Medium Term Budget Policy Statement 2021

ENABLING POST-PANDEMIC ECONOMIC RECOVERY

Dr Dion George MP
DA Shadow Deputy Minister of Finance

Introduction

New Finance Minister Enoch Godongwana's first Medium Term Budget Policy Statement, to be presented on Thursday, will be a key determinant of the pace at which South Africa's post pandemic economic recovery will unfold.

This year's alternative MTBPS builds on the DA's alternative budget proposed in February and sets the scene for our alternative budget in February 2022.

The DA will build on our past suggestions, including a freeze on nominal expenditure increases, to set out how government can stave off a fiscal crisis by turning the primary balance deficit into a surplus within the next three fiscal years.

The Minister needs to focus on the post-pandemic economic recovery that will ensure fiscal sustainability. This requires debt reduction through an acceleration in economic growth and expenditure management.

Prospects for an economic recovery are particularly bleak as daily power failures bring the country's economy to a grinding halt and further damages already fragile investor confidence. Without a solution to the energy crisis, government will remain unable to create an environment conducive to economic growth and will remain unable to tackle our high levels of unemployment and poverty.

While the recent cyclical commodities boom has provided temporary reprieve to the fiscus, in the form of improved revenue, it is imperative that Minister Godongwana sets the country on a path of continued fiscal consolidation, sustainable public debt management and accelerated structural economic reform.

Minister Godongwana's primary point of departure should be to hold the fiscal line and ensure that South Africa remains on course to achieve the fiscal targets set by his predecessor in the February budget, which commits government to closing the main budget primary deficit, achieving a primary surplus on the main budget in 2024/25 and stabilising government debt at 88.9 percent of GDP in 2025/26.

The attainment of this target will depend, primarily, on firm cost containment measures and a definitive assurance that government will resist public sector wage increases for non-frontline workers. In the MTBPS, the Minister must remove any doubt about the necessity of freezing public sector wage increases, except for frontline workers.

It is important for the Minister to resist the temptation to use tax overruns realised from the cyclical commodities upswing to spend on distributive expenditure rather than on investment in the economy.

Equally important for Minister Godongwana is abandoning his predecessors' policy of reprioritising budgets from essential public services to bail out failing State Owned Enterprises (SOEs).

Recurrent bailouts of SOEs send the wrong message to investors and expose the fallacy of the government's empty rhetoric on structural economic reforms.

We have already seen how compound challenges affecting Transnet are threatening network industries which rely on its infrastructure to move their products. The cumulative effect of structural inefficiencies in the economy will negatively affect growth and job creation.

Cabinet cannot continue to delay the inevitable in the misplaced hope that moribund SOEs will somehow self-correct and start funding themselves from their own balance sheets.

Failure to act now by opening the sector to private sector investment will keep the country locked in a low growth trap and will slow down the post pandemic economic recovery.

As the country begins to exit the short term emergency budget instruments that were meant to address the economic impact of the pandemic, a resilient fiscal framework that focuses on growth and jobs is imperative.

Economic data shows that the most urgent challenges facing South Africa's post pandemic economy are modest economic growth, high levels of unemployment and the disproportionate impact of rising inflationary pressures on the poor. To mitigate the impact of this triple challenge, the MTBPS should be oriented towards creating post pandemic economic resilience through an emphasis on 'Rebuilding, Recovery and Resilience'.

The DA's core expectations for the Medium-Term Budget Policy Statement include:

1. Accelerating the post-pandemic economic recovery
2. Reducing gross national debt and managing expenditure
3. Supporting the vulnerable
4. Committing to no tax increases
5. Leveraging pension fund assets

<u>Accelerating the post-pandemic economic recovery</u>

Structural weaknesses in the economy severely constrain our ability to emerge from the devastating effects of the pandemic. Without an acceleration in economic growth, the rate of unemployment will spiral upwards and GDP growth will remain tepid at best.

Government has demonstrated, over and over again, that an incapable state at the centre of our economy is unable to generate growth. Active steps are required to enable the economy to grow by removing the barriers that government has imposed.

The greatest barrier to economic growth, a prime example of our incapable state, remains government's inability to provide a reliable power supply. Power failures are costing our economy in excess of R100 billion per annum.

Eskom remains on the brink of collapse, with outdated infrastructure and budget overruns in excess of R300 billion at Medupi and Kusile power stations.

It is time for Treasury to enable South Africans to become independent of Eskom through a 100% solar power rebate. Eskom's debt must be paid off to the extent that it has at least a 2:1 asset-to-liability ratio, after which it must be split up into three separate entities – generation, transmission, and distribution – and privatised as much as is reasonably possible.

Urgent steps need to be taken to stimulate economic activity, especially in the small, medium and informal sectors. More detailed proposals will be included in our Alternative Budget in February 2022.

A growing economy increases revenue, reduces unemployment and poverty and will enable us to avoid the looming debt trap that will result in significant hardship for all South Africans.

Reducing gross national debt and managing expenditure

The 2021 MTBPS should provide a clear fiscal departure away from emergency budgeting, implemented to address the short term effects of the pandemic, towards a resilient fiscal framework that is focused on a balanced budget, economic growth and drivers of job creation.

In order to ensure that this resilience building focus is sustainable, it is important that South Africa urgently addresses its twin challenges of a high debt burden and stubbornly low economic growth rates.

The consensus is that 'if debt rises above 90 percent of GDP, economic growth slows by as much as 1.3 percent annually compared to countries with lower debt'.

South Africa appears to be heading towards this debt precipice at full speed.

Government has consistently missed its own fiscal targets on debt containment. In his June 2020 emergency budget, former Minister Mboweni committed government to narrowing the deficit and stabilising debt at 87.4 percent of GDP in 2023/24 while achieving a primary surplus by 2023/24.

But just months later, in his October mid-term budget, former Minister Mboweni rowed back from this commitment, and extended the target date for debt stabilisation out to 2026.

South Africa cannot afford to keep going down this path of a debt based fiscal policy. The policy has only succeeded in saddling the country with high interest rates on debt repayments, slower economic growth and fewer resources to spend on growth drivers.

The DA's modelling, presented in our February 2021 Alternative Budget, provides a clear blueprint for getting national debt under control sooner than government proposes while protecting essential social spending for the poor and most vulnerable.

Table 1 below, is a snapshot of the DA's model which demonstrates that by implementing these changes to expenditure, **notwithstanding any changes to revenue**, government can go from a forecasted primary balance deficit this year of R474,8 billion, to a primary balance surplus of R4.3 billion by 2023/24.

The DA's modelling further illustrated how targeted spending cuts and priority spending proposals can, whilst still protecting essential social spending and frontline staff wages, help turn around debt by 2024/25 and at 2.5 percentage points lower than the ANC (see Fig.1 below):

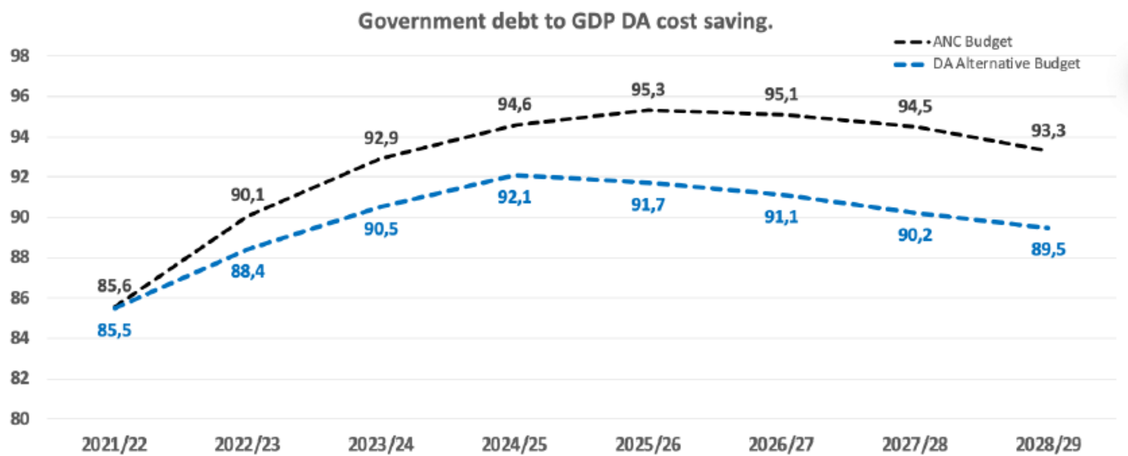

Fig 1: Debt to GDP projections – DA vs ANC

It is important to stress that these projections are without any changes to growth assumptions. Still, the model shows that South Africa's debt crisis is a problem of low spending compounded low economic growth.

Minister Godongwana should therefore use his first MTBPS to set the tone for a growth oriented fiscal policy that, in addition to economic structural reforms, pursues aggressive debt stabilisation to balance the budget. If the economy was to grow by just 1.5 percentage points above the current growth rate, the DA model shows that this would markedly go a long way in resolving the national debt crisis.

A defining feature of Tito Mboweni's tenure as Finance Minister was his failure to reign in out of control spending. Minister Godongwana's approach in addressing this elephant in the room will define his tenure, either as a reformer or a foot soldier for the status quo.

With the ANC elective conference due in December 2022, and public sector unions agitating for salary increases after the expiry of the one year deal that was struck in May this year, the Minister is faced with an urgent test to resist any pressure to offer an increase to public sector workers.

Failure to hold the fiscal line kicks the problem down the road and will increase spending on debt and leave less room to spend on public services and infrastructure. In addition it sends

the wrong message to credit rating agencies and opens up the country to further rating downgrades.

To prevent a budget blowout, a public sector wage freeze should continue to be enforced. However, this burden should not fall on frontline service delivery staff who include nurses, teachers, and police officers.

As such, in order to address the public sector wage bill conundrum, the DA proposes the following:

- Freezing the wages of public servants not covered by the Occupation Specific Dispensation (OSD) (including the likes of head-office managers and supervisors) over a three-year MTEF period. This would yield savings of R116.7 billion.
- Ensuring that the 66.3% of public servants covered by OSD receive inflation-linked increases over the MTEF period. In order to achieve this and stay within the deficit target, the government needs to mobilize an additional R9.55 billion. This can be achieved by reducing the number of managers at non-OSD salary levels 11 to 16.
- In addition to the R116.7 billion that would be saved by freezing non-OSD salaries, the government can save another R29.4 billion over the MTEF period by reducing the number of 'millionaire managers' in the civil service by a third, which translates to 9000 posts.

Government has avoided a difficult discussion with public sector unions about the cost and composition of the public wage bill. Now is the time for decisive moral action in the interests of the country.

Additional revenue and savings amounting to R30,1 billion can be realised from the following items:

- R13.5 billion saved by cutting the New Development Bank funding by R4.5 billion each year;
- R4.2 billion in fruitless and wasteful expenditure;
- R3.4 billion slashing VIP blue light security;
- R8 billion from digital spectrum auction;
- R1 billion shutting down the NYDA.

The scourge of corruption, together with fruitless and wasteful expenditure, continues unabated without any political will to hold anyone to account. Even minimal action to address this will promote the culture of accountability that is needed in the public financial sector and return much needed revenue to the service delivery for which it was intended.

Supporting the vulnerable

Rising food and fuel costs have seen inflation rise to 5% in September which, according to StatsSA, is significantly higher than the average inflation rate of 3,3% in 2020. This has

potentially devastating implications for low income households, especially those that rely on social grants.

The MTBPS should make provision to cushion the poor and vulnerable against inflationary pressures. To this end, a clear effort must be made to protect social spending by increasing direct social support to the poor.

Within the current fiscal framework, the DA model budgets for social grant increases of R30,1 billion over three years to keep in line with inflation. (see Table 1 below).

The DA does not support a permanent expansion of the grant system at this stage. Due to increased revenue from the commodity boom, there may be fiscal space to extend the relief grant temporarily. However, in the medium to long term South Africa's approach should focus on reforms which will boost growth. In an environment of strong growth, and reduced corruption and wasteful expenditure, expansion of social support as a dividend on growth and good governance could be possible. In such an environment the number of people reliant on state assistance may also reduce, enabling better support for few beneficiaries. It is not prudent, however, to introduce an expansion of the grant system in an environment of low to modest growth, high levels of corruption, runaway spending, and rising potential beneficiaries.

Committing to no tax increases

Households are already heavily taxed with minimal return from government. The DA will not support tax increases or any new taxes.

The DA expects Minister Godongwana to provide finality on e-tolls, especially how the bonds that were used to build the Gauteng Freeway Improvement Project (GFIP) will be settled. We remain guided by our long held position that the obligation to repay these bonds should not be passed on to road users nor should it be financed through a state bailout. Not only are e-tolls another expensive tax on already overburdened consumers, they affect the economy because they add to the cost of doing business.

South Africans are already paying a high price on fuel and transport costs. What they do not need is an additional tax to be added to their cost of mobility in the form of e-tolls. To avoid further uncertainty on the issue, the Minister should take a bold step and ring-fence a portion of the fuel levy to pay for e-tolls.

Based on renegotiated terms with the e-toll bondholders, government can use the ring-fenced portion of the fuel levy to settle the outstanding amount over a fixed term period not exceeding 20 years.

Leveraging Pension Fund assets

The DA is encouraged that our proposal to accelerate the pace of reform in the pension sector has finally gained traction. We expect some major announcement in the MTBPS.

The Pension Fund Amendment Bill, which I introduced in the National Assembly on 2 November 2020 as a Private Members Bill, seeks to amend the Pension Funds Act of 1956 to enable pension fund members to leverage a portion of their pension fund before retirement as guarantee for a loan. Loans will be subject to repayment affordability and surety amounts will remain invested in the fund.

National Treasury appears to favour a “two-pot” approach that will permit a once-off withdrawal of a portion of the member’s pension fund asset, either while the member is currently employed or when they leave their employer. The remaining portion will be “locked in” until retirement, even if a member leaves employment before their retirement age. Thus, a compulsory preservation.

The Minister in his MTBPS should strike a balance between allowing pension fund members to leverage their asset in the form of a loan, a pre-retirement partial withdrawal and the preservation of pension funds as a long term investment vehicle.

Table 1: DA's Alternative Main Budget Framework

Alternative Main Budget Framework				
	2020/21	2021/22	2022/23	2023/24
Main budget revenue	R 1 159 900 000 000,00	R 1 263 600 000 000,00	R 1 388 300 000 000,00	R 1 487 100 000 000,00
Main budget expenditure	R 1 805 800 000 000,00	R 1 813 790 928 946,67	R 1 782 081 982 480,93	R 1 811 777 388 630,39
Non-interest expenditure	**R 1 572 700 000 000,00**	**R 1 541 990 928 946,67**	**R 1 464 481 982 480,93**	**R 1 458 677 388 630,39**
Debt-service costs	R 233 000 000 000,00	R 271 800 000 000,00	R 317 600 000 000,00	R 353 100 000 000,00
Main budget balance	-R 645 900 000 000,00	-R 550 190 928 946,67	-R 393 781 982 480,93	-R 324 677 388 630,39
Primary balance	**-R 412 800 000 000,00**	**-R 278 390 928 946,67**	**-R 76 181 982 480,93**	**R 28 422 611 369,61**
Nominal GDP	R 5 132 300 884 955,75	R 5 309 243 697 478,99	R 5 620 647 773 279,35	R 5 972 289 156 626,51
Primary balance/GDP	**8,04%**	**5,24%**	**1,36%**	**0,48%**
Main budget balance/GDP	**12,58%**	**10,36%**	**7,01%**	**5,44%**
		2021/22 changes	**2022/23 changes**	**2023/24 changes**
Net cut		**-R 30 709 071 053,33**	**-R 77 508 946 465,73**	**-R 5 804 593 850,54**
Social grants inflation-linked increase		R 8 824 262 280,00	R 10 324 386 867,60	R 11 028 739 482,79
Freezing of non-OSD wages[1]		-R 45 700 000 000,00	-R 71 000 000 000,00	R -
Other wage cuts (R29.4 billion over MTEF)		-R 9 800 000 000,00	-R 9 800 000 000,00	-R 9 800 000 000,00
Cut New Development Bank		-R 4 500 000 000,00	-R 4 500 000 000,00	-R 4 500 000 000,00
Fruitless and wasteful expenditure		-R 1 400 000 000,00	-R 1 400 000 000,00	-R 1 400 000 000,00
Slashing VIP blue light security		-R 1 133 333 333,33	-R 1 133 333 333,33	-R 1 133 333 333,33
Auctioning off digital spectrum		-R 8 000 000 000,00	R -	R -
Shutting down NYDA		-R 1 000 000 000,00		
Providing no further capital to SAA		-R 3 000 000 000,00		
Vaccine rollout funding		R 35 000 000 000,00	R -	R -

References

National Treasury. 2021. *Budget Speech by the Minister of Finance 2021*. http://www.treasury.gov.za/documents/national%20budget/2021/speech/speech.pdf

National Treasury. 2021. *2021 Full Budget Review*. http://www.treasury.gov.za/documents/national%20budget/2021/review/FullBR.pdf

DA Alternative Budget Preview Document 2021. https://www.da.org.za/2021/02/the-das-alternative-budget-2021-only-the-da-will-get-debt-under-control

National Treasury. 2020. Medium Term Budget Policy Statement 2020. http://www.treasury.gov.za/documents/mtbps/2020/mtbps/FullMTBPS.pdf?fbclid=IwAR21nTm_wfVEgoxwU-

Salim Furth, "High Debt Is a Real Drag," Heritage Foundation Issue Brief No. 3859, February 22, 2013, https://www.heritage.org/debt/report/high-debt-real-drag.