If South Africa’s tax gap could be narrowed by only 10% in 2025/2026, that would give rise to an additional R40bn to R45bn in revenue and would remove the need for tax increases.

To this end, Budget Review 2025 notes that the National Treasury has allocated an additional R3.5bn over the medium term to support SARS’s capital projects and to strengthen its revenue-raising capabilities.

PwC South Africa’s Taxing Times Survey 2024 notes that SARS also needs to improve taxpayer trust. Building trust will eventually translate into restored public confidence in SARS, increased overall tax morality and, ultimately, the payment of taxes.



3.3 Revised SACU revenue sharing

The Southern African Custom Union (SACU)¹ agreement provides for duty-free trade between the member countries and the sharing of customs duties (on imports of goods from the rest of the world) based on their intra-SACU imports. It also provides for the sharing of excise duties on a different basis.

In 2025/2026, the cost to South Africa of this deal—in the form of revenues foregone relating to domestic consumption of dutiable goods—is estimated by the National Treasury at R73.5bn. (The number is close to the amount that was planned to be raised with the initially suggested two percentage point increase in VAT).

This foregone revenue must be weighed up against the benefits to South Africa of having duty-free access to its neighbouring markets; exports by South Africa to the SACU economies amounts to around R200bn annually.

Clearly, these taxes could make a valuable contribution to the pressures faced by the South African fiscus, and it would be in the best interests of South Africa to negotiate a more equitable revenue-sharing formula. To be fair, Pretoria has been trying to renegotiate the agreement, including the revenue-sharing formula, since 2011—with no success.

Failure to revise the SACU formula is hardly surprising given that smaller member states rely on SACU revenues for substantial shares of their overall fiscal revenues. Between 30% (Botswana) and 40% (Eswatini) of their government revenues come from this source. A reduction in their SACU revenue shares would mean that these countries would need to reduce expenditure or implement significant tax increases to maintain their current levels of fiscal spending.

The current revenue sharing formula is not sustainable for South Africa's fiscus. Should South Africa withdraw from SACU to secure back its foregone revenue, it would obviously leave the smaller SACU members in a serious financial predicament. This could potentially plunge them into a fiscal crisis unless they are able to conclude bilateral agreements with South Africa to replace SACU. Up to this point, South Africa has not been prepared to follow this route of withdrawal. But perhaps it is time to consider this possibility to encourage a revised SACU agreement and revenue-sharing formula which can be phased in over time to allow for adaptation.



¹ The SACU agreement was entered into between Botswana, Eswatini, Lesotho, Namibia and South Africa.

Growing the economy to create more tax revenue

Plans around VAT increases, the size of tax gap and adjusting the SACU revenue sharing formula might be less of a focal point if South Africa's economy was growing at a healthier pace. Real GDP growth measured only 0.6% in 2024, down from an already meagre 0.7% in the preceding year. Meanwhile, population growth exceeds 1.0% per annum. As a result, the country's real GDP per capita has been declining for the better part of a decade.

South Africa's private sector has in recent years forged strong cooperative relationships with the government in support of enabling key reforms in critical bottlenecks for economic growth. Work in energy, transport and logistics, and crime and corruption have had some positive results, though as the economic growth number for 2024 shows, more work still needs to be done.

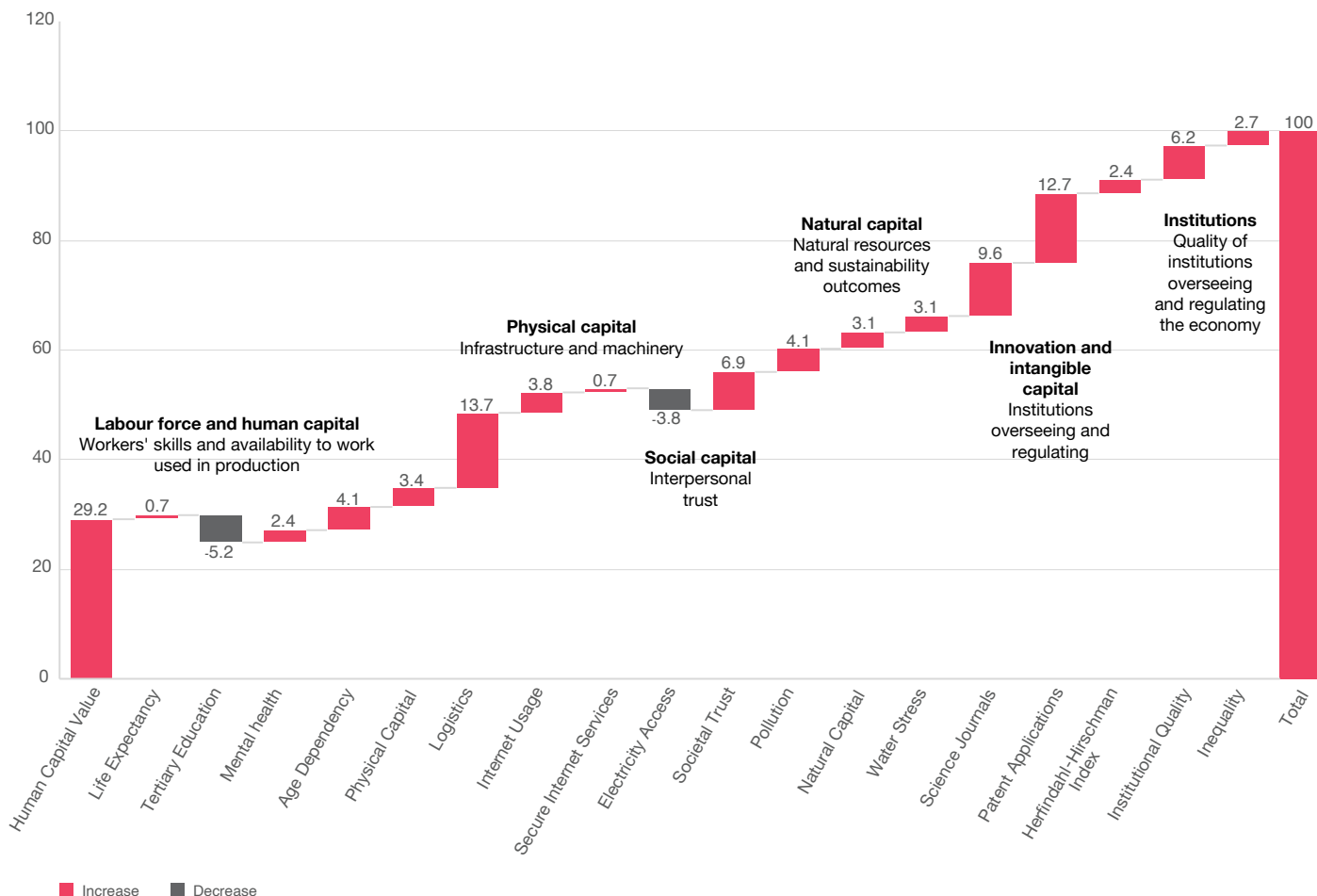
4.1 Productivity

One of the ways that South Africa's economy can grow faster is through productivity gains. Productivity is a catalyst for economic development, enabling nations to produce more with the same scarce resources. It plays a crucial role in bolstering employment opportunities, leading to better wages and improved economic conditions for individuals at the household level and across the nation.

The **Strategy& Middle East Ideation Centre's Productivity Potential Index (PPI)** looks at what determines a country's labour productivity and what levers can be pulled to improve their factors. In other words, how can South African workers be more productive, in the interest of greater economic growth and development?

As per Figure 1, the biggest contributors to South Africa's productivity and economic potential are labour and human capital, accounting for 29% of productivity. The quality of education is an important factor here. Another key productivity element is logistics, contributing 14% to productivity. That is the same logistics bottle necks that are currently getting much attention from the public and private sector, specifically the quality of railway and port services. The same goes for electricity which in the presence of load-shedding is a detractor from productivity.

Figure 1: Components of the Productivity Potential Index (PPI)



Source: Strategy& Middle East Ideation Centre

The PPI highlights the importance of quality infrastructure for productivity. If, hypothetically, South Africa's infrastructure was at the same quality level as that of Denmark, then South African labour productivity could have been two-thirds higher. Think of it this way: with a seamless public transport system, a dock worker can get to work quickly, cheaply and safely, where he/she works with equipment that offloads shipping containers quickly and sends them to their end destination via an efficient railway system and last-mile truck transport. All of this requires high quality infrastructure and logistics systems.

Of course, comparing South Africa's infrastructure and logistics capabilities to that of Denmark is just a thought exercise. But it does show how far South Africa is from top-performing countries; Denmark's productivity as measured in US dollars is more than three times higher compared to South Africa.

We know what the levers are that need to be pulled to accelerate South Africa's productivity and economic growth, with energy, logistics and infrastructure being some of the main ones. There is a close relationship between nominal economic growth and tax revenue growth, with a long-term average of 1:1. So, if we can get the economic levers right, we can help improve the course of the fiscal ship.



Towards climate-resilient infrastructure

Budget Review 2025 (page 3) announced that, over the next three years, R1tn will be spent on public infrastructure. This is a massive investment in physical capital. Elsewhere, the document refers to the risks posed by adverse weather events to inflation (page 17) and economic growth (page 20).

However, frequent references to infrastructure spending are not accompanied by discussions about the impact of climate and weather on infrastructure. This should not be surprising, a year ago, the deputy finance minister said that while South Africa wants to increase funding for climate-resilient infrastructure, the fiscus cannot afford to financially support the amount of investment that is required.

Climate-resilient infrastructure

Climate-resilient infrastructure is the design, construction, and maintenance of infrastructure systems that can withstand and adapt to the impacts of climate change. This includes extreme weather events, rising sea levels, and other climate-related challenges.

While South Africa wants to increase funding for climate-resilient infrastructure, the fiscus cannot afford to financially support the amount of investment that is required.

This funding question is a challenge experienced in many (if not most) countries around the globe: not only finding money for infrastructure spending but also having the resources to make this capital climate resilient. As with many public sector investments, there are trade-offs between the short and the long-term: climate-resilient infrastructure is more expensive in the short-term but more financially attractive over the long-term due to its resistance to e.g. weather damage.

This funding shortfall and trade-off decisions are made even more challenging by the urgency at which some spending needs to take place. When floods occur, for example, rebuilding needs to happen quickly and money needs to be found even faster. In 2023/2024, funding for rebuilding after flooding, droughts and wildfires in the Western Cape was R7bn short. Deficits in the Eastern Cape and KwaZulu-Natal also amounted to billions of rands.

5.1 Harnessing nature and communities to protect infrastructure

South Africa is ranked 71st out of 187 countries by Notre Dame Global Adaptation Initiative for its vulnerability to climate change, specifically its exposure, sensitivity and ability to adapt to the negative impact of climate change. As such, the country needs to make sure its infrastructure is resilient against climate change. It needs roads that can handle heavier rains, bridges that can withstand the torrent of more severe flooding in rivers, and power grids that does not buckle under increasingly stronger winds, amongst many others.

This does, however, not require the process of infrastructure planning and development to be reinvented.

Rather, there are some considerations that could improve traditional infrastructure delivery processes to increase the climate resilience of fixed capital. These include:

- **Incorporate climate risk assessments into project planning:** South Africa already has stringent Environmental Impact Assessment (EIA) requirements for infrastructure projects. Depending on the project, there may be a requirement to conduct a climate change assessment which considers the potential impact the project may have on the climate and surrounding environment. However, another consideration that should be added at the project planning phase is a climate risk assessment to understand how existing risks may change over time. For example, could a 1:100 year flood event become a 1:20 year flood event? While it may not be financially feasible to design this infrastructure to accommodate every risk, it could influence the design to at least consider the material risks that may change over the lifetime of the infrastructure.
- **Nature-based solutions:** Human-made infrastructure is placed in a natural environment that, in turn, is governed by natural processes. Nature can be harnessed to help protect infrastructure against extreme weather events. For example, the nurturing of wetlands and mangroves help absorb flood waters and provide natural barriers against extreme weather conditions for the benefit of roads and bridges. Local communities also benefit from the bounty of these areas – like edible plants and fishing opportunities.

- **Community engagement:** South Africa has an effective public participation process for engaging local communities on the potential impacts they may experience through the Environmental Impact Assessment (EIA) process, which is a standard part of any infrastructure project. However, this process often emphasises the impacts on communities rather than gathering valuable insights from them to design more resilient infrastructure. Local community-based knowledge can prove much more valuable than spreadsheets and design software when it comes to understanding the risks of extreme weather. Data on the hundred-year flood line, for example, is instrumental in designing a bridge. But understanding all the floods in-between from people who lived through them can be equally, if not more important. Community members are also more likely to be involved in a volunteer capacity in e.g. maintaining wetlands and mangroves if their voices are included in design and build plans.
- **Updating building codes and standards:** While codes and standards are periodically updated, the immediate need is for adjustments that will take into account the realities of climate change over the next decades. Extreme weather conditions will become more frequent and more severe, necessitating solutions at the design stage. Here, engineers will have the responsibility of figuring out how buildings can withstand more heat, more moisture and more wind. The dual challenge is to not only consider the climate aspects but also the financial challenges. Within a specific funding envelope, the challenge is for designers to find the answers to government's challenge in finding the money for climate-resilient infrastructure.
- **Attracting private sector investment:** Budget Review 2025 (page 3) reiterates that South Africa needs higher capital investment to accelerate economic growth and that the public sector's infrastructure delivery mechanism is being reformed to better support private-sector participation. Government is hard at work to get more private money invested in public infrastructure—much the next page of this report. This is most valuable when a community requires investment spending but where the government does not have the financial resources to build the required infrastructure – much less afford the premium needed for climate-resilient building. For the private sector, contributing to infrastructure solutions in their geography can contribute to managing risks like disruption to supply chains.

Local community-based knowledge can prove more valuable than spreadsheets and design software when it comes to understanding the risks of extreme weather.



Contacts



Lullu Krugel

Africa Sustainability Leader and Southern Africa Chief Economist, PwC South Africa

LinkedIn <https://www.linkedin.com/in/lullu-krugel-5ba63939/>

Email: lullu.krugel@pwc.com



Kyle Mandy

Africa Technical and Tax Policy Leader, PwC South Africa

LinkedIn <https://www.linkedin.com/in/kyle-mandy-597b863/?originalSubdomain=za>

Email: kyle.mandy@pwc.com