Medium Term Budget Policy Statement 2020

Preview Document

Geordin Hill-Lewis MP
DA Shadow Minister of Finance

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Introduction

In an already extra-ordinary year, this week the Finance Minister will deliver his third budget of 2020.

While economic conditions have changed dramatically since the first budget was delivered in February, the core job description of the National Treasury has not.

The Treasury, and the Finance Minister, must restore South Africa to a sustainable debt path and re-establish fiscal discipline.

Equally important is protecting essential public services from deep budget cuts. These two goals are related. If we spend more on interest on debt, we will have less to spend on essential services.

And if spending is focused on wasteful projects and failing state companies, there will be less for essential services.

The Minister and his excellent Treasury team know this full well. That is why the Minister committed the government to achieving primary balance and debt stability by financial year 2023/24.

In that budget, the Minister set out clearly the risks associated with failing to close the mouth of the hippo – the yawning gap between government revenue and government expenditure.

This was the so-called "active scenario" requiring meaningful progress on wide-ranging economic reform to reorient the economy for growth.

The active scenario would require some difficult and painful decisions in the short term – most notably, deep cuts to the public wage bill, and ending the cycle of perennial bailouts for failing state entities.

Like the stubborn patient who refuses to deal with a gangrenous foot, and so eventually loses the entire leg, the ANC has refused to take the action now that would prevent far more painful consequences later.

The consequences of not achieving the "active scenario" are a full-blown sovereign debt crisis that would see South Africa cede a portion of policy sovereignty to international lenders, be they based in Beijing or Washington. More than that - far deeper cuts across every public service, affecting the poor above all.

Cabinet has so far paid little heed of Treasury's warnings. There has been little meaningful progress on economic reform, national debt continues to mushroom, and South African Airways (SAA) is set to receive another R10.5 billion bailout.

We expect that the trend will continue of ever more dire warnings about what is coming, followed by inadequate action to change course. This means that we do not expect the targets in the "active scenario" to be met, and that Minister Mboweni will try to find ways to redefine these targets.

A fundamental choice: "State Ambition" versus giving "Power to the People"

Lying behind various debt scenarios and fiscal targets, there is a more fundamental underlying problem that will continue to hobble any latent recovery.

South Africa's economic recovery depends on a simple yet crucial choice that the ANC must make: state ambition versus giving power to the people.

The ANC must abandon its ambition for a state-led economy, which is smothering the entrepreneurial talent of South Africans.

In what was to be his final public engagement before his untimely passing, Professor Daniel Plaatjies (to whom we pay tribute for his long and distinguished contribution) spoke just 3 weeks ago of the ANC's failed ambition to build a developmental state. He concluded that the edifice constructed by the ANC is developmental in name only – all of the ambition, with none of the substance.

This 'state ambition' with low capabilities and corruption has been a lethal combination: it has nearly crippled South Africa.

The ANC aspired for the state to lead industry, to be the primary employer, to determine what gets produced by whom, to determine who gets a job, and to maintain an ironclad monopoly on the delivery of essential services etc.

In pursuit of this 'state ambition', the ANC has expanded public spending massively.

Government debt as a ratio to GDP

This gamble has not paid off. South Africa has high debts and nothing to show for it.

In pursuit of this 'state ambition', the ANC has given endless public financial support to state owned companies whose control they have also guaranteed through cadre deployment.

Now, nearly every state-owned enterprise without exception is a failing businesses, with unreliable or collapsing services.

A bloated public sector delivers increasing salaries and declining services.

Roughly half of all South Africans above the age of 18 live below the upper-bound poverty line (R1 227) and, by law, they are not permitted to escape it. South Africans are required to sit at home rather than accept a job for less than R2 491 a month in the private sector.

Finally, the services paid for by taxpayers are broken. In fact, they are so broken that after paying the government, taxpayers pay the private sector again to actually deliver them the services they need - private security, private healthcare, private education, private transport, etc.

This is the legacy of the ANC's 'developmental state' ambition.

The South African economy requires a radical reorientation from state ambition towards giving power to the people.

South Africa already has the natural endowments, entrepreneurial talent, and ideas to drive an economic renewal, but it requires a government willing to unleash it.

A growing economy enables us to provide better and more meaningful welfare support to the poor and the unemployed - the kind of support that actually gives you an opportunity to escape poverty and become independent. Not support so paltry, important as it is, that it keeps you trapped in a cycle of government-induced poverty. A basic income becomes more and more feasible in the context of a growing economy where fewer people would be out of work.

If South Africa continues with state ambition over giving power to the people, we will forever be trying to do more, but with a declining base of taxpayers to provide the revenue needed to fund more.

Changing direction will not be easy. South Africa has built up significant momentum towards economic ruin. It can be done, but it requires tough choices to overcome inertia.

This document highlights the tough choices South Africa needs to make in order to give power to the people.

The sapping of the National Treasury's authority:

First, the National Treasury must reassert itself as the centre of fiscal and economic policy making in the government.

The authority of the Treasury has slowly been sapped, and it is starting to show. Senior staff are beginning to leave, and the vacancy rate was at 9.6% at the start of fiscal 2020/21.

Other departments and the Presidency have moved into the policy-leading space the Treasury once held.

The credibility of the Treasury has also been undermined by presenting budgets which are treated by the rest of government only as suggestions of what to aim for, rather than essential to achieve.

Related to this, the Treasury also harms its own credibility when it makes budget assumptions which are clearly not possible.

For example, we expect that this budget will assume zero growth in the public wage bill, when that is clearly very unlikely to eventuate.

Finally, Treasury must be sure to win the fights it picks. Drawing a line in the sand on SAA, and then capitulating to fund another bailout, leaves the Treasury weaker.

This bailout has become symbolic of all that is wrong with the government, and all the difficult choices the ANC must make in this budget.

South African Airways:

The SAA bailout is why this budget is ultimately bound to disappoint. It represents the failure of the ANC to make the choice to move away from state ambition to giving power to the people.

Besides insiders and vested interests, there is no one left in South Africa still trying to make a case for why SAA should be bailed out again. The ANC does not even try to make a case for it.

And yet, another bailout is coming. R10.5 billion, on top of R16.4 billion in February.

This is perfectly symbolic of the choice of 'state ambition' over empowering people.

It is a morally indefensible choice to make.

In the context of the scale of financial stress and personal suffering faced by so many South African families right now, spending should be prioritized for protecting essential services, or providing greater relief.

This is the choice being made:

- R10.5 billion could fund, on average, a little more than one additional month of TERS support for families who are still not earning their full pre-lockdown salaries.
- R10.5 billion represents 130 new schools
- R10.5 billion represents roughly 1.4 times the entire annual budget of the National School Nutrition Program
- R10.5 billion represents over 80 000 education degrees.
- R10.5 billion represents 13 new 300-bed district hospitals.
- R10.5 billion represents over 440 new green community clinics.
- R10.5 billion represents over 27 000 medical degrees.
- R10.5 billion represents over 66 500 RDP houses.

That is the choice the ANC is making: SAA above SA. State ambition above empowering people.

Independent expert analysis by Dr Joachim Vermooten has shown that total government financial assistance (guarantees plus cash) to South African Airways up until the MTBPS given in October 2019 amounted to a massive R54 billion. Of these billions, R44.042 billion was cash assistance, whilst R9.914 billion were government guarantees. Transnet, whilst SAA was under its control, also provided cash assistance to SAA to the tune of R13.3 billion. In total, SAA thus received over R67 billion in financial assistance over the previous two decades.

Then, in February of this year, Treasury allocated R16.4 billion to SAA in order to repay guaranteed debt to, amongst other creditors, the Big Banks and the Development Bank, who are complicit in the wasting of taxpayer money.

The final picture thus looks very bleak. Billions in financial assistance that has been given to SAA, without anything to show for it. The latest request for R10.5 billion to "restructure" our dead 'national bird' will push the assistance given to SAA over the R75 billion mark.

Assuming that these billions would have been spent anyway, why not use it to invest in South African citizens themselves, thus ensuring positive multipliers that translate into levels of economic growth that are high enough to both pay off the debt and create jobs, without requiring billions in tax hikes.

Western Cape Premier Alan Winde summed it up perfectly this week when he said "…we don't need state funded planes, but we do need working trains…we don't need chicken or beef being delivered in the skies to those who already have an income. But what we do need is good nutritious food delivered to our children so we can eradicate extreme hunger".

And that is why we are so committed to raising public awareness about how wrong this choice is. We will continue to escalate our campaign against this bailout - Both in the hope of stopping it, but also so that the ANC is held accountable.

Public Spending

The ANC needs to make the following tough choices:

State Ambition	**Power to the People**
Spend its way out of crisis	Stabilise debt by passing the Fiscal Sustainability Bill and stop crowding out private sector investment
Increase taxes to fund fiscal expansion	Cut taxes and allow citizens to decide how to properly spend the fruits of their labour
Use the state as an employment vehicle that pays exorbitant salaries	Cut the bloated public sector both in terms of number of employees as well as wages and stop crowding out the private sector
Bail out of unnecessary state-owned enterprises such as SAA	Sell off or liquidate white elephants such as SAA and spend the monies on things that actually help ordinary South Africans such as healthcare, education, etc.

State expenditure in South Africa is ballooning out of control and is increasingly reliant on accruing more and more debt with higher and higher financing costs. This places a heavy burden on taxpayers and the economy at large. What piles onto the problem of state spending is the fact that spending priorities are severely misguided.

For every R10 that government spends, over R3 goes towards the salaries of state officials. Public wages take up roughly half of total tax revenue. This produces a crowding-out effect that forces government to borrow the rest of the money that is needed for expenditure on healthcare, education, and infrastructure. The excessive borrowing causes debt financing costs to increase to unsustainable levels, which simply exacerbates the crowding-out effect.

Current projections estimate that debt-servicing costs, which is projected to take up nearly 22% of main budget revenue by the end of fiscal 2020/21 and which currently takes up 12% of government spending (which is on par with healthcare expenditure), will take up nearly 5% of GDP by the end of fiscal 2020/21. Coupled with non-interest expenditures, the deficit is set to increase to almost 15% of GDP by the end of this fiscal year.

This negative outlook exacerbates the debt problem because it lowers demand for government bonds by investors, forcing prices down, and causing borrowing costs to increase.

It is a prerequisite to cut the public sector wage bill if the pressure on government to borrow is to be reduced.

Last year, the DA called for a R168 billion cut to the public wage bill over the period 2020/21 to 2022/23. In the 2021 Supplementary Budget Review, Treasury made a promise to South Africans that the 2021 Medium Term Expenditure Framework will assume the *necessary* revisions to the wage bill. It is non-negotiable that Minister Mboweni must strive to drastically reduce the total compensation of both head-office management, as well as all non-occupation specific dispensation (frontline) wages.

Minister Mboweni announced in the Main Budget Review in February that employee compensation was reduced by roughly R37.8 billion. However, no further adjustments were made in the Supplementary Budget Review. This still leaves R130.2 billion that needs to be cut if the R168 billion reduction suggested by the DA is to be realized. Not a lot of time is left to effect this drastic cut before the end of fiscal 2022/23, which is only 28 months away.

Furthermore, to relieve pressure on the fiscus as well as assist ordinary South Africans, the DA again calls on government to auction of digital spectrum, sell off as many public enterprises as it can, and cut planned expenditures for disastrous ideological pipedreams such as National Health Insurance.

In 2019, the DA pointed out that the auctioning of digital spectrum coupled with cutting NHI can save government around just over R38 billion.

Any further bailouts, whether in the form of cash recapitalization or taxpayer-backed loan guarantees, to non-crucial state-owned enterprises must also be stopped.

Most notably, South African Airways should not be bailed out with a further R10.5 billion that is required in terms of the proposed business rescue plan. It is worrying that Minister of Public Enterprises, Pravin Gordhan, has already stated that Cabinet supports the bailout, which is on top of the R16.4 billion in loan guarantees provided to SAA in the February budget speech. Strangely, nothing about SAA was mentioned in the Supplementary Budget Review.

Other non-crucial state-owned entities such as Denel should preferably also be sold to the highest bidder. There is absolutely no reason that domestic private companies subjected to market forces cannot compete to supply the South African National Defence Force with the equipment it needs. Notwithstanding risks related to cronyism and political lobbying, private defence contractors around the world such as Raytheon and Lockheed-Martin have shown that it is practical to not have the state effectively engage in vertical integration when it comes to weapon supply chains.

Energy

State Ambition	**Power to the People**
Retain Eskom	It is imperative that Eskom be unbundled, and that the generation, transmission, and distribution entities be sold off to the highest bidder.
Restrict and delay IPPS	Legislative and regulatory changes must be effected that allow independent power producers to contribute to the country's energy needs.
Keep Eskom bundled up	Eskom should be unbundled and split up into three entities with three separate functions: generation, transmission, and distribution.

Eskom is currently in disarray, with CEO Andre de Ruyter warning the nation last week that they will take between 8 000 and 12 000 megawatts out of commission over the next decade. Granted, there will be a procurement of 11 000 megawatts according to de Ruyter, but this will still leave South Africa with either a net gain of 3 000 megawatts at best, or a net loss of 1000 megawatts.

If the economy is to be saved, it is crucial that Eskom not be 'saved', but that power truly be given to the people by creating an environment conducive to independent power producers not merely contributing to the grid, but dominating it. The necessary legislative and regulatory changes must be effected to allow IPPs to save the economy and our people.

The unbundling of Eskom into three separate entities – generation, transmission, and distribution – is also long overdue. It is a good sign that President Ramaphosa's Economic Reconstruction and Recovery Plan explicitly states that the creation of a transmission company to facilitate electricity trading is on the cards, but talk has unfortunately become extremely cheap. This commitment was also made in the Supplementary Budget. South Africans want, and need, to see implementation of all the lofty promises of structural reform.

At the start of 2020, BNP Paribas senior economist Jeff Schultz predicted that, with a minimum of 15-20 days loadshedding during the first half of 2020, 0.3-0.4 percentage points would be cut from South Africa's economic growth rate. That is 0.02 percentage points per day of loadshedding. Thus far, the loadshedding during 2020 has been the worst on record, even though demand for electricity slumped owing to Minister Dlamini-Zuma's draconian lockdown policies that forced millions more South Africans into the unemployment line.

For January, electricity consumption decreased by 2.5% on a year-on-year basis. For March, electricity consumption decreased by 4.1%. For April, the decrease in consumption was 23.3%. For May, the decrease was 13.6%. For the winter, the monthly year-on-year decreases in consumption were 5.8%, 4.5%, and 0.4%, for June, July, and August respectively. Thus far, electricity consumption only increased in the month of February, and by a meagre 1%. Yet, Eskom still could not keep the lights on.

It is simply non-negotiable that National Treasury pressure the President to speed up Eskom's unbundling and the gradual privatization of generation plants, whilst opening up the grid to IPPs. The R112 billion that Treasury allocated to Eskom over the MTEF is simply to meet its short-term financial obligations, with R23 billion being allocated for restructuring purposes.

Small Business

State Ambition	**Power to the People**
Onerous regulations such as a National Minimum Wage	Decrease regulatory burdens on micro, small, and medium-sized enterprises. A job that pays badly is better than no job at all.

President Ramaphosa's administration clearly still does not value entrepreneurs and small businesses to the extent that it should.

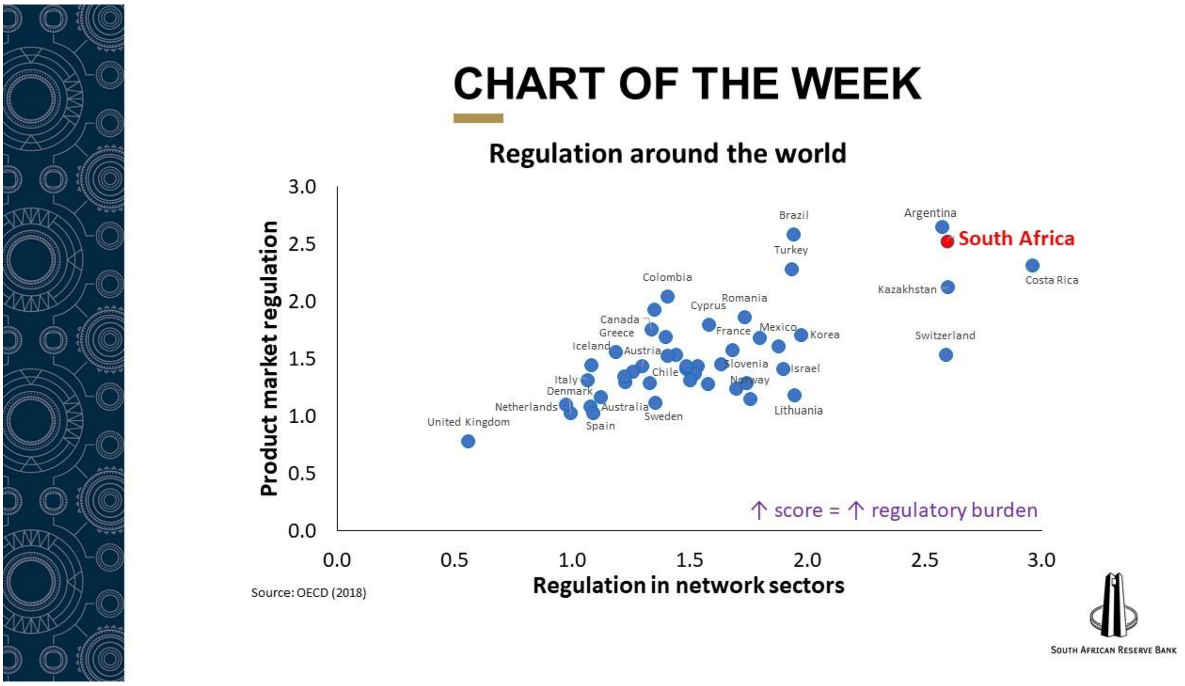
In Main Budget Review in February, the Small Enterprise Development Agency was allocated a mere R2.8 billion, whilst R2.4 billion was allocated to small business development. In the Supplementary Budget Review, the funds for the latter were cut by R67 million.

But developing small business does not only entail funding it, but also cutting red tape and reducing regulatory burdens faced by SMMEs.

In the European Union, a little over two thirds of employment comes from SMMEs. In 2015, enterprises employing fewer than 250 persons represented 99 % of all enterprises in the EU. For fiscal 2018/19, SMMEs in Europe employed two-thirds of the entire European Union labour force produced more than half of all value added in the EU economy.

If South Africa is to move towards a prosperous market economy, where individuals can freely associate with one another in mutually beneficial, wealth-creating economic relations, it is imperative that corporate power be decentralized through the creation of an environment that is conducive to SMMEs.

As can be seen below, regulations in South Africa are some of the most stringent in the world.



Welfare

State Ambition	**Power to the People**
More people on state welfare	Lessen the amount of people dependent on state welfare by allowing the private sector to breathe and create jobs

The number of South Africans dependent on grants now stands at around 18 million. But worse than that, the ruling party probably figures it is an achievement that the number of South Africans dependent on the state for survival has increased.

Social grants now take up 3.5% of our entire gross domestic product. In the Supplementary Budget, Treasury estimated that this ratio would stay constant over the medium term.

The best measure, however, of how well a state serves its citizens, and how effective a welfare system is, is the rate at which people become *independent* of such a system.

It is crucial that the concept of welfare must be reimagined and reconstructed to entail the notion that free individuals can care for themselves and their loved ones. Welfare is not dependence. It is the ability to freely strive towards achieving one's own goals through independent, yet still mutually beneficial means, in a social market society.

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