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Parliamentary Standing Committee on Finance
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Dear Sirs

COMMENTS ON THE 2019 MEDIUM TERM BUDGET POLICY STATEMENT (MTBPS)

1. We present our comments and submissions on behalf of the South African Institute of Chartered Accounts' (SAICA) National Tax Committee on the MTBPS released by Minister Mboweni on 30 October 2019.

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.

RISE OF A NEW DAWN – A BRUTAL PAUSE

3. Last year, we commended Minister Mboweni as a new minister for not only acknowledging the problems with the fiscal and economic landscape, but also for observing that things cannot continue as they had in the past and that a "new fiscal dawn" was needed.

4. We had hoped that this honest acceptance of our precarious fiscal position would result in concomitant drastic action, which had been missing from previous years.

5. The "new fiscal dawn" might have shown a glimmer of an appearance at the beginning of 2019 but the sun did not rise after the 2019 MTBPS. This was reflected in the fact that by the end of the Minister's speech the currency had declined by 2,5% against the US dollar and by the end of the week Moody's had issued a media release that the economic outlook after the 2019 MTPBS was credit negative.

6. The hope, once again, for a fiscal policy that would create a climate conducive to economic growth was shattered when the reality was laid bare – expenditure continues

to exceed the country's revenue, national debt is increasing at an unsustainable pace and the economy is not performing well.

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

8. This statement by the Minister implies that, in order to fund its expenditure, South Africa has to incur even more debt than it has already incurred. It is predicted that the country's debt will rise to 71% 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. To do this, Government must either increase its income by R300bn (the current budget deficit) or slash its expenditure by this amount (approximately a 20% reduction of expenses based on 2019 figures).

INCREASING REVENUE – ADDITIONAL TAX MEASURES

9. Minister Mboweni announced that Government is contemplating an increase in revenue by introducing additional tax measures that will be announced in the February 2020 Budget. This is despite the very significant tax increases in recent years (in VAT, dividends tax, donations tax, estate duty, fuel levies, the introduction of the sugar tax and carbon tax) that taxpayers have had to deal with.

10. South Africa was already ranked 8th in the world for Tax to GDP ratios per the International Monetary Fund and that was for 2017, before the most recent tax increases. South Africa's tax to GDP has increased to 29,3% per the Budget 2019 whereas the world average is only about 15,4%.

11. As noted in the 2019 STATSSA report, which we agree with, tax to GDP is not in itself detrimental if value for money is provided by government, the latter being problematic in South Africa.

12. The last few year's tax increases have also been quite counterproductive as noted by the Minister where tax collections have severely underperformed notwithstanding the tax rate increases (i.e. tax elasticity is decreasing). Tax buoyancy has also significantly been adjusted downwards in the MTBPS from 1,31 to 1,08 for the current year thus the responsiveness of taxes to the economy is drastically declining.

13. This all affirms that previous increased taxes are already hurting the economy and more increases will do even further damage. As we had explained to SCoF in our 2018 Budget presentation, one of the reasons is that South African households have a very low savings culture (lowest of the G20) and its citizens are some of the most indebted in the world (71,3% household debt to income ratio).

14. It is important to note that South Africa's corporate tax rate of 28% is considered high (or even an outlier) by comparison with South Africa's main trading partners and corporate income tax rates in other developing countries. There is no scope to increase corporate taxes without seriously jeopardising the economy and foreign direct investment.

15. Personal income tax rates in South Africa are also high compared to other countries, but of major concern is the country's dependency on a small number of taxpayers – around

540 000 taxpayers are responsible for more than 50% of total income tax collected. This amounts to less than 1 person in every 100 of the population. Thus, increasing personal taxes or estate duty further might result in the loss of high net worth individuals (who are generally very mobile) which would be detrimental to the fiscus, not only because of the immediate loss of revenue but also because these people generally have skills and talent that are needed to create growth in the future.

16. Submission: It appears that South Africa is already beyond the peak of the Laffer curve. This is the point at which tax revenues are maximised and beyond which tax rate increases will actually result in a decrease in tax revenues. Therefore, increasing income taxes that will be levied on a taxpayer base that is already overburdened and dissatisfied is not advisable and could achieve the opposite of what is intended.

17. Although it seems counter-intuitive, lowering income tax rates in order to stimulate investment and economic growth is more likely to prove the wiser option in order to increase tax revenues. We are encouraged by the allocation of R1.3bn to the National Prosecuting Authority and R1bn to SARS for the next two years. These amounts should help strengthen SARS's capacities to collect tax and bolster efforts to combat corruption. If these amounts are put to good use, they should yield returns many times over.

REDUCING EXPENDITURE

18. The better way to reduce the country's debt is by reducing Government expenditure. However, the MTBPS does not propose cutting overall expenditure as can be seen from the estimates of expenditure for 2020 – expenditure is set to increase from R1,84trn to R1,98trn.

19. The largest contributors to the increase in expenditure are the public sector wage bill and financial support for state-owned enterprises.

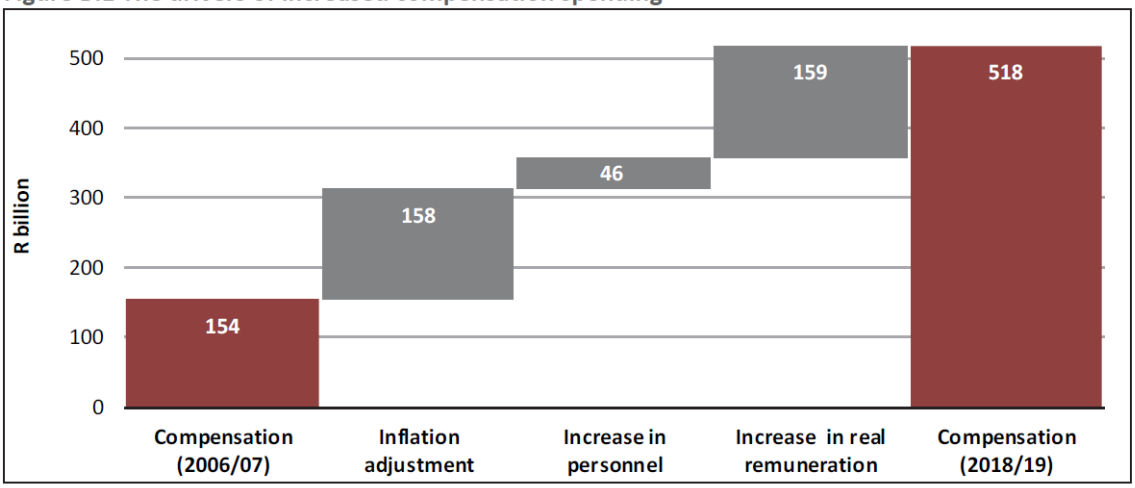
Public Sector Wage Bill

20. Minister Mboweni went to great lengths to explain the challenges afforded by the public sector wage bill, which he admitted has grown so fast it has become unaffordable.

21. Public sector wages have grown 66% after inflation over the last decade. This means that wages to public servants are 66% higher even after adjustment for inflationary increases. This translates to salary increases of more than 9% per year for more than 10 years over which period the growth rates have been muted at best, and many of the country's businesses have shed jobs. Should the pace of growth of the public sector wage bill continue at the current rate, the public sector wage bill will account for 100% of tax collections by 2040.

22. The diagram below illustrates the above-inflationary public sector wage remuneration increases that have accounted for the largest portion of the spending on public sector wages. This is despite the fact that the actual number of personnel has only increased slightly.

Figure B.1 The drivers of increased compensation spending



Source: National Treasury (PERSAL data)

23. The Minister highlighted that more than 29 000 public sector workers earn more than R1m per annum. In a country with a basic wage of R3 500, an average annual salary of R250 000 and 15.5 million unemployed persons in the available workforce (i.e. 38,5% of total workforce), this is unjustifiable.

24. Statistics South Africa's Quarterly Employment Survey (QES) 18/19 shows that the average salary in the private sector is R273 000, compared to R393 000 in the public sector by Treasury's estimations. The public sector also remains the last bastion of guaranteed pension benefits (GEPF defined benefit scheme) which also come at great cost, especially when investment returns are low. The latter should have served as incentive for lower and not higher average salaries.

25. Tough decisions and actions are required, before there will be any meaningful reduction in expenditure.

26. <u>Submission:</u> Although certain cost-cutting measures were announced by the Minister (namely, freezing higher level salaries, introducing a cap on the cost of cars and on expenditure on cell phones, only allowing economy class travel on domestic flights and the cutting of subsistence and travel allowances), these costs amount to a mere fraction of expenditure and are not remotely enough.

27. The public sector wage bill needs drastic reduction and tough decisions and actions are required. It is important to realise that cutting the rate of expenditure growth is not the same as actually cutting expenditure (refer to the example in point 33 below).

<u>State Owned Enterprises (SOEs)</u>

28. Poorly performing SOEs are a constant drain on the fiscus. Eskom stands out as the biggest culprit requiring the most additional support:

Financial support to state-owned companies:	
Eskom Special Appropriation Bill	26 000
South African Airways	5 500
South African Broadcasting Corporation	3 200
Denel	1 800
South African Express	300

Source: MTBPS

29. Stabilising Eskom is essential to mitigate the immediate risk that its failure poses to the economy. It is important to set out strict requirements to which Eskom needs to adhere as a pre-requisite to receiving support. In this regard, the announcement to this effect by the Minister is welcomed.

30. Submission: Providing sizeable funding to an entity that has no permanent CEO or Board in place would probably be regarded as negligent behaviour in similar circumstances in the corporate world. The provision of loans at interest rather than bailouts may not make any practical difference, since repayment of such loans is in any event unlikely. The privatisation of at least parts of Eskom should be considered with urgency. The acknowledgement by Minister Gordhan in his speech on 29 October that 'competition is good' is encouraging, as was the indirect mention of 'privatisation' for certain SOEs by Minister Mboweni.

31. The separation of Eskom into three functions (generation, transmission and distribution) to achieve operational efficiency might be readily implementable, but numerous unanswered questions remain, including whether efficiencies will actually be achieved and whether there will be a level playing field for private sector power generators.

32. Although a R630m upward expenditure adjustment has been made for infrastructure projects and project preparation, more needs to be done to ensure that the capital infrastructure is maintained to avoid any further crises (water infrastructure being the next primary concern).

Hard choices - Other service delivery expenditure

33. To put all of the current expenditure incurred by the Government into perspective, for each R100 of tax that is collected from income tax, VAT, the fuel levy etc. the following is paid:

- R46 goes to formal public sector wages, this excludes costs for renewed fixed term "contractors" and consultants;
- R13 goes to servicing debt costs;
- R12 goes to social grants; and
- R3 goes to neighbouring countries for SACU.

- So, of the R100, currently R74 goes to these four items, leaving only R26 for other "service delivery" costs. To reduce the budget deficit (R300bn) Government must effectively cut these expenses by 20% (as discussed in point 8. above). Thus R20 (20% of the R100), must be cut to effectively start reducing debt. The Government will therefore be left with only R6 (R26 – R20) out of R100 for "other service delivery costs" including capital infrastructure.

34. Submission: The above four costs represent costs that are the most difficult to adjust as all four will have consequences. The above illustration highlights the distortion created by the grotesquely high public sector wage bill and the fact that this hamstrings Government's ability to properly allocate resources to areas where it is most needed. It is submitted that it is the only item that government can take short term drastic action against to increase budget manoeuvrability in repaying debt at an accelerated rate.

35. Should this not occur, the other immoveable of debt service costs will continue to crowd out the remaining R26 for service delivery and CAPEX (and eventually social grants and wages), thus expenditure required to grow the economy. South Africa will not have the opportunity to grow the economy without making hard choices and changes first.

CONCLUSION

36. The minimum market expectations raised by SAICA last year – that Government would set an absolute threshold for public debt/deficit that it would not exceed and that it would seek to apply tougher spending austerity measures in the Budget should the budgeted revenue not materialise – were ignored.

37. Lack of accountability still remains a major concern and it is unfortunate that this was barely addressed in the MTBPS. This is evidenced by the 15.5% increase in fruitless and wasteful expenditure (from R71m in 2017/18 to R82m in 2018/19) and in irregular expenditure that has ballooned to R1bn (R960m in 2017/18). Furthermore, the 2019 Auditor General's Annual Report highlighted that 75% of the entities audited were found to be non-compliant with key legislation. Poor consequence management, unfortunately, still appears to the be the order of the day.

38. The public's patience is wearing thin. Government should, as is happening at large organisations in the private sector (for example at EOH and Sasol), take on corruption and mismanagement directly. This must be demonstrated by its willingness to deal with mismanagement decisively and effectively, prosecuting those responsible and recovering money where still possible.

39. What South Africa now needs is leadership that is courageous enough to not only talk about the tough decisions that need to be made, but to actually make them. South Africa is in crisis. There is a responsibility not only to the present citizens of South Africa but also to future generations to get South Africa out of this crisis. The public sector wage bill needs drastic reduction, as do the wage bills at SOE's, which are virtually all problematic. Capital infrastructure spend needs to be prioritised to prevent further

electricity and water supply crises. Crime needs urgent attention as this is hampering investment into the country and encouraging taxpayers to leave the country.

40. As stated by Rahm Emanuel, "*You never let a serious crisis go to waste. And what I mean by that is an opportunity to do things that you think you could not do before*".

41. South Africa cannot afford to waste this crisis – it needs to shift its focus from ideology to pragmatism.

42. "*Rock the boat! Shake the baobab tree! Do the unusual, disrupt the comfort zone. Get things moving*!"

43. Taking these words of the Minister in the 2019 MTBPS to heart, we urge the SCoF to prevail upon the various Government departments to exercise proper oversight over their portfolios, to ensure fiscal discipline and effective spending and to hold non-compliant departments accountable. This is essential to ensure the sustainability of South Africa's finances in the 2020 Budget and thereafter.

44. We implore SCoF not to shy away from its responsibility and obligation in ensuring the Executive are acting in a responsible manner with the finances of the country.

45. Increasing debt as forecasted in the MTBPS2019 (and the last 5 years) is not such responsible behaviour. Given the levels of wastage, irregular and corrupt expenditure exposed in the last 18 months, there is more than enough scope for government to enhance efficiencies and achieve the 20% budget cuts, even if it results in short term anguish. This remains better than the alternative.

Yours sincerely

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