Alternative Budget 2022

BUDGETING FOR JOBS – ACCELERATING GROWTH AND FIGHTING POVERTY

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DA

Introduction

The DA's alternative Medium Term Budget Policy Statement in October 2021 proposed a fiscal policy platform that would enable a post-pandemic economic recovery built on job-creating economic growth, prudent fiscal management and support for vulnerable South Africans.

We emphasised our view that enabling post-pandemic economic resilience would unlock and accelerate economic growth, disrupt high levels of unemployment and alleviate the disproportionate impact of rising inflationary pressures on the poor. The DA's core expectations for the Medium-Term Budget Policy Statement included:

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

The policy imperatives of these key deliverables have not changed and provide the framework for the DA's Alternative Budget for 2022.

In this alternative budget, we present practical solutions that would help facilitate an investment friendly environment to drive growth, create jobs and reduce poverty.

Achieving economic growth that generates jobs, especially after the devastating effects of a global pandemic, will test the mettle of our collective national resolve. It is a challenge that we have to confront head on if we are to address the staggering levels of unemployment and increasing poverty among vulnerable groups in the country.

The DA's 2022 Alternative Budget presents how a DA government will:

- Reverse the upward debt spiral
    - Contain debt
    - Manage expenditure
- Accelerate economic growth
    - Attract investment capital

    - Encourage saving
    - Ensure energy and water security
    - Attract retired educators
    - Reform SOEs for private investment
- Support vulnerable South Africans
    - Basic Income Grant
    - Support SMMEs in particular
    - Leverage Pension Fund Assets

The DA continues to emphasize the importance of faster economic growth to address staggering levels of unemployment, unsustainably high public debt and growing poverty levels. Over the past decade, the country has remained in a low growth trap, largely due to policy inconsistency, disproportionately low levels of capital formation and lack of adequate investment in the productive sectors. **To unlock the growth dividend, the economy should be opened up to more private investment and innovation.** Only a growing economy can create employment opportunities and create the necessary fiscal space to enable adequate provision of social support to the poor.

Debt warning alarm for South Africa

For the first time since South Africa's democratic transition, the International Monetary Fund (IMF) and the World Bank have extended emergency loans to the country with a combined total of R76 billion. Although Treasury has tried to justify the loans as concessionary with low interest rates, and necessary to stave off the socio-economic effects of the Covid-19 pandemic, the reality is that government is unable to meet its spending obligations from the fiscal balance sheet and has now been forced to borrow from international finance institutions. It is borrowing to pay for bloated government consumption expenditure. This creates a vicious upward spiral in interest repayments that increasingly crowd out the service that government is elected to deliver.

Notwithstanding the conditions attached to them, the loans from the IMF and the World Bank place South Africa firmly in the orbit of the Bretton Woods institutions. **Failure to take the necessary steps now to address the growing national debt crisis, restore economic**

growth and the conditions necessary to create jobs, will push South Africa further into the debt embrace of the IMF/World Bank, this time for loans with more onerous conditions.

For a small middle income economy, South Africa's debt burden is unsustainably high and the corresponding debt service costs a prohibitive factor on public investment in the economy. Despite these dire indicators, government's borrowing appetite has continued to grow, with previously set debt control measures constantly being breached and Cabinet not speaking with one voice on economic structural reforms. **<u>The DA will re-introduce a Fiscal Responsibility Bill to bring National Debt under control and introduce a statutory fiscal rule for the first time.</u>**

The frequency of budget reprioritisations, as the go to fiscal tool for Treasury to meet emergency spending priorities, points to the growing public financial crisis. While this approach helps to keep spending within the main fiscal framework, it takes critical resources away from key functions such as health, policing, education, social support and housing. This has a direct effect on service delivery, resulting in less housing opportunities, limited access to healthcare and poor resourced schools. However, with a pro-reform agenda that priorities economic growth and growing the tax base, as advocated by the DA, South Africa should not have to choose which services can remain, and which will have to be discontinued.

DA debt containment proposals

The Minister of Finance, Enoch Godongwana, in his 2021 Medium Term Budget Policy presentation in October, projected that gross national debt will reach over R4 trillion (75% of GDP). In the 2022/23 fiscal year, over R303 billion will be spent servicing interest on public debt – which is more than the allocations made to health, education and police in the 2021/22 fiscal year.

Government's fiscal consolidation measures have not gone far enough to reign in rapidly rising public expenditure and debt accumulation. Expenditure containment measures have been breached repeatedly - a notable example being the once-off non-pensionable cash gratuity to public sector workers which cost the fiscus R20,5 billion that was unbudgeted for.

With economic growth expected to average 1,7% over the next two years, the fundamentals in the DA's debt containment model, which we presented in the 2021/22 alternative budget, remain. Through targeted spending cuts and savings, the model shows that national debt can be brought under control sooner, and at a lower rate, than the ANC government's stated objective.

The model's core proposals for savings include:

- Freezing the wages of public servants not covered by the Occupation Specific Dispensation (OSD) (including the likes of head-office managers and supervisors) over the three-year MTEF period. This would yield savings of 140 billion;
- In addition to the R140 billion that would be saved by freezing non-OSD salaries, the government can save another R60 billion over the MTEF period by reducing the number of 'millionaire managers' in the civil service;
- Spending increases should be focused on protection for the most poor and vulnerable. And if debt is to be brought under control, departments which do not deliver core services on which the public rely, will need to have their budgets maintained at current nominal levels throughout the MTEF;
- R15 billion saved by cutting the New Development Bank funding by R5 billion each year;
- R3.5 billion slashing VIP blue light security;
- R8.4 billion from digital spectrum auction;
- R1 billion shutting down the NYDA;
- R60 billion over the MTEF period through more efficient procurement and a focus on reducing corruption

Accelerate Economic Growth

The urgent macro-economic imperative is to find innovative ways to move beyond the lethargic growth rate of the past decade and unlock growth levels that will open up opportunities for economic participation among South Africans. To achieve this, the DA proposes incentives that would facilitate capital formation and investment in the productive sectors of the economy. To grow, our economy must attract capital for investment. That capital will come from foreign investors, local businesses and individuals. **For investment**

capital to flow, the investment climate must be attractive, barriers to doing business must be lowered and individual saving must be encouraged. An excessive tax burden drives households into poverty.

Boost savings and investment

South Africa must find innovative ways to incentivize sustained investment in the economy, especially by corporate players. According to the South African Reserve Bank, non-financial corporates have reserves of approximately R1-trillion in cash. This is despite the fact that the country is struggling to revive its fixed investment rate which fell to 13.7% of GDP in 2020, its lowest level since the mid-1990s. With emerging economies averaging 23%, South Africa's poor fixed investment rate is far from stimulating growth and creating jobs.

The DA believes that part of the intervention needed to improve South Africa's fixed income investment indicator is through investment relief. Companies which, for example, invest between R10 billion – R12 billion in the economy should be given time bound tax breaks. These tax breaks should also be accompanied by practical interventions to provide policy certainty and economic structural reform.

South Africa's savings rate, especially at household level, is among one of the lowest in the world. According to the Investec/GIBS Savings Index, in the past 20 years the household savings rate has fallen from between 25-30% to 16,3%. The major downside of a low savings rate culture is that it limits capital formation, which is a key requirement for investment in the economy to drive growth. To put this in perspective, the Investec/GIBS Savings Index concluded that South Africa's 16,3% savings rate corresponds with an investment rate of about 18% which:

'…is not nearly enough to fund 5% economic growth. In fact, an 18% investment rate will fund 2% economic growth.'

The remedial action needed to reverse South Africa's perennially low savings rate involves a series of reforms at policy and tax level:

- **Reducing regulation and oversight levies for the financial sector** – In a recent presentation to Parliament, Treasury revealed that under the Twin Peaks model of financial regulation, Financial Institutions (FIs) are required to pay levies totalling

R1,6 billion to fund their regulation by the Prudential Authority and the Financial Sector Conduct Authority (FSCA). The latest proposal increases costs by R250 million. These high regulatory costs on FIs dampen the savings rate because banks transfer the costs to consumers in the form of high bank fees. The regulatory levies on the financial sector should therefore be rationalised to lower the cost of banking and consumer access to the financial system.

- **Raise the threshold on taxes on interest earned** - Interest income below R500 000 should not be taxed. This will encourage more savings to be available for investment and will alleviate the burden on fixed income earners in particular.
- **Tax relief on rental income for individual taxpayers** – individual taxpayers must pay tax on rental income. This creates an administrative burden in filing provisional tax and impoverishes households reliant on rental income for survival.
- **Increase annual tax free savings limit to R100 000.**
- **Scrap remaining exchange controls** – The implementation of measures to scrap exchange controls, announced by the former Minister of Finance Tito Mboweni in 2020, has been slow. In order to unlock foreign direct investment and enable businesses to transact freely in the global financial system, government must scrap the remaining exchange controls. Scrapping these controls will be an added incentive for businesses to remain in South Africa rather than relocate offshore due to exchange control red tape.
- **Cut tax on fuel** – The cost of fuel is adding to inflationary pressures for South Africans, especially among the poor and the vulnerable. It does not help that levies, including 'opportunity taxes' for the Road Accident Fund now constitute 52% of the fuel price. This is unsustainable. The government must immediately review its fuel price determination model and cut the fuel levy. Taxpayers should not carry the financial burden of subsiding gross inefficiency in entities such as the RAF while also shouldering high transport costs.

How the DA proposes to fund the tax cuts

The DA opposes any new taxes or tax increases. We retain our position that the government cannot tax South Africa's economy back to growth.

If anything, South Africa's tax regime should be reformed to ensure that it is aligned with international benchmarks and the tax structure is competitive especially against other emerging markets and Sub-Saharan Africa.

To fund the tax cuts and the elimination of taxes contained in the DA alternative budget, we propose the following:

- **Procurement** – prices paid by government departments must be open to public scrutiny and checked against what is readily available at retail and wholesale level. Severe penalties should be given to departments that overpay. To retain control on procurement volume, the quantum of what is procured requires controls so that excesses are curbed.
- **Reward budget savings** - Use it or lose it is a perverse incentive that results in unnecessary wasteful expenditure. Budget savings should be rewarded where appropriate.
- **Expenditure efficiency benchmarks** - Expenditure efficiency benchmarks should be used to improve departmental performance. This is to avoid "throwing money at problems" and essentially rewarding incompetence and inefficiencies. This would involve budget cuts in departments that have efficiency problems rather than expanding them.
- **Department relevancy tests/assessment** – there are some departments that can be scrapped resulting in budget savings. The DA has previously argued that 15 core departments are enough to meet the administrative and governance needs of South Africa. A case in point is defence spending where an opportunity exists to restructure and right size the Department of Defence, consolidate spending to between R55-60 billion, focus funding on core Constitutional responsibilities and rebuild the essential prime mission equipment capabilities of the South Africa Defence Force.
- **Real action on corruption** – **The DA will soon be introducing a Private Members Bill in Parliament to initiate a Corruption Tax.** The PMB will amend the Tax Administration Act and introduce provisions that will require that any company or organization implicated in corruption to pay an additional percentage of company tax above the country's corporate tax rate. The idea of a Corruption Tax, originally conceived by Professor Sean Gossel from the University of Cape Town's Graduate

School of Business, follows the relative ease with which companies that aided and abated state capture got off without any accountability. South Africa has to progressively increase the cost of corruption to act as a deterrent to future offenders.

The purpose of this budget is to accelerate economic growth and provide support for the most vulnerable South Africans. It aims to squeeze grossly bloated government and unlock money that can be more effectively applied to economic growth. Measures to stimulate the economy will lift GDP growth and resultant government revenue.

Economic enablers

South Africa's 14 year electricity crisis is part of the reason why the economy continues to score low on competitiveness indices when compared with the country's emerging market peers. Data compiled by the Council for Scientific and Industrial Research (CSIR) concluded that 2021 was the worst year on record on loadshedding. 1 136 hours of outages were recorded, up 37% from the 859 hours recorded in 2020. This means that the amount of energy shed was 2 455 GWh, up from 1 798 GWh in 2020. Audit firm, PWC, concluded that power supply disruptions may have cost the economy 350 000 in potential jobs. Addressing South Africa's energy crisis begins with breaking Eskom's monopoly and opening the sector to Independent Power Producers.

Energy security

While the DA welcomes the announcement made by the President in his State of the Nation address to establish an electricity transmission company, we are opposed to the idea that it be made a state controlled Eskom subsidiary. The continued involvement of the state in energy generation, transmission and distribution will always be a key hurdle to private sector investment. Independent estimates suggest that R200 billion in private investment could be unlocked were the electricity transmission sector opened up to market driven participation.

What South Africa needs is an Independent Transmission Grid System and Market Operator (ITSMO) which will be responsible for system operation and the purchase of electricity from electricity generators. Even though a DA Bill advocating for an Independent

Electricity Market Operator (IEMO) was rejected by Parliament in 2020, we still strongly believe that the country stands to benefit from an independent entity that would operate as an electricity wholesaler, selling electricity to distributors and large customers at wholesale tariffs.

With amendments to the Electricity Regulation Act currently out for public comment and due to come before Parliament, the DA will work to ensure that the proposed National Transmission Company is truly independent, run by experts rather than politically deployed cadres, and that it fosters competition both in the private and public sector.

Water Security

South Africa is a water stressed country. According to the World Bank's Water Resources Group (2030 WRG), at current water use efficiency levels – South Africa is on course to have a water supply deficit of over 3.8 billion cubic metres by 2030. Independent estimates project that if planned water investment projects aren't carried out or extensive water management interventions implemented, water demand in South Africa will exceed supply by 10%. With erratic electricity supply over the years having negatively affected investment and economic growth, a water shortage crisis will be a devastating blow to the struggling economy.

In order to improve water quality infrastructure and reverse the existing backlog in infrastructure maintenance, there is an urgent need to:

- Progressively increase public investment in water infrastructure as a percentage of GDP.
- Ensure that a Treasury-determined percentage of government grants to municipalities is spent on operational expenditure to manage existing infrastructure, especially the outdated water reticulation systems**.**
- **<u>Open the water sector to private sector investment by allowing municipalities in good financial standing to enter into public-private partnerships for infrastructure investment</u>.**

Attracting retired educators

According to the CRAMS-TIMMS survey, the disruptions caused by the Covid-19 pandemic in the education sector resulted in the loss of between 50-75% learning time for some learners. **As part of interventions to recover the learning and teaching-time lost, and to address the high vacancy rate in the education sector, the DA proposes that government hires retired educators to fill the gap.** The DA sets an initial investment of R3 billion to fund this initiative. Retired teachers will bring their experience to enrich the learning process and help schools recover lost learning time much quicker.

Readying SOEs for private investment

The President's announcement that preparatory work has begun for the establishment of a state-owned holding company to house all commercial SOEs was not only ill-informed but does nothing to solve the current systematic challenges affecting these entities.

Instead of creating a new SOE to manage bankrupt SOEs, the government should be readying them for private sector investment. The DA has taken the lead in this regard by tabling the Public Finance Management Amendment Bill, 2020.

Following the repeated failure of SOEs to submit their financial and annual reports on time, the Bill aims to "*provide for additional measures in instances where the executive authority fails to table an annual report and financial statements of a department or a public entity, and the audit report on those statements, in the National Assembly or the relevant legislature*". The DA calls on all parties represented in Parliament to support this Bill.

Should the Minister of Public Enterprises follow through on his promise to introduce an SOE Shareholder Management Bill, meant to create a new centralised entity that will manage its shareholding in state-owned enterprises (SOEs), DA members represented on the Public Enterprises Committee in Parliament will work to ensure that it is rejected. The proposed new holding company will only make it easier for the state to interfere more in areas of procurement, financial management and on who gets appointed to what post. It will be a perfect platform to re-institute state capture and further entrench cadre deployment in these entities. **Only a systematic programme of private sector participation will remove SOEs from being a burden on the fiscus and make them competitive on the market.**

Support for vulnerable South Africans

The DA's emphasis on the need to increase the economic growth dividend is informed by the proven metric that faster economic growth creates jobs, boosts investment and improves revenue collection. Prioritizing economic growth is key in rolling back poverty, providing support for the unemployed and investing in infrastructure.

The poor and vulnerable continue to shoulder most of the economic burden from the disruption caused by Covid-19 and lack of growth in the economy. As such, the Government spending on direct cash support for the poor should be protected from cuts. **With the savings realised from the DA's targeted spending cuts and savings, the DA commits to protecting inflationary increases in social grants. This would entail social grant increases in excess of R30 billion over three years.**

Basic Income Grant

The DA has been a longstanding supporter of the idea of income support for the unemployed. Our view is that a Basic Income Grant (BIG) would provide an economic floor for the most vulnerable as well as put money directly in the hands of the people who are best placed to decide where to spend it. The market makes better allocative decisions than the government. However, we are concerned that the country simply cannot afford to support a growing number of dependents in an environment of low growth and a shrinking revenue base. It would seem therefore, that a BIG would become increasingly feasible as an expenditure from the proceeds of growth, as opposed to increased taxes.

As economic growth is realised, a BIG would become affordable. **The DA has budgeted an additional R105 billion over the next three years for the introduction of a conditional Basic Income Grant. The grant would be made available on the understanding that it would only be provided when revenue generated from GDP growth is available. It would not be funded from additional tax.**

Small Medium Enterprises support

Small to Medium Enterprises are the vehicles through which South Africa can unlock the growth dividend that has been elusive for the past decade. However, the SME sector has been struggling for some time and to fully unlock its potential, there is an urgent need to

lessen the regulatory hurdles that stand in their way. To this end, the DA proposes the following:

- Expansion of tax free savings especially into SMME companies by allowing more types of products into tax free accounts.
- Better targeted tax incentives into venture capital and early stage companies.
- Tax relief/holiday for startups and SMEs – this also include employees of the startup so that necessary skills are more affordable as part of the business set up costs.
- Full BEE scorecard exemptions for startups - Upgrading the contribution level to level 1 from level 4 for exempt SMEs (assuming BEE legislation is retained at all, given that the DA does not support this legislation).
- Raise the threshold for what is classified as a (a) microenterprise: 50 million turnover (b) Small enterprise: R500 million turnover and (c) Medium enterprise: R2bn turnover.
- Comprehensive regulatory relief for startups, microenterprises and small enterprises in conjunction with raising the threshold limits substantially. These measures will prove valuable for startups and SMEs against the context of a very corporatized economy, especially on lowering the barriers to entry. The key is to lower the investment hurdle rate for new investment capital into the economy.

Leveraging Pension Fund Assets

A significant amount of investment capital is owned by Pension Fund members. To fund its developmental state model, Government aims to encourage funds to invest members' money in infrastructure projects in the hope that this will create jobs. Given government's track record, that outcome is unlikely and will result in sub-optimal returns on members' capital. Pension Fund reform has been under discussion for decades without sufficient resolution. **Pension Fund members should be permitted to leverage their pension fund assets as collateral for a pension-backed loan and be able to access a portion of their pension fund before retirement.** This two-tier system will enable a balance between current and future consumption to the benefit of hard working South Africans.

Conclusion

The DA is fully aware that economic reform cannot occur overnight. After decades of policy incoherence, economic damage caused by failed B-BBEE interventions, public financial mismanagement and high levels of corruption, an economic turnaround will require time and effort. A pathway to prosperity for all South Africans is possible.

Table 1: DA Alternative Fiscal Framework

As per MTBPS	2021/22	2022/23	2023/24	2024/25
Main budget revenue	1 483 200 000 000	1 517 500 000 000	1 581 300 000 000	1 689 400 000 000
Main budget expenditure	1 893 100 000 000	1 897 900 000 000	1 936 700 000 000	2 039 100 000 000
Non-interest expenditure	1 623 900 000 000	1 594 800 000 000	1 602 100 000 000	1 673 300 000 000
Debt-service costs	269 200 000 000	303 100 000 000	334 600 000 000	365 800 000 000
Main budget balance	-409 900 000 000	-380 400 000 000	-355 400 000 000	-349 700 000 000
Primary balance	-140 700 000 000	-77 200 000 000	-20 800 000 000	16 100 000 000
Nominal GDP growth	10.9%	2.9%	5.5%	6.3%
Tax Buoyancy	1.73	0.99	0.97	1.05
CPI inflation	4.5%	4.2%	4.3%	4.5%
Alternative	2021/22	2022/23	2023/24	2024/25
Main budget revenue	1 483 200 000 000	1 517 500 000 000	1 581 300 000 000	1 689 400 000 000
Adjusted main budget revenue (GDP+)			1 564 883 000 000	1 672 965 000 000
Adjusted for revenue reduction		**1 486 500 000 000**	**1 549 390 000 000**	**1 656 401 570 000**
Main budget expenditure	1 893 100 000 000	1 897 900 000 000	1 936 700 000 000	2 039 100 000 000
Adjusted main budget expenditure		**1 833 000 000 000**	**1 900 915 000 000**	**2 004 178 395 000**
Non-interest expenditure	1 623 900 000 000	1 594 800 000 000	1 602 100 000 000	1 673 300 000 000
Adjusted non-interest expenditure		**1 529 900 000 000**	**1 566 315 000 000**	**1 638 378 395 000**

Debt-service costs	269 200 000 000	303 100 000 000	334 600 000 000	365 800 000 000
Main budget balance	-409 900 000 000	-380 400 000 000	-355 400 000 000	-349 700 000 000
		-346 500 000 000	-351 525 000 000	-347 776 825 000
At increased GDP			-336 032 000 000	-331 213 395 000
Primary balance	140 700 000 000	-77 200 000 000	-20 800 000 000	16 100 000 000
		-43 400 000 000	-16 925 000 000	18 023 175 000
At increased GDP			-1 432 000 000	34 586 605 000
Nominal GDP growth (adjusted)	10.9%	2.9%	6.5%	7.3%
		2022/23 changes	**2023/24 changes**	**2024/25 changes**
Wage freeze		60 000 000 000	40 000 000 000	40 000 000 000
Wage reduction		20 000 000 000	20 000 000 000	20 000 000 000
New Development Bank		5 000 000 000	5 000 000 000	5 000 000 000
Blue Light Security		3 500 000 000	3 500 000 000	3 500 000 000
Digital spectrum auction		8 400 000 000		
Shut NYDA		1 000 000 000	1 000 000 000	1 000 000 000
Procurement Efficiency		20 000 000 000	20 000 000 000	20 000 000 000
Social Grant Inflation Link		10 000 000 000	10 550 000 000	11 214 000 000
Basic Income Grant (Conditional)		35 000 000 000	35 000 000 000	35 000 000 000
Water infrastructure		5 000 000 000	5 000 000 000	5 000 000 000
Educators		3 000 000 000	3 165 000 000	3 364 395 000
Tax on individual rental income		14 000 000 000	14 910 000 000	15 998 430 000
Corporate investment relief		7 000 000 000	7 000 000 000	7 000 000 000
Fuel Levy cut		10 000 000 000	10 000 000 000	10 000 000 000
Expenditure reduction		117 900 000 000	89 500 000 000	89 500 000 000
Expenditure increase		53 000 000 000	53 715 000 000	54 578 395 000
Net expense adjustment		64 900 000 000	35 785 000 000	34 921 605 000
Revenue reduction		31 000 000 000	31 910 000 000	32 998 430 000