***Funding the NHI - Income tax vs VAT vs sin taxes***

AFTER the South African government released its long expected Policy Paper on National Health Insurance (NHI) funding on 11 August 2011, quite a few questions remained unanswered. For that reason, market commentators are anticipating more clarity from the National Budget Speech, in particular regarding the funding mechanism form NHI. According to the Policy Paper, government planned for an additional R145 billion funding requirement in real 2010 prices for the roll-out of NHI over the next 14 years. The expectation is that these additional funds will be sourced through increased tax revenues. An additional R15 billion is needed over and above the Medium-Term Expenditure Framework (MTEF) estimated health budget for the implementation of NHI in the 2012/13 financial year. This represents an increase of 14 percent in the MTEF budget estimate and will bring the health budget from the original estimate of R110 billion to R125 billion in the 2012/13 financial year. Over the entire roll-out period, the estimate equates to an average of R10.4 billion in additional funding in real 2010 prices being required every year. Some of the funding mechanisms currently being discussed include a potential increase in the VAT rate, a surcharge on individuals' taxable income and the phasing in of a payroll tax (payable by the employee). When governments consider increasing tax rates to fund a new policy decision, it is not a straightforward decision. Factors such as equity, efficiency, flexibility, ease of administration and collection and potential revenue should be taken into account. Questions around equity will centre on whether or not the tax promotes an equitable or fair distribution of income. This would typically speak to the regressive or progressive nature of taxes. The debate round VAT, and those opposed to it, is that it is regressive in nature, meaning it affects the poor relatively more than the rich. On the other hand, proponents of VAT as a source of funding feels the tax base is broadened and that everybody can contribute. By zero-rating certain necessary items, the regressive nature of VAT is also reduced and it is relatively cheap and easy to administer if compared to income tax. Due to the broader nature of the tax base, research conducted by KPMG on the nature of a tax increase to fund NHI through VAT or through personal income tax, also indicated that increasing VAT might have a slightly less distorted nature. However, due to the socio-economic make-up of South Africa, changes in the VAT rate can and should be carefully considered. There is another, less common alternative. Many people believe that increasing the tax on cigarettes and alcohol could and would discourage harmful behaviour and, in turn, improve the population's health. From that perspective, it makes sense to use sin taxes as a potential source of funding for public health policy initiatives. In addition, sin taxes also serve as a source of revenue and are considered by some analysts to have less distortionary effects than other types of taxes. On the downside, research indicates that sin taxes might be regressive in nature and if the consumption of taxed products actually reduces on the back of the introduction of sin taxes, it might have a negative impact on the estimated revenue. Increasing sin taxes, on the face of it a potentially reasonable alternative, might therefore have other, unintended consequences that the fiscus might like to avoid. Finally, it is important to consider that tax revenue in South Africa goes into one pool and are normally not ring-fenced. The policy stance is unlikely to change with the introduction of NHI. Therefore, no matter the tax revenue source considered, the funds will be paid from the same pool of tax revenue. The question remains - who will contribute and how much?

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