MTBPS 2017

David Maynier MP, Shadow Minister of Finance

&

Alf Lees MP, Deputy Shadow Minister of Finance

Preview of the

Medium-Term Budget Policy Statement 2017

1. Introduction

The Minister of Finance, Malusi Gigaba, delivers his “maiden” medium-term budget policy statement on Wednesday 25 October 2017 in Parliament.

The medium-term budget policy statement is normally an opportunity for the minister to make adjustments to the main budget requiring the approval of Parliament.

However, we are now in deep economic trouble with weak economic growth, staggering unemployment, significant “fiscal slippage”, vulnerable financial institutions, “zombie” state-owned enterprises, major long-term fiscal risks, and ratings agencies waiting to pounce.

The medium-term budget policy statement is, therefore, an opportunity for the minister to take decisive action to reverse the economic decline by dealing with the “big five” challenges including:

- **weak economic growth** by presenting a credible plan to boost economic growth to an average of at least 3%;

- **“fiscal slippage”** by presenting a credible plan to stabilize national debt below 50% of GDP;

- **institutional vulnerability** by presenting a credible plan to support the independence of financial institutions to ensure inflation remains within the “target range” between 3% and 6%;

- **“zombie” state-owned enterprises** by presenting a credible plan to reform failing state-owned enterprises to ensure national debt, together with contingent liabilities, remains below 60% of GDP; and

- **long-term fiscal risks** by presenting a credible plan to mitigate long-term fiscal risks such as the nuclear build programme, which has the capacity to “blow up” the balance sheet.

The minister’s “maiden” medium-term budget policy statement will be a defining moment and will be made all the more difficult by the fact that he has very little political space in which to manoeuvre, as:

- decision-making on the budget has been centralized under President Jacob Zuma in a new and mysterious “presidential committee”, which appears to circumvent the Minister’s Committee on the Budget;

- decision-making on budget priorities has been centralized under the Minister of Planning, Evaluation and Monitoring, Jeff Radebe, in terms of a new budget prioritization framework, which appears to circumvent National Treasury;

- successfully implementing the minister's "Inclusive Growth Action Plan" depends on the cooperation and goodwill of a number of ministers, state-owned enterprises and public entities;

- there is general paralysis with the executive behaving like wasps in a jar as the governing party heads towards the ANC's 54th National Conference on 16 December 2017; and

- the minister is widely regarded as having played a major role in greasing the wheels of state capture and is not trusted, especially by the markets.

What will define the success, or the failure, of the minister's medium-term budget policy statement will, in the end, be whether he can give hope to the 9.3 million people who do not have jobs, or have given up looking for jobs, in South Africa.

2. "Big Five" Challenges

2.1 "Weak Economic Growth"

The main budget forecasts economic growth of 1.3% (2017), 2.0% (2018) and 2.3% (2019) for South Africa.

However, despite strong global economic growth, higher commodity prices and the end of the drought, economic growth remains low in South Africa.

We expect the economic growth forecast to be revised down in the medium-term budget policy statement closer to 0.6% (2017), 1.2% (2018) and 1.5% (2019) in line with forecasts of the South African Reserve Bank.

What this means is that the average growth rate over the medium term is likely to be close to 1.1%, which is well below the 3% required to increase employment levels, decrease poverty levels and sustain public finances in South Africa.

The most terrifying statistic when it comes to economic growth is that private sector investment contracted by 1.4% in 2015; contracted by 3.9% in 2016; and is forecast to contract by 0.4% in 2017.

Which should not come as a surprise because business confidence has plummeted to its lowest level since the global financial crisis in 2008/09.

The minister's "Inclusive Growth Action Plan" failed because it was aimed at speeding up the implementation of existing economic policy, when what we really need is a fundamental shift in economic policy to boost economic growth and create jobs in South Africa.

That is why we believe the minister should announce a package of structural reforms comprising a few short, sharp, achievable measures to boost business confidence and stimulate private sector investment, including:

- *withdrawing the current version of the Mining Charter and the Mineral and Petroleum Resources Development Amendment Bill;*
- *exempting small businesses employing fewer than 250 employees from having to comply with restrictive labour legislation, other than the basic conditions of employment;*
- *removing the extension of collective bargaining agreements to non-parties, who often cannot carry the cost of wage agreements imposed on them; and*
- *auctioning off the high-demand spectrum and using the proceeds to facilitate access to mobile internet and roll out fibre fixed-lines to support competitive technologies*.

2.2 "Fiscal Slippage"

The main budget provided for total consolidated revenue of R1.4 trillion, or 29.8% of GDP, and total consolidated expenditure of R1.5 trillion, or 33.0% of GDP, and a fiscal deficit of R149.0 billion, or 3.1% of GDP, in 2017/18.

However, because of lower-than-expected economic growth, revenue, which was projected to grow at 10.61%, has only grown by 6.14%, which suggests there may be a revenue shortfall of about R56.5 billion in 2017/18.

Moreover, expenditure, which was projected to grow at 8.09%, has only grown at 6.95%, suggesting there may be an underspend of as much as R16 billion in 2017/18.

The revenue shortfall could be partially offset by "projected underspending"; "declared underspending"; the "contingency reserve"; and possible "revenue windfalls" like the Special Voluntary Disclosure Programme, which may generate additional revenue in 2017/18.

However, this is not enough to close the "budget hole" and means we can expect significant "fiscal slippage" with a higher-than-expected consolidated fiscal deficit of about R189.4 billion, or 4% of GDP, in 2017/18.

This will in turn increase national debt, which was expected to be R2.22 trillion, or 47% of GDP, to R2.26 trillion, or 49% of GDP, in 2017/18.

The "fiscal slippage" as a result of lower-than-expected economic growth will require a fiscal adjustment beyond the R46 billion already penciled in for 2018/19.

What makes the decision concerning the adjustment even more complex is that there are significant “known unknowns” which may generate additional spending pressures including:

- in the short term: the need to provide emergency funding to support communities that have been afflicted by floods and drought; and

- in the medium term: national health insurance and post-school education and training, following the recommendations of the Commission of Inquiry into Higher Education and Training, which submitted its final report on or about 31 August 2017.

The minister would normally use the medium-term budget policy statement to send “fiscal signals” about the mix of revenue and expenditure measures to be expected and announced during the main budget in 2018.

However, we believe the minister needs to act now to begin cutting wasteful spending because we now know that:

- at national government level spending on items subject to mandatory cost containment measures decreased in real terms by only R4.5 billion between 2013/14 and 2015/16; and

- at provincial government level spending on items subject to mandatory cost containment measures decreased in real terms by only R1.7 billion between 2013/14 and 2015/16.

To put this into perspective, the savings that arise from mandatory cost containment measures, over three financial years, is only 0.39% of total consolidated expenditure in 2017/18.

That is why we believe the minister should announce:

- *the implementation of a 6% per year “haircut” on all mandatory cost containment items in general government, which would save an estimated R3.5 billion in 2018/19, R6.6 billion in 2019/20 and R8.5 billion in 2020/21, or a total of R18.7 billion between 2018/19 and 2020/21; and*

- *the implementation of a Comprehensive Spending Review aimed at reviewing the composition of spending, efficiency of spending and future spending priorities with a view to cutting spending, and changing the composition of spending, over the medium term between 2018/19 and 2020/21.*

A Comprehensive Spending Review would be geared to identify savings, for example:

- *reducing the size of the executive to approximately 15 ministries could save an estimated R4.6 billion per year, or a total of R13.8 billion between 2018/19 and 2020/21; and*

- *running the provincial legislatures more efficiently could save an estimated R1.8 billion in 2018/19, R1.9 billion in 2019/20 and R2.0 billion in 2020/21, or a total of R5.7 billion between 2018/19 and 2020/21.*

The savings identified as a result of a Comprehensive Spending Review should be allocated:

- *to fund investment in infrastructure and skills development to support economic growth; and*

- *to cut the fiscal deficit in order to reduce national debt and debt service costs over the medium term between 2018/19 and 2020/21.*

The fact is that the Comprehensive Spending Review model has proved to be successful in Australia (Comprehensive Spending Review 2010), Canada (Strategic and Operating Review 2011), and the United Kingdom (Comprehensive Spending Review 2010).

However, if we are going to get serious about cutting spending we will have to confront the ballooning cost of "compensation of employees", which is projected to cost R1.7 trillion, and which is projected to grow at 7.2%, between 2017/18 and 2019/20.

To illustrate the possibilities, consider the following:

- a freeze on the salaries of senior management, who earn more than R918 000 per year, and who are employed on salary levels 13 to 16 in general government, would save an estimated R1.2 billion in 2018/19, R2.0 billion in 2019/20 and R2.8 billion in 2020/21, or a total of R6 billion between 2018/19 and 2020/21;

- a freeze on the salaries of senior management, together with inflation-related increases to employees, who earn between R227 000 and R918 000 per year, and who are employed on salary levels 7 to 12 in general government, together with a 1% above inflation-related increase to employees who earn between R84 000 and R216 000 per year, and who are employed on salary levels 1 to 6 in general government, would save an estimated R6.5 billion in 2018/19, R10.6 billion in 2019/20 and R15.1 billion in 2020/21, or a total of R32.3 billion between 2018/19 and 2020/21; and

- a freeze on the salaries of all employees in general government would save an estimated R57.8 billion in 2018/19, R92.7 billion in 2019/20 and R129.1 billion in 2020/21, or a total of R279.7 billion between 2018/19 and 2020/21.

2.3 "Institutional Vulnerability"

The South African Reserve Bank, Public Investment Corporation and National Treasury's institutional independence are under threat, which risks compromising monetary policy, fiscal policy and pension savings, not to mention the sovereign credit rating of South Africa.

We have Governor Lesetja Kganyago in court defending the constitutional mandate of the South African Reserve Bank.

We have the Chief Executive Officer of the Public Investment Corporation, Dr. Dan Matjila, defending himself against charges which have been found to be baseless.

Worse, we have the:

- reported centralization of decision-making in the Finance Ministry at the expense of experienced senior officials in National Treasury; and

- reported restructuring of the Governance, Monitoring and Compliance Unit, which is responsible for approving, or not approving, applications for tender deviations and extensions, in the Office of the Chief Procurement Officer in National Treasury.

The fact is that, when you join the dots, this amounts to the "defanging" of National Treasury.

> *We believe the minister needs to make a strong and unequivocal statement to the "state capturers":*
>
> - *that supports the institutional independence of the South African Reserve Bank, Public Investment Corporation and National Treasury;*
> - *that provides a clear assurance that there will be no review of the functions of the Governance, Monitoring and Compliance Unit in the Office of the Chief Procurement Officer; and*
> - *that provides a robust defence of the independence and constitutional mandate of the South African Reserve Bank*.

2.4 "<u>Zombie State-Owned Enterprises</u>"

The fact that Dudu Myeni, who behaved more like a "corporate warlord" than a chairperson, and who was responsible for generating losses of R15.3 billion, has effectively been fired, following major pressure from the domestic lenders, is a step in the right direction for South African Airways.

The minister has stated that in order for the national airline to remain in business it requires bailouts of R10 billion in 2017/18 and a further R3 billion in 2018/19.

However, the national airline remains in danger of "crash landing", not just because it is insolvent, and not just because its going concern status rests on a R19.1 billion guarantee, of which R16.1 billion has been utilized, but because things have got so bad that the national airline has:

- consumed two bailouts, using emergency funding provisions, under Section 16 of the Public Finance Management Act (No. 1 of 1999), totaling R5.2 billion;
- owes domestic lenders R5 billion on 31 October 2017, with an option to roll over to 31 March 2018, and owes a further R13.7 billion to various lenders, in the future; and
- is experiencing a cash crunch: average losses of about R400 million per month have been projected for the next 6 months of 2017/18.

The minister will have no option but to provide for both the emergency bailout, totaling R5.2 billion, and a further R4.8 billion for working capital, in the adjustments budget.

However, the mystery is how the R10 billion will be funded in a "deficit neutral" way, given the fact that the appetite to sell Telkom shares, which would have been worth about R14.4 billion, seems to have cooled.

We cannot be sure but there are various options available including securing a private equity partner, selling liquid assets, reprioritizing expenditure, and ultimately funding from the Public Investment Corporation.

> *We believe that the minister should put the national airline into business rescue with a view to stabilizing and then privatizing South African Airways*.

We expect that South African Airways will absorb most of the "oxygen" when it comes to "zombie" state-owned enterprises during the medium-term budget policy statement.

However, there are other "zombie" state-owned enterprises including Eskom, South African Broadcasting Corporation, South African Post Office and PetroSA, which may require some form of financial support over the medium term between 2017/18 and 2019/20.

2.5 "<u>Long-Term Fiscal Risks</u>"

The appointment of the new Minister of Energy, David Mahlobo, following a reported "final warning" from the Russians, signals an intention to accelerate the implementation of the nuclear build progamme, which is terrifying. The nuclear build programme may cost up to R1.2 trillion, over a period of perhaps 20 or 30 years, and has the capacity to "blow up" the balance sheet.

> *We believe the minister should announce the termination of the nuclear build programme in South Africa*.

3. Conclusion

We began by pointing out that the minister should take decisive action to reverse the economic decline by dealing with the "big five" challenges including: weak economic growth, “fiscal slippage”, institutional vulnerability, “zombie” state-owned enterprises, and long-term fiscal risks such as the nuclear build programme in South Africa.

We believe the minister could deal decisively with the “big five” challenges by using the medium-term budget policy statement to take decisive action to reverse the economic decline as follows:

- **boosting economic growth** by announcing a package of structural reforms to build business confidence and stimulate private sector investment;

- **stabilizing public finances** by announcing a “haircut” on all mandatory cost containment items and implementing a Comprehensive Spending Review;

- **supporting the independence of financial institutions** by making a strong statement in support of the institutional independence of the South African Reserve Bank, Public Investment Corporation and National Treasury;

- **reforming “zombie state-owned enterprises** by putting the national airline into business rescue with a view to stabilizing and then privatizing South African Airways; and

- **mitigating significant long-term fiscal risks** by terminating the nuclear build programme.

We believe that this would go a long way to giving hope to the 9.3 million people who do not have jobs, or have given up looking for jobs, in South Africa.

Because, in the end, as the former Minister of Finance, Nhlanhla Nene, used to say, “*Without economic growth, revenue will not increase. Without revenue growth, expenditure cannot increase*.”