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Parliamentary Standing Committee on Finance
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Dear Madam and Sirs

PARLIAMENTARY PUBLIC HEARINGS - COMMENTS ON THE 2020 BUDGET REVIEW

1. We present our comments and submissions on behalf of the South African Institute of Chartered Accountants (SAICA) National Tax Committee on the 2020 Budget Speech released by Minister Mboweni on 26 February 2020.

2. We once again thank the Standing Committee on Finance (SCoF) for the ongoing opportunity to provide constructive comments in this regard. SAICA continues to believe that a collaborative approach is best suited in seeking solutions to complex challenges.

ICEBERG AHEAD – INDECISION LEADS TO DECISION IN TIME

3. When an iceberg is spotted, the captain of the ship must make some very quick decisions which will have important consequences. These decisions are informed by the distance from the iceberg, the speed of the ship and the knowledge that the portion of the iceberg that is visible above the water is only about one third of the iceberg and that, although the rest can't be seen, he still needs to allow for it.

4. Indecisiveness in these circumstances is still in effect a decision that may result in the ship hitting the iceberg and the suffering of many.

5. Ahead of South Africa's economy lies such an iceberg, with our President as captain and our Finance Minister as his navigator. They have to make vital decisions swiftly, in the knowledge that although they can't see the full iceberg, they still need to cater for it.

6. In this regard there are positive signs in this Budget 2020 that the Minister and the President have started to make these decisions to implement change. We commend the Minister on the following:

   6.1 Changing policy thinking to that of a low rate, broad based fiscal policy with enhanced tax simplicity. Ireland and New Zealand have been able to recover from their fiscal problems of the 1980's to the good, stable financial situation they are in today at least partly because of the application of these principles.

6.2 Acknowledging the high burden that already rests on taxpayers by introducing no substantial tax increases, particularly on the corporate and personal income tax side.

6.3 Strengthening the Tax Ombud's Office by seeking to make it financially and operationally independent from SARS.

6.4 Focusing on the rebuilding of the capacity at SARS.

6.5 Reprioritising funds to enhance prosecutions and address corruption cases.

6.6 Creating certainty and transparency in the macroeconomic framework. We hope that broad consultation will inform this imperative.

6.7 Seeking to reduce the increase in the non-interest costs in the Budget by R156 billion over 3 years. In our view, this is too low - nevertheless, it is double reductions that occurred when "austerity measures" were previously introduced.

6.8 Seeking to reduce the increase in the wage bill by a substantial amount. In our view R160 billion over 3 years is not enough but it is a step in the right direction.

7. Last year Mr Mboweni stated:

"*Our problem is that we spend more than we earn. It is as simple as that*."

8. To put the Ministers words in context, this year we are expected to spend **R326bn** more than we will earn and next year we will overspend by **R372 bn**.

9. The overspending problem still persists and SAICA's main concern remains the continual increase in public expenditure. It should be added that the increases in wages have occurred in the absence of increases in productivity.

10. Since 2008, debt has been used as the means of financing the difference between revenue collected and the expenses incurred. On the whole, Budget 2020 follows the same unsustainable recipe by making nominal spending cuts and financing the difference through debt.

11. It is predicted that the country's debt will rise to 71.6% of GDP (from 25% of GDP in 2009) in the next 3 years. To reduce debt, the Government must in effect ensure that its income at least covers its expenditure. Increasing tax collections by R326.6bn, which is the current budget deficit, is no longer an option taking into account the already high tax rates imposed on the country's citizens and the low number of income taxpayers actually contributing to the fiscus (7.1 million).

12. National Treasury's estimates of tax revenue are also concerning, considering that the estimates are based on growth rates that are 0,2% (2020/21: 0,9% versus 0.7%) higher than other predictions, from Moody's for instance. This difference may appear to be relatively insignificant, but using the current estimated tax to GDP ratio it leaves an

additional R2,8bn shortfall in 2020 and R3,1 bn shortfall in 2021. These problems are compounded by the fact that we approve expenditure based on estimated GDP and tax revenues. Therefore, over estimating GDP and revenue leads to further overspending in reality.

13. Being unable to raise revenue leaves only one other option – that is to reduce expenditure.

14. The tip of the iceberg is thus the R326,6 billion deficit. Government needs to run budget surpluses if it wants to meaningfully reduce debt. However, revised estimates for national expenditure show a R23,5 billion increase.

15. In response to the 5th Parliaments request to provide it with practical steps on how to reduce this expenditure, SAICA has started analysing in more detail what ministries are spending money on and we will also start looking at efficiency and productivity measures obtained from annual reports. Below we list a few expenditure items that could assist Parliament in ensuring that money is allocated to appropriate areas in order to ensure the necessary public services are provided.

EXPENDITURE ANALYSIS

Public Sector Wage Bill affordability

16. Minister Mboweni has proposed reducing the public wage bill by R160 billion over 3 years. The trade unions have argued that this reduction is not warranted because the public sector wage bill has remained at about 35% or so of the total expenditure over the last decade, so wages are not the problem and government should instead cut other expenditure.

17. However, it must be noted that the **35%** is calculated as a percentage of the **total government expenditure i.e. the expenditure mix or how one expense relates to another in the ratio**. Government expenditure has increased significantly over the last few years, thus any percentage increase in wages would not be readily apparent due to the increase in the 'denominator' (being the other government expenditure).

18. Using tax revenue as a 'denominator' would perhaps be more appropriate as it would indicate the '*affordability*' of the public sector wage bill not the expense mix. That is, the wage bill should be determined relative to the income that is being received by the government, not by the other expenditure that the government is incurring.

19. If the wage bill is compared to **tax revenue** over the last 12 years, the public sector wage bill has not remained constant and has grown from over 30% to **over 40%**.

20. When compared to **Gross Domestic Product** (which is an indicator of our overall economic ability to generate tax revenue), it has consistently grown from 10,29% in 2001, to 10,73% in 2011 to 12,3% in 2021. These percentage increases might not appear large, but one must consider that that GDP equates to approximately R5.4 trillion

and therefore that the increases are actually vast. It also indicates that the public sector wage bill has become a greater and greater burden on the economy.

21. Using the latter two measures, it is clear that **there has been an enormous growth** in the public sector wage bill but the affordability of this growth – as it relates to what government can afford (i.e. in .as relates to revenue) and to what the country can afford (i.e. as relates to GDP) – is what is of concern as these costs are now unaffordable.

22. The trade unions also claim that **public sector staff are overworked**, but questions have been raised about the **productivity** of the public sector staff. Some, like 'Prophet Analytics' in its 2012 quarterly Labour Market Navigator, have tried to analyse productivity. It found that private sector employee productivity was 450% higher than in the public sector employees. In 2015, the Financial and Fiscal Commission found that government was not doing enough to provide services "efficiently, effectively and economically". Both last year and this year, the Minister, conceded as much stating that civil servant's salaries had grown by 40% in real terms (i.e. after accounting for inflation) but without the equivalent increase in productivity.

23. A **lack of accountability** in the public sector is also well documented by the Auditor General where it states in its 2019 report:

> "*accountability continued to deteriorate in local government, some departments and public entities. The deterioration had a negative effect on delivering key government programmes in education, health and infrastructure, and at municipalities, which all have an impact on citizens*".

These may all be persuasive rather than conclusive factual findings as relate to productivity, but they appear to affirm what the public largely experience on a day to day basis.

24. The unions also claim that the high salaries and lack of accountability also reflect at the highest level of government. To contextualise this statement, our President's earnings put him in the OECD Top 10 in real terms. When further compared as a ratio of GDP and revenue (i.e. affordability) it is significantly higher than his OECD or BRICS counterparts and that applies equally to our parliamentarians.

25. The same problem persists at SoE's, where management are paid at the market rates or higher, yet management at the SoE's have the benefit of not have to address the greatest reason for the large salaries that are paid to CEO's in the private sector, namely market risk. For example, who are ESKOM and TRANSNET's market competitors in SA that their executives have to compete against for revenue and customers?

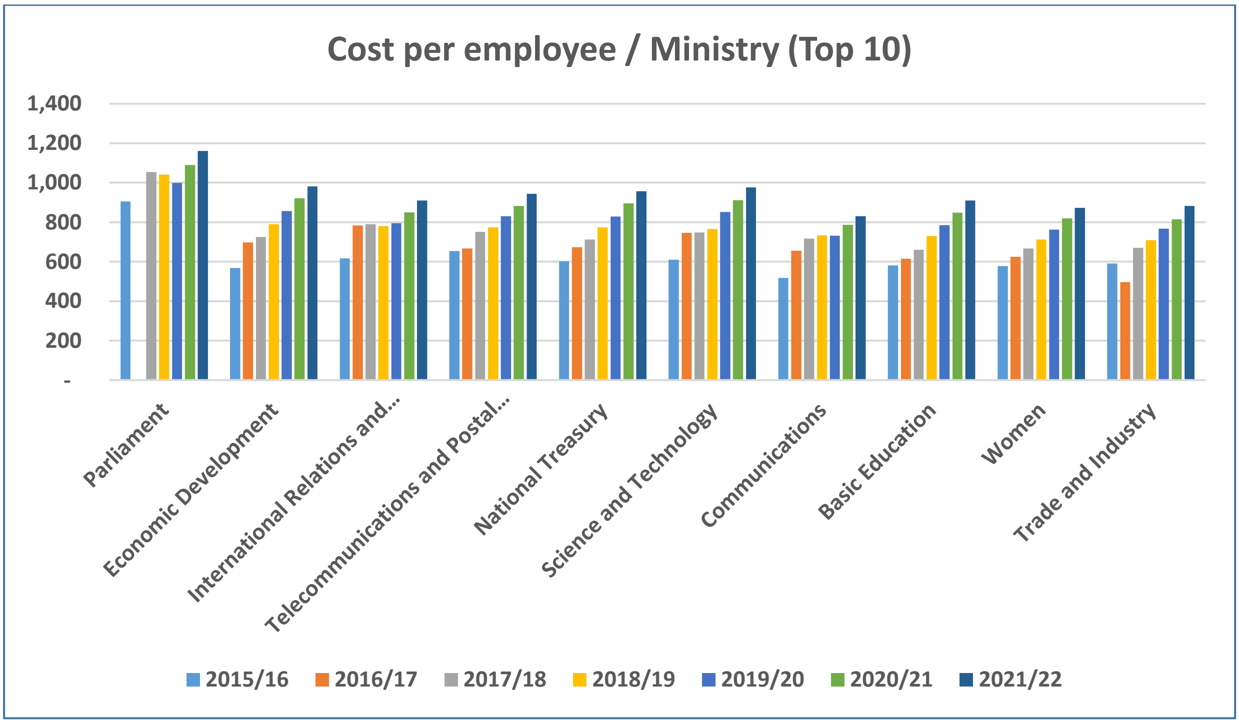
26. <u>Submission:</u> Compensation is particularly problematic when it is accompanied by a lack of productivity – that is, there must be a definite need for a function to be performed by an employee and this function must add value added to the economy, greater than the cost of the compensation. Trade unions, together with government, need to collaborate in implementing an effective and **transparent productivity enhancement plan** to ensure accountability is enforced at all levels. If Government is unsuccessful in its

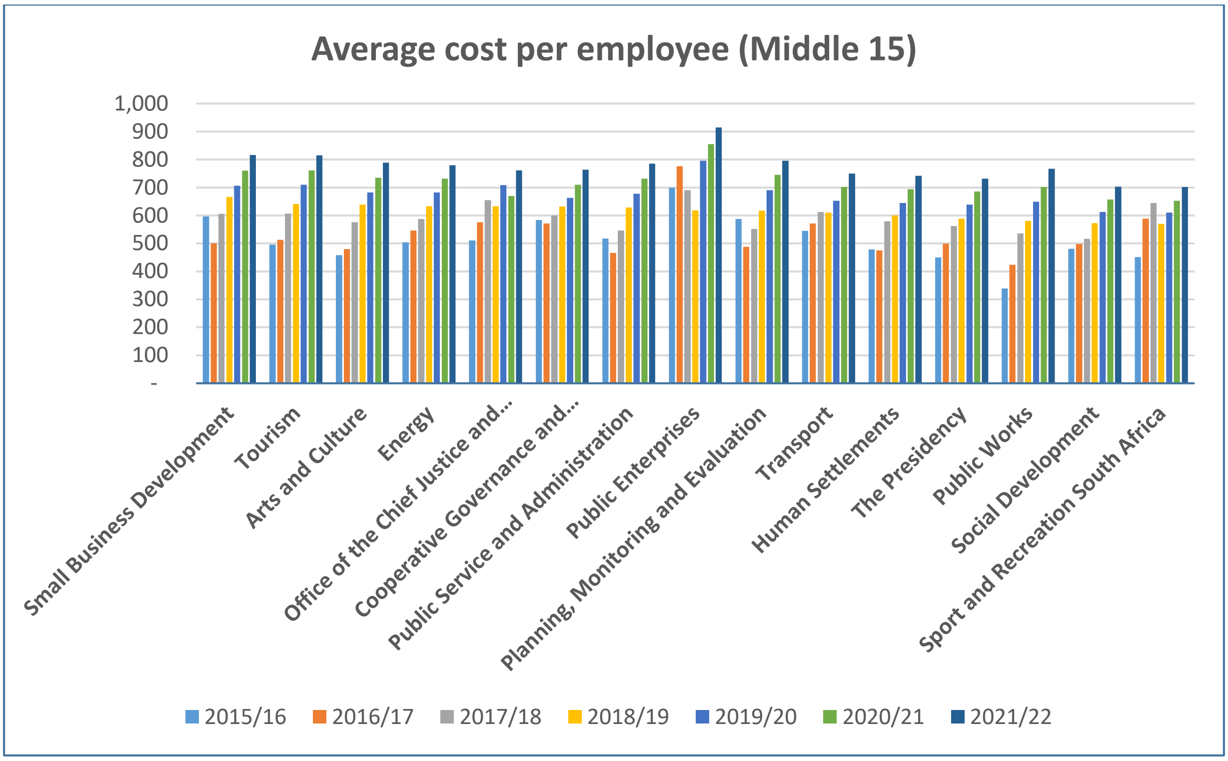
negotiations with the unions to reduce the wage bill, an additional R38 billion in 2020/2021 would need to be recovered from somewhere else. The debt burden of the country would not be stabilised as predicted and this would increase the likelihood of a downgrade by Moody's.

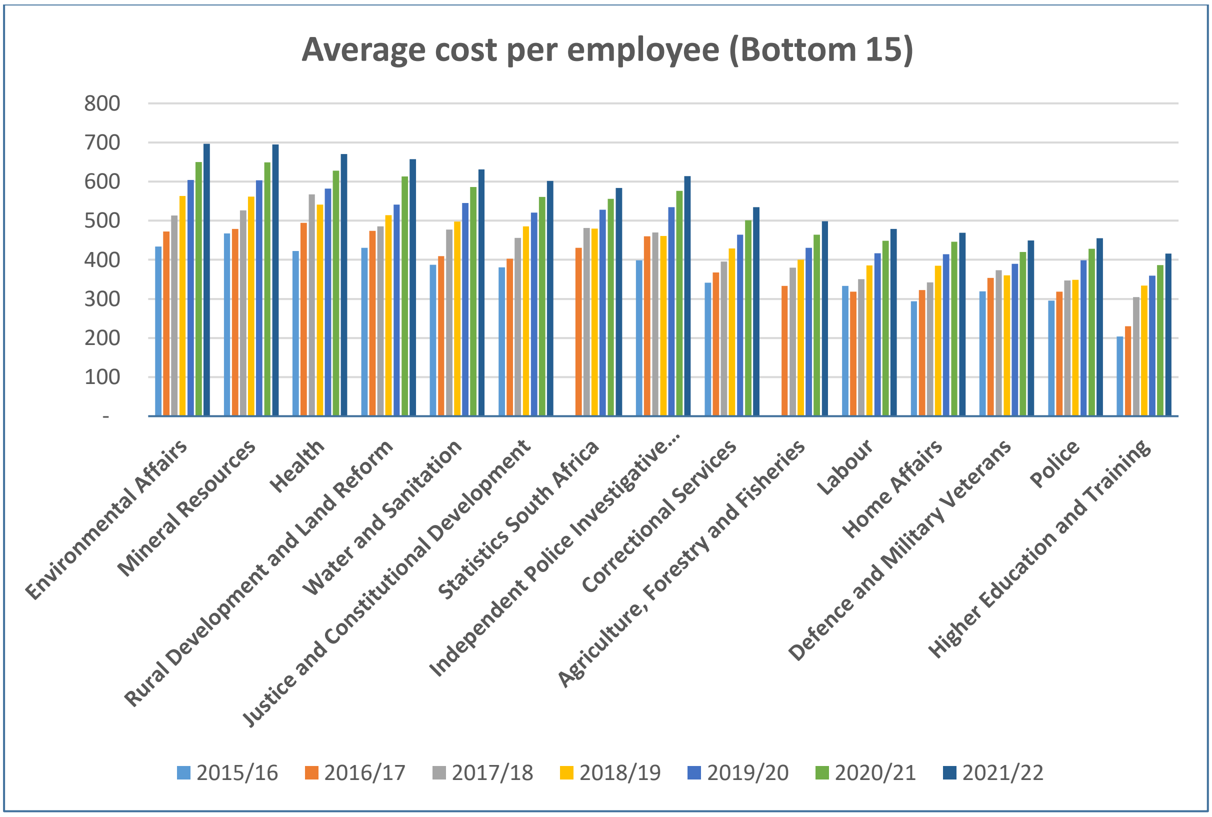
27. The government, by retaining unproductive employees in the public sector, is effectively choosing to hamper job creation in the private sector, as the money spent on the unproductive employees in the public sector is not being channelled to businesses that have the potential to use this money productively to grow the economy. The whole question of cuts in the wage bill is therefore not merely about retaining public sector jobs.

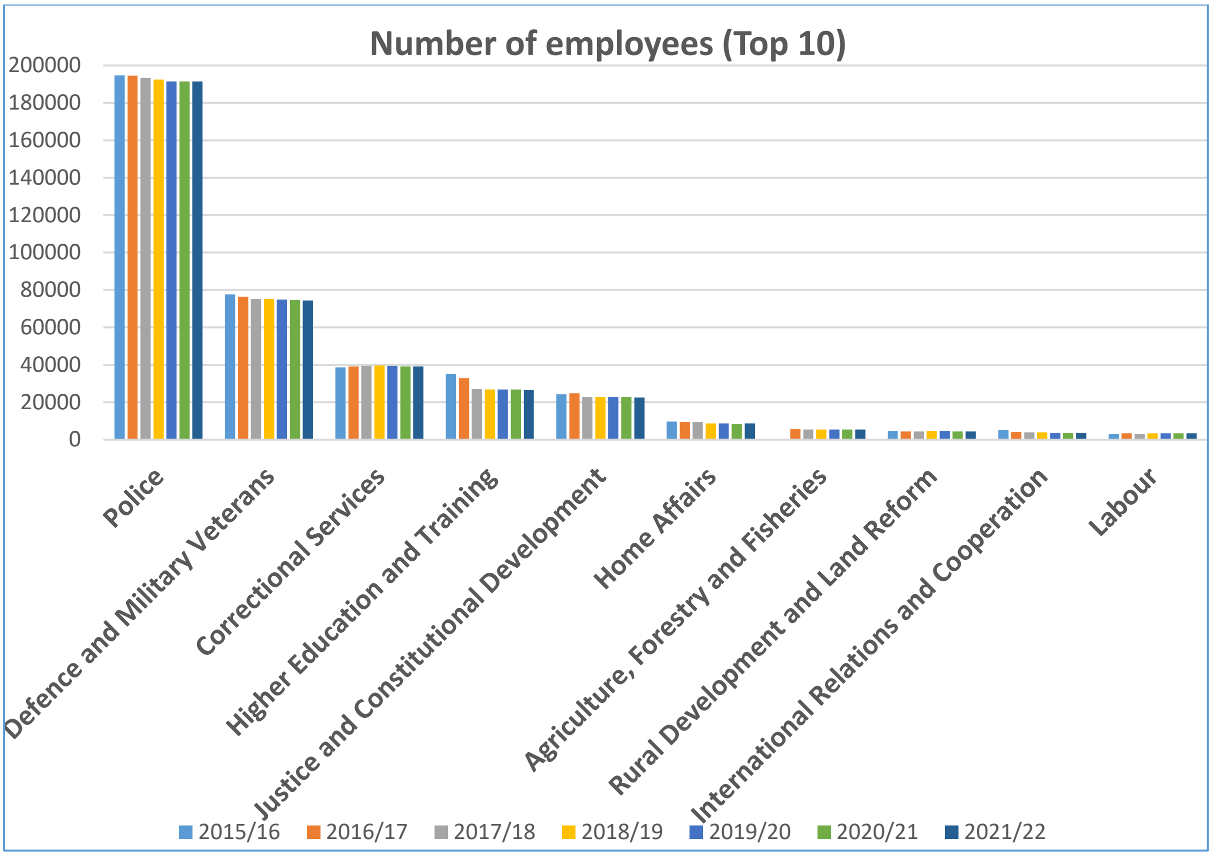
28. Budget cuts for compensation and benefits, starting at the top, are necessary. Research findings informing this statement are set out below.

29. SAICA has analysed the national compensation expenditure per employee per Ministry over the last 12 years. The average cost per employee per ministry was calculated from the information available and is depicted below.




Average cost per employee (Middle 15)
1,000
900
800
700
600
500
400
300
200
100
-
Small Business Development
Tourism
Arts and Culture
Energy
Office of the Chief Justice and...
Cooperative Governance and...
Public Service and Administration
Public Enterprises
Planning, Monitoring and Evaluation
Transport
Human Settlements
The Presidency
Public Works
Social Development
Sport and Recreation South Africa
2015/16
2016/17
2017/18
2018/19
2019/20
2020/21
2021/22


Average cost per employee (Bottom 15)
800
700
600
500
400
300
200
100
-
Environmental Affairs
Mineral Resources
Health
Rural Development and Land Reform
Water and Sanitation
Justice and Constitutional Development
Statistics South Africa
Independent Police Investigative...
Correctional Services
Agriculture, Forestry and Fisheries
Labour
Home Affairs
Defence and Military Veterans
Police
Higher Education and Training
2015/16
2016/17
2017/18
2018/19
2019/20
2020/21
2021/22



30. The Minister of Finance noted in his Budget Speech that staff numbers are decreasing and will make up for the increased compensation. However, from the above graphs, it appears that staff numbers have remained stagnant or decreased, but there has still been a considerable increase in the compensation cost – that is, staff wages are increasing faster than the saving from staff leaving.

31. It also means that the budget for vacancies is eroded.

32. Most of the annual reports note that the high average salary does not mean that the staff are overpaid, but instead that it represents the skill level of the staff. Parliament leads this top 10. We would question why more skilled staff are needed in Basic Education (8th) than in Higher Education (40th), especially considering who each of these departments need to consult, manage and create learning environments for.

33. The **value received from the spend** is also of serious concern. For instance, spend on basic education is one of the highest in the Budget, yet the national aggregate teacher absenteeism rate on an average day is 10%. The Department of Basic Education (DBE) confirmed this as a problem to Parliament as recently as 17 April 2018. However, no steps appear to have been taken to remedy this issue.

34. South Africa is striving for a 30:1 teacher learner ratio and the maximum set by the then Minister Motshega was 40:1 in primary schools and 35:1 in secondary schools.

35. The DBE's figures state that the current national average learner-educator ratio (LER) for government primary schools is 35.2 but that his drops to 27.7 at the secondary school level.

36. We acknowledge the theoretical difference between teacher-learner ratio and class sizes, but in practice what appears to be implemented is simply one teacher per class, irrespective of its size.

37. A 2016 research paper by Petro Marais in the SA Journal of Education found schools with a ratio of 54:1 (24 teachers for 1300 students) and many schools with classroom sizes between 54-78 learners. Ironically, even Model C Schools spending parents' money on additional teachers struggle to maintain the 30:1 ratio for which the DBE itself strives.

38. It should be examined which schools have low LERs and why some schools have more than 40 learners per class. In this regard, principals, as non-teaching teachers don't explain the difference. These and many more questions need to be investigated to ensure that the money that is being spent is spent wisely.

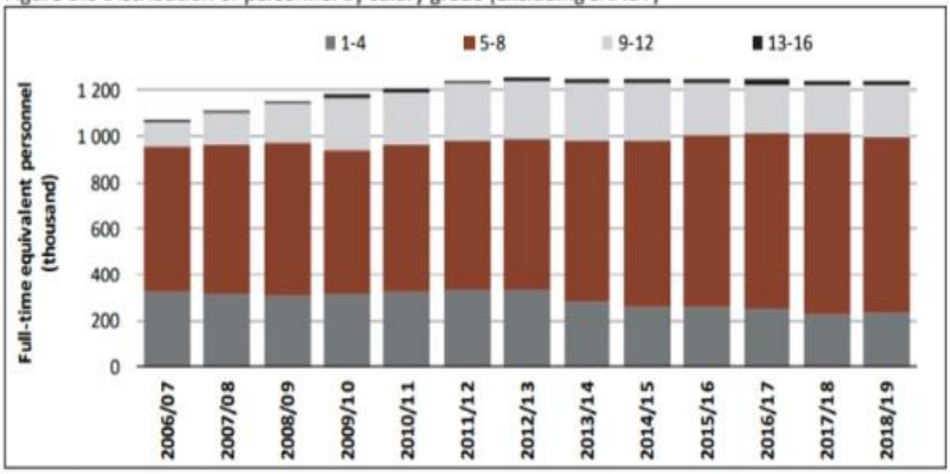
39. It appears to us that the available data may not be accurate in some instances.

40. In last year's Budget, the public sector wages appeared to be overstated, even when compared to the private sector. Using the data from the various Ministries' votes, it was calculated that at a national level the average salary is R49 551 compared to the private sector at R22 358 (StatsSA Quarterly Employment Statistics – Sept 2019). This does not appear to be correct. What is also interesting is that in the quasi-private sector of Water and Electricity, average salaries are indicated as R44 491, which is 80% more than the remainder of the private sector, but very close to the public sector average.

41. Though it is acknowledged that part of the difference is accounted for in the margins between levels (i.e. the private sector has greater margins), this does not account for the entire difference as the uptake of low-skilled staff is approximately the same in the public and private sectors as a percentage. However, it is in the middle and upper tiers where there are differences.

42. On the next page is the staff mix for national and provincial government:

Figure B.6 Distribution of personnel by salary grade (excluding SANDF)



Source: National Treasury (PERSAL data)

What is glaringly obvious is the huge growth in the R540 000 to R964 000 band (grade 9-12) and the R1,2m to R2,1m bands (grade 13-16) in just the last 12 years. The majority of staff numbers are, however, in the R250 000 to R450 000 band (grade 5-8). The decrease in the R130 000 to R240 000 (grade 1-4) is also quite noticeable. As this represents the average private sector wage band and considering average wages and household income in South Africa, you would expect more staff in this category for government.

43. Submission: A lot more questions need to be asked regarding how our public sector, especially, in general, given its commonly perceived state of service delivery, can command such salaries. It should be noted that pension benefits for these staff are also guaranteed at the cost of taxpayers. The latter means taxpayers not only incur exorbitant costs while public servants are employed, but will also do so for their entire retirement.

44. A comparison of the salaries paid per Ministry and per job description needs further consideration taking the role of each Ministry into account as well as the Auditor General's findings in this regard. Performance- based appraisals and monitoring are critical.

Other national government expenditure

45. Of the R326.6 billion deficit, a significant contributor is the debt servicing cost which amounted to R205 billion in 2019/20. The figure is growing at an alarming rate. Addressing the significantly high costs of compensation and of fruitless and wasteful, unauthorised and irregular expenditure, is really just the tip of the iceberg and we urge Government to not only address these swiftly, but to also look below the surface and analyse all costs to identify which costs are unnecessary and how to reduce these costs.

46. SAICA has commenced analysing expenditure by Ministry to determine where Government is spending, what it is spending on and whether it is getting value for money. We examined eight of the separately disclosed expenses in the national Budget (compensation being one of them), and provide high-level insight on these below. We do, however, need to mention our general concerns on the integrity of the data.

47. Based on our initial analysis, the following is apparent:

47.1 The data does not appear to tie up year on year and audited outcomes appear to change significantly each year - for example, the audited outcome for 2015 in respect of certain expenses changed from the 2016 report to the 2019 report - for the exact same financial year. Treasury should indicate where audited numbers have changed and why these numbers have been adjusted.

47.2 There are huge anomalies in the growth of specific expense line items which could be errors or could be correct. However, in most instances, no explanation is provided where there are large increases from one year to the next.

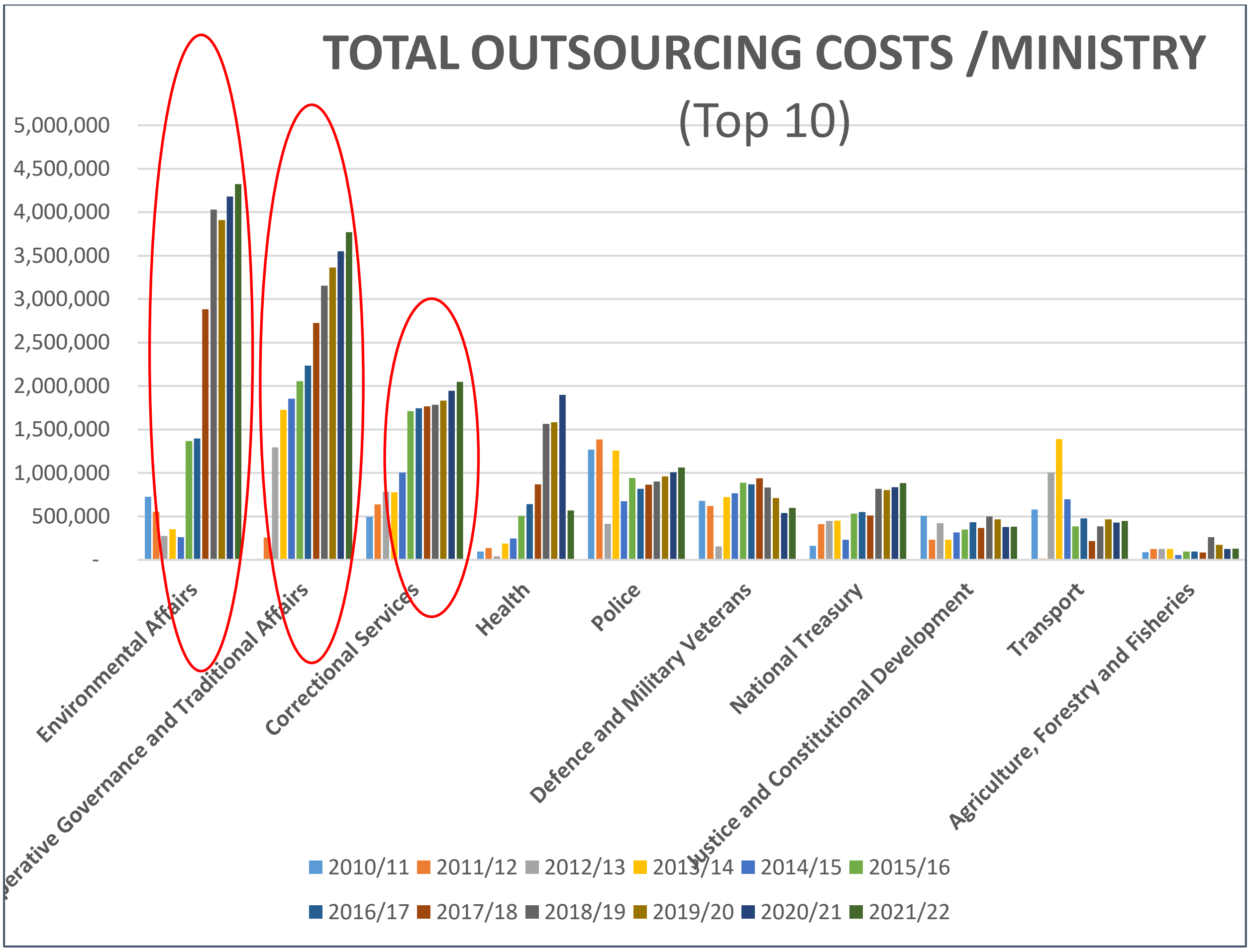
47.3 There is insufficient or no explanation as to spending on certain items and outcomes sought.

47.4 The numbers reported on are often difficult to analyse. For example, main budget, consolidated at national / provincial and consolidated with listed entities do not have the same comparative detail to ensure that one can consistently compare data sets.

48. The expenses analysed over the last 12 years are: consultant, contractor, agency and support, legal, catering, fleet and travel and subsistence expenses.

Total outsourcing costs: Consolidation of costs in respect of consultants, contractors and agency and support services

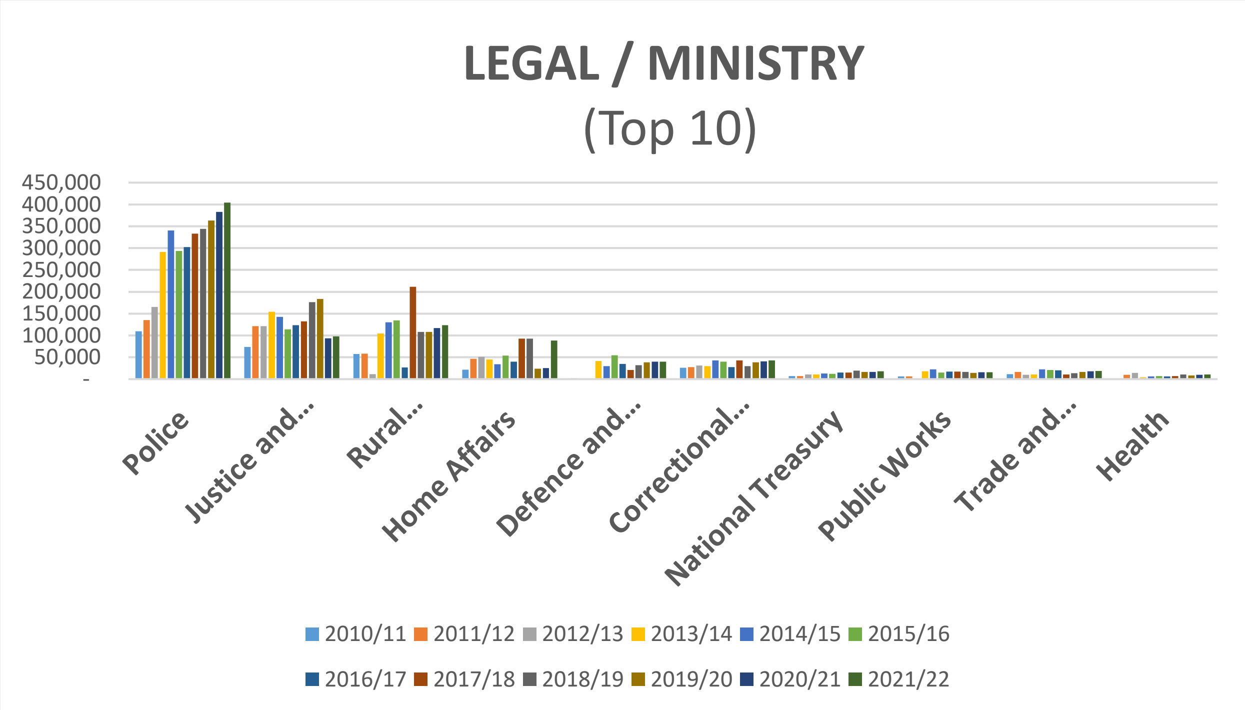
49. The costs incurred in respect of external consultants, contractors and agencies over the last 12 years caught our attention due to the quantum of the costs and it is questionable as to why these costs are so high when compensation for full time employees is also high.



50. There seems to be a trend in that certain ministries are consistently incurring high costs in this regard – these are Environmental Affairs, Cooperative Governance and Traditional Affairs and Correctional Services. More investigation is required in order to determine what these costs relate to and whether there is room to reduce these by capacitating the departments with full time/permanent staff.

51. For example, the Environmental Affairs Ministry which has more than 400 employees spends R4,3 billion on outsourcing which means they could have employed 2 800 people at R1,5 million/pa salary. One can question how the Ministry could get its human capacity needs so wrong.

Legal services



52. The increase in legal fees, especially in the police, seems to be related to competence of the staff in performing their duties. Why Rural Development, Defence and Correctional services are on this list invites a number of questions including what those relating to the the role and scope of the State Law Advisor. The State Law Advisor's website states that its mission is:

"To provide reliable legal advice, representation, legislation and legislative drafting services to the State in a cost effective and efficient manner".

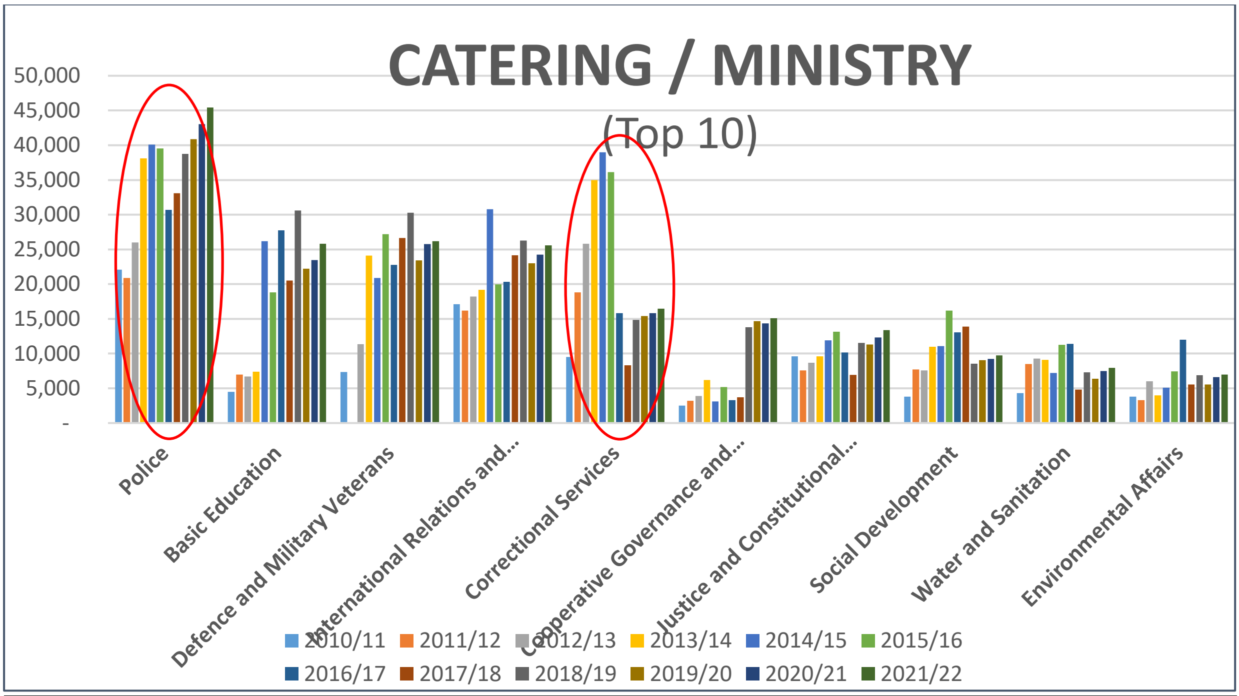
53. It should therefore be questioned why there is the need to incur such high costs on outsourced legal services when there is meant to be a whole department to meet this need for Government. If the staff don't have the skills or resources, one can question whether it would not be more cost efficient to incur costs on training the staff appropriately.

Catering

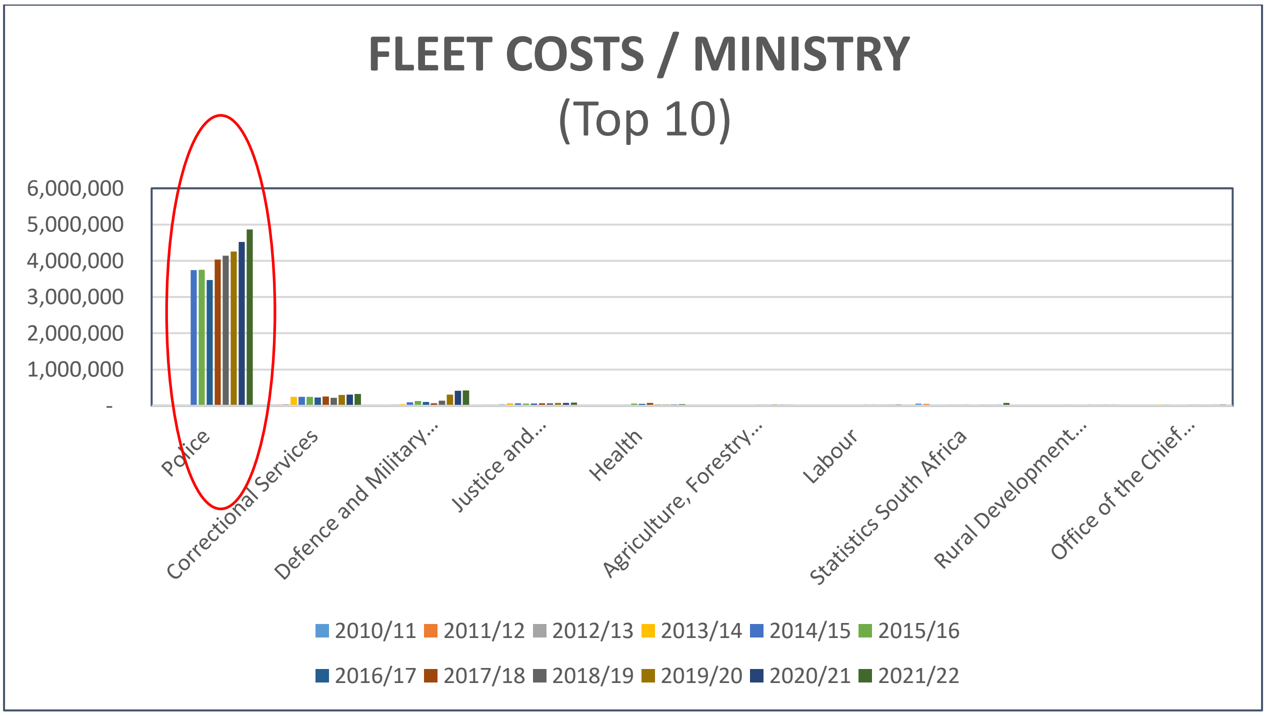
54. National Treasury noted in prior years that catering costs in respect of some departments need to be reviewed with a view to reducing expenditure in this area. Based on the analysis of the expenditure (see graph below), it is unclear why certain departments, for example the Police and Correctional Services, are incurring significantly high catering costs. Basic Education, Water and Sanitation and Environmental Affairs also appear on this list.

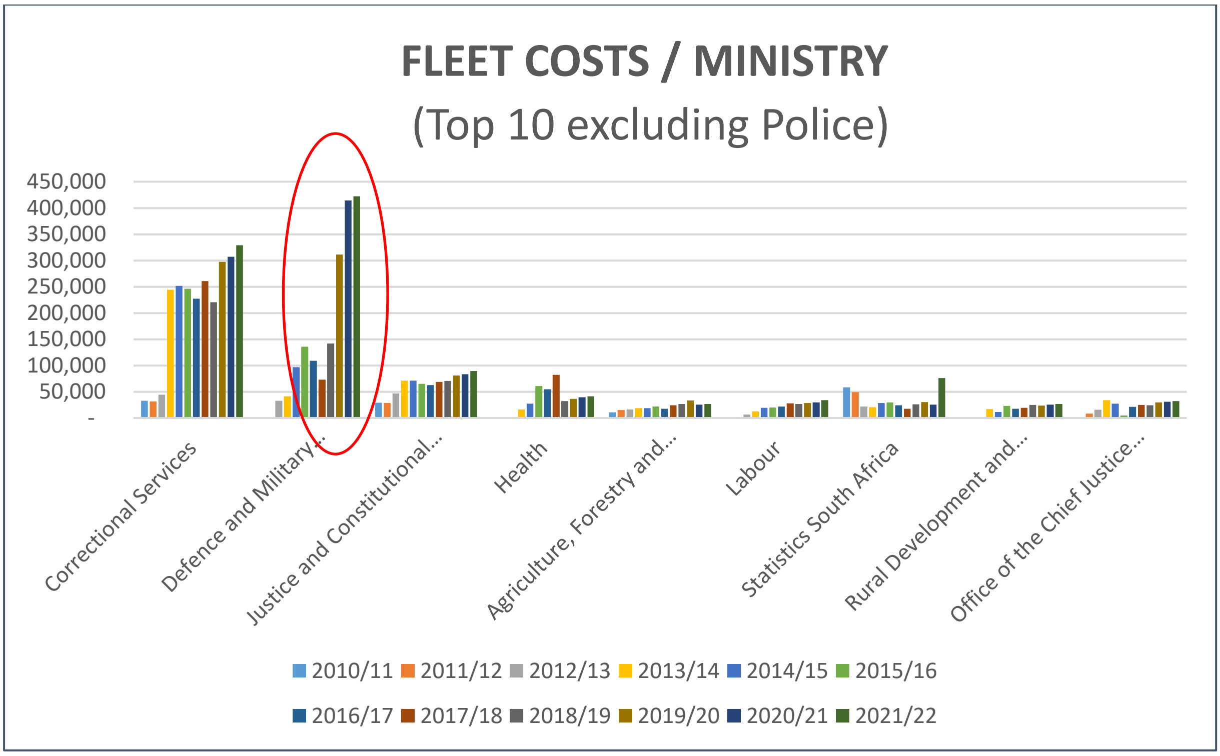
55. Unfortunately, the reports year on year do not provide sufficient detail as to what is included in 'catering' and whether this is used on staff or on other events. For one

department the cost of catering per employee amounted to R30 000 a year. It is worrying that despite "austerity" measures being in place, many Ministries show year on year increases or even continual growth in catering costs.



Fleet services



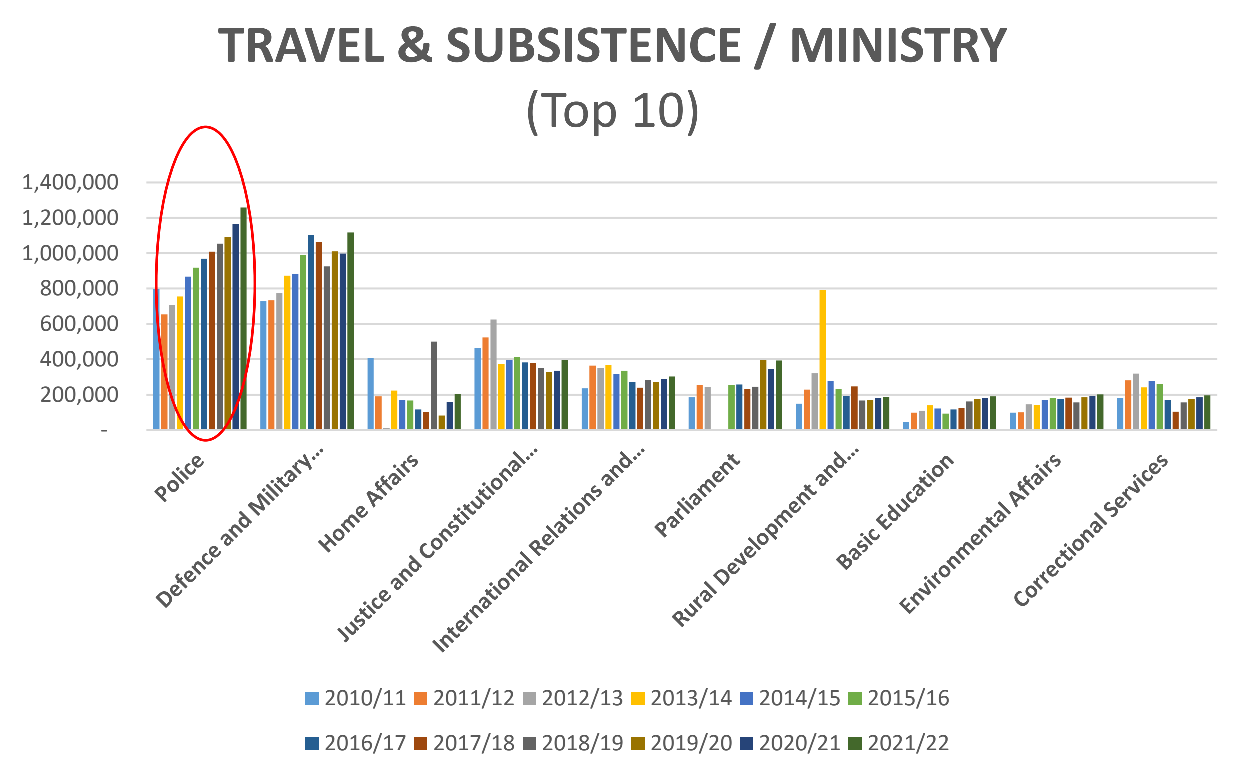


56. The first of the above graphs reflects fleet costs for the Top 10 ministries, where one can easily see that the costs attributable to the Police Services significantly exceeds that of the other 9 in the Top 10. The second graph shows Fleet Costs in respect of the lower 9 of the Top 10 ministries. The fleet costs in relation to the Police are significantly higher than the fleet costs of the other departments and it appears that this department acquired a significant number of vehicles over the last 4 years. However, in our view, this may be justifiable given the focus on reducing crime. One can question whether the increased fleet costs have led to higher police visibility and a reduction on crime. Crime continues to be a huge concern and one of the significant factors contributing to poor economic growth. Given the high expenditure levels in terms of compensation and fleet costs, one would expect the Police Services to be more effective in reducing crime.

57. One can also question why Defence and Military veterans would need to purchase so many normal vehicles, especially given their mandate.

Travel & subsistence

58. As identified in this year's Budget, travel and subsistence expenditure needs to be addressed. Again, Police and Defence lead this expenditure category and it is important to interrogate why this is the case. It is difficult to understand why Basic Education and Environmental Affairs appear on this list. Parliament, however, has itself not been blameless and expenditure on travelling continues to grow.



59. Submission: The analysis of costs at a high level and considering whether these costs are necessary for the running of the particular Ministry has provided some insights but it has also highlighted the significant questions which we hope Parliament will explore in the appropriations process to ensure that money is allocated to appropriate areas.

60. Parliament has the constitutional mandate to approve expense appropriations. Given the state of the economy of South Africa, important and informed decisions need to be taken urgently.

61. Budgets need to be scrutinised, especially in light of the Auditor General's findings that the audit outcomes have regressed since 2014-15 with only 80 auditees improving and 91 regressing. Only 100 (26%) of the auditees managed to produce quality financial statements and performance reports and to comply with key legislation, thereby receiving a clean audit. In 2014-15, 106 auditees had clean audits.

62. In light of these findings, we urge Parliament to carefully interrogate budgets that show increases in expense allocations and to further scrutinise expenses within those budget for reasonability and value-add. In addition to this, Parliament needs to hold to account those individuals who have exceeded their budgets or misspent their budgets. These individuals should be black-listed and be prevented from being redeployed at other government departments.

Other unrealised/urgent matters

63. The following items mentioned in the 2019 Budget Speech did not materialise in 2019 and we eagerly await further details in this regard:

63.1 Introduction of the Gambling tax draft legislation;

63.2 Publication of the Environmental Fiscal Reform Policy Paper;

63.3 Further details on the funding plan for the NHI; and

63.4 All legislative changes necessary to practically implement s10(1)(o)(ii) dealing with the taxation of South African expatriates.

63.4.1 We refer Parliament to the Regulatory Controlling Body Forum submission sent to Parliament on 29 November 2019 and to the SAICA's submissions submitted to SARS on Draft Interpretation Note 16 and 18 in December 2019 (attached for your convenience), highlighting our concerns regarding the legislative and practical difficulties with implementing the changes to section 10(1)(o)(ii) on 1 March 2020.

63.4.2 Not having clarity on various legislative and administrative issues relating to these changes poses serious challenges for employers who have to amend their payroll systems in order to comply with the law.

64. It is unclear why there in no cohesion between the above and this year's Budget given that some of the items are policy matters. It again raises questions of fiscal policy cohesion and overall government policy cohesion.

CONCLUSION

65. Mr Mboweni demonstrated his courageous leadership by addressing the tip of the iceberg of expenditure, being the public sector wage bill that needs drastic reduction.

66. Even if the wage costs are addressed, the iceberg under the water remains. The Minister has failed to adequately consider the country's deteriorating water infrastructure including sewage and river systems, state debt guarantees that are becoming state debt (at the SOEs for instance) and deterioration in services offered by municipalities.

67. Two of the largest factors responsible for our economic plight were not addressed, namely the lack of a coherent overall policy framework and a significant reduction in crime. The latter requires the total rethink of our whole criminal justice system.

68. Reduction in crime is even more important since one cannot implement policy and legislation changes to which few adhere, or that are actively undermined. Small businesses in all sectors struggle to survive in our crime- ridden country where they find it difficult to cannot connect goods and services to customers in all areas. Children are unable to learn in an unsafe environment in which schools are looted and destroyed and funds misappropriated.

69. We once again urge the SCoF to prevail upon the various Government departments to exercise proper oversight over their portfolios, to ensure fiscal discipline and effective spending. Budgets should be particularly interrogated where departments have not met their targets and/or they have received qualified audit reports. This is essential to ensure the sustainability of South Africa's finances.

70. More measures are needed in holding officials accountable for spending. In this regard, a coherent plan cross all of Government is required. Hopefully, the additional spend on investigative and prosecuting resources will go some way to address these urgent concerns.

71. SAICA agrees with the Minister that all is not lost and that as South Africans we have overcome obstacles before. Political will is required in order to start addressing the many challenges. In relation to the Budget, in our view this should start with an analysis of productivity of Government employees and value for money received for their services.

72. We implore SCoF not to shy away from its responsibility and obligations in ensuring that the Executive act in a responsible manner with the finances of the country that we all hold dear.

Yours sincerely

David Warneke
Chairperson: National Tax Committee

Pieter Faber
Senior Executive: Tax legislation and practitioners