BUSA POSITION IN ADVANCE OF THE 2019 MEDIUM-TERM BUDGET POLICY STATEMENT: PRESENTATION TO THE NEDLAC PUBLIC FINANCE & MONETARY POLICY CHAMBER

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BUSA – Voice of Business in South Africa

- BUSA is a confederation of business organisations representing a cross-section of business, large and small

UNISECTORAL	CHAMBERS	PROFESSIONALS	CORPORATES
All main sectors of the Economy	Chambers of Commerce & Industry	Professional Bodies	Corporates Board of Trustees

- BUSA's function is to ensure business plays a constructive role in economic growth, development and transformation

- As the apex organisation of business in South Africa, BUSA conveys the views of its members in various structures, including NEDLAC

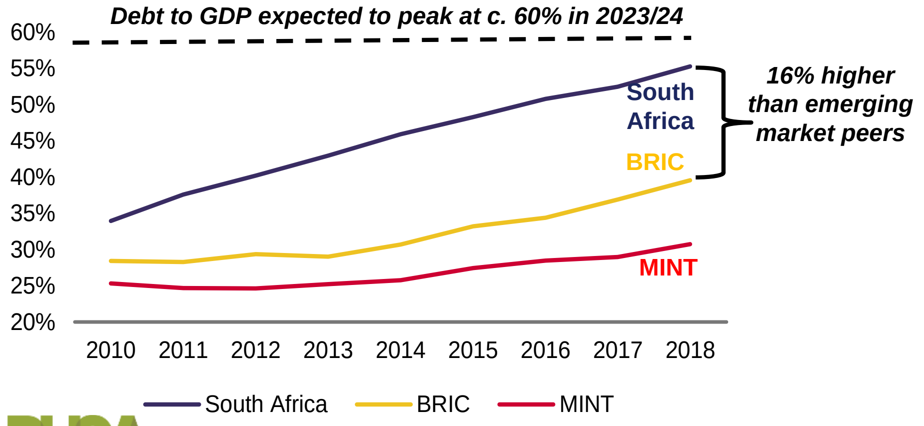
Weak macro-economic backdrop

Budget deficit and increasing debt-to-GDP ratio approaching unsustainable levels

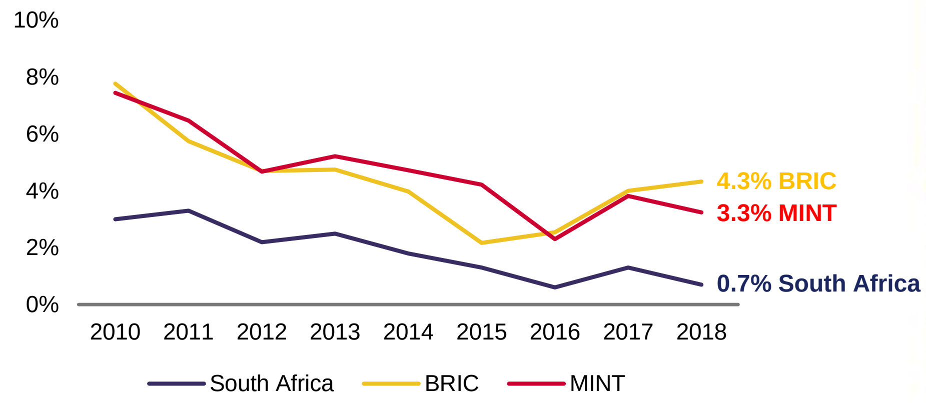
- 6 fundamental prescripts in the 2019 Budget aimed at placing the state finances on a sustainable basis, however there is continued deterioration in key fiscal metrics
  - (i) Higher economic growth
  - (ii) Increased tax collection
  - (iii) Affordable expenditure
  - (iv) Stabilising and reducing debt
  - (v) Reconfiguring SoEs
  - (vi) Managing public sector wage bill

Persistently low economic growth is compounding this conundrum

Debt to GDP (excluding SoE guarantees) – Growing levels of debt



Real GDP growth – Weakening trend. SA well below peers



BRIC: Brazil, Russia, India, China
MINT: Mexico, Indonesia, Nigeria, Turkey

Fiscal pressures remain with debt service being the fastest growing expense

Medium Term Budget Policy Statement 2018/19

A	**Revenue outlook has deteriorated** ***(2019/20: R1.47tn to R1.42tn)***	**Shortfall** ● 2019/20: R243bn ● 2020/21: R253bn ● 2021/22: R252bn	**Key drivers** ● Weak GDP ● Lower tax collection (SARS capacity and tax morality)	✘
B	**Expenditure remains inline with the Budget** ***(2019/20: R1.8tn)***	**Compensation is a major driver of spending** ● 2006/7: R170bn, 33% of total spend *vs* ● 2019/20: R628bn, 34% of total spend		?
		Expenditure priorities ● Basic education (14% of total spend) ● Public health (12% of total spend)		✓
		Fastest rising expenditure: Debt servicing ● Increase by 14% from 2019/20 to 2021/22 ● Ave annual spend R131bn, 7% of budget: R202.2bn in 2019/20		✘
C	**SOEs a major risk to public finances**	**R23bn allocated to Eskom and further guarantees for SOEs** ● Denel: R1bn ● SAA: R6.2bn	**Key driver** ● Insufficient profits to cover debt obligations	✘

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A Balance needed between revenue increases and expenditure reduction

- **Declines in tax buoyancy requires robust tax collection to balance the budget over the medium term**
  - R15bn FY2018/19 revenue collection shortfall implies the 2019 budget deficit forecasts have been overshot, leading to credibility concerns among rating agencies
- **The shortfall is partially a reflection of a long overdue institutional reform within SARS** (including the re-establishment of the LBC and Illicit Economy Unit)
- **Ongoing economic weakness, makes it even more critical for Government to focus on measures that improve tax compliance and administration**
  - Business proposes regular reports from Treasury / SARS on efforts to stabilise SARS and the effect of fiscal interventions to do so
- **Declining tax buoyancy and consistent revenue collection shortfalls, suggests there is little scope for tax increases in the short to medium term**
- **Fiscal consolidation dependent on generating greater efficiencies (e.g. effective tax collection), reducing expenditure and generating growth**
  - Including the disposal of non-core assets and mothballing of under-performing government programmes and reducing / merging departments.
  - Development of an investment-led growth strategy with aligned support across government needed: lack of detail in 2019 Budget Review.
  - Deeping effective tax administration and taxation policy (e.g. carbon tax implementation rules), increase trust and tax morality.

B Expenditure and Support for Growth

2019/20 Budget Spending Programmes

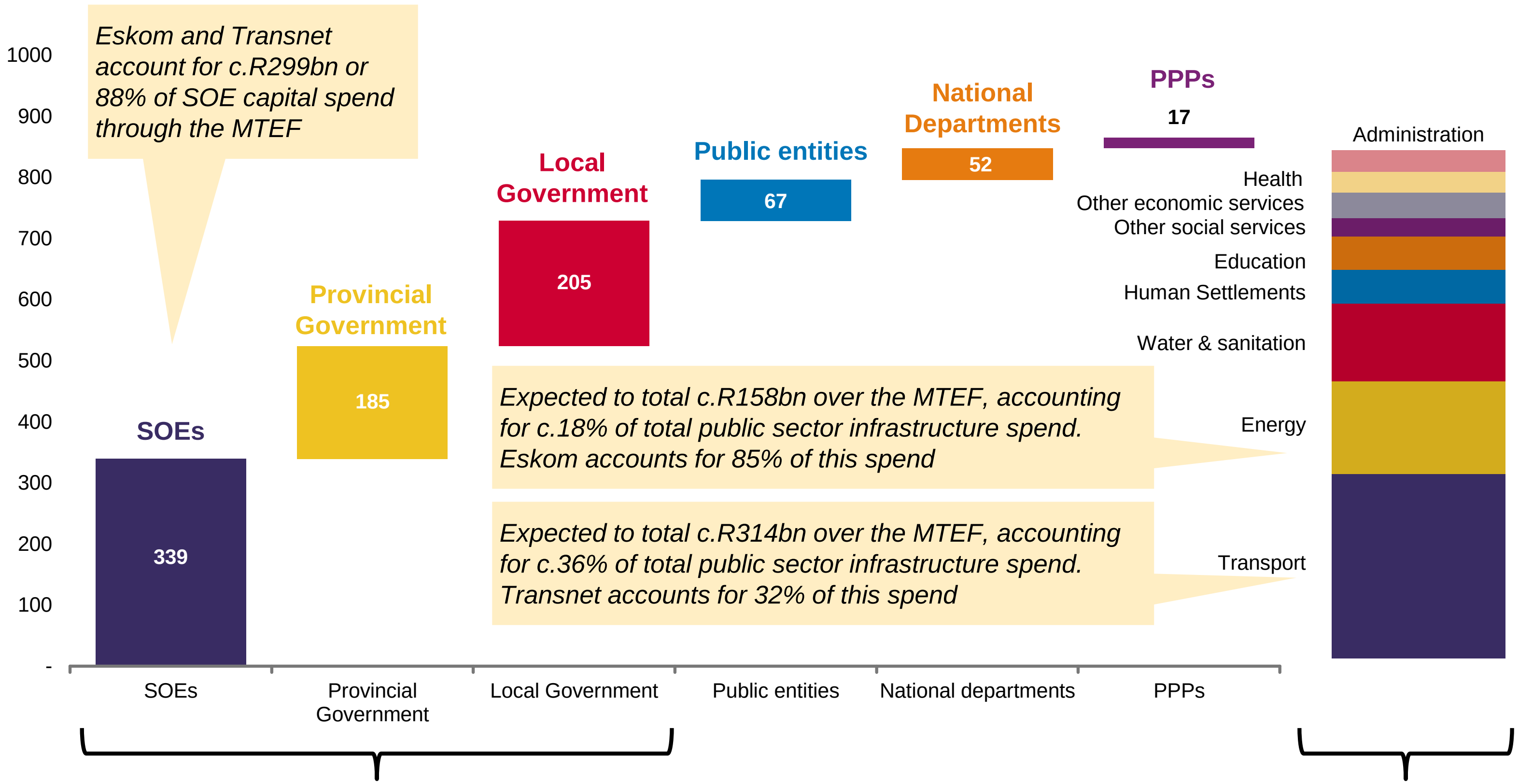
- **Total public spending over the MTEF period is expected to be R5.9tn**
    - Bulk of spending is allocated to learning and culture, social development, health and community development
- **Expenditure ceiling is increased by R16bn over the next three years**
- **c.R33bn have been reprioritised over the MTEF, mainly for service delivery and infrastructure**
- **Compensation of employees remains the largest category of spending**
    - Accounting for an average of 34.4% of consolidated expenditure over the MTEF period ~ measures are introduced to realise a R27bn reduction
    - A more sobering comparison of compensation spend is as a proportion of non-interest expenditure or as a compensation: GDP ratio (11.6% for 2019/20 vs 8.9% for 2006/7)
    - Public sector wage increases in excess of CPI funded through higher taxes and not through any measurable increase in productivity (with corresponding economic benefits)
    - A full review of public sector human resource requirements, including incentive plans, is required to pave the way to an efficient, service orientated public sector

○ **Development of an investment-led growth strategy with aligned support across government needed: lack of detail in 2019 Budget Review**

C Infrastructure Requires a Viable Funding Plan

SOEs will need to strike a balance between 3 sources of funding: revenue, debt and equity – with the State as lender of last resort

Medium Term Expenditure Framework ("MTEF") infrastructure (2020 to 2022) (Total of R865bn)



84% of total MTEF spend of R865bn

39% of total MTEF spend of R865bn allocated to infrastructure spend by SOEs

- **South Africa's quality of infrastructure is ranked 67th out of 140 countries**
- **Improving governance and administrative functions will have a disproportionately large positive impact on the economy**

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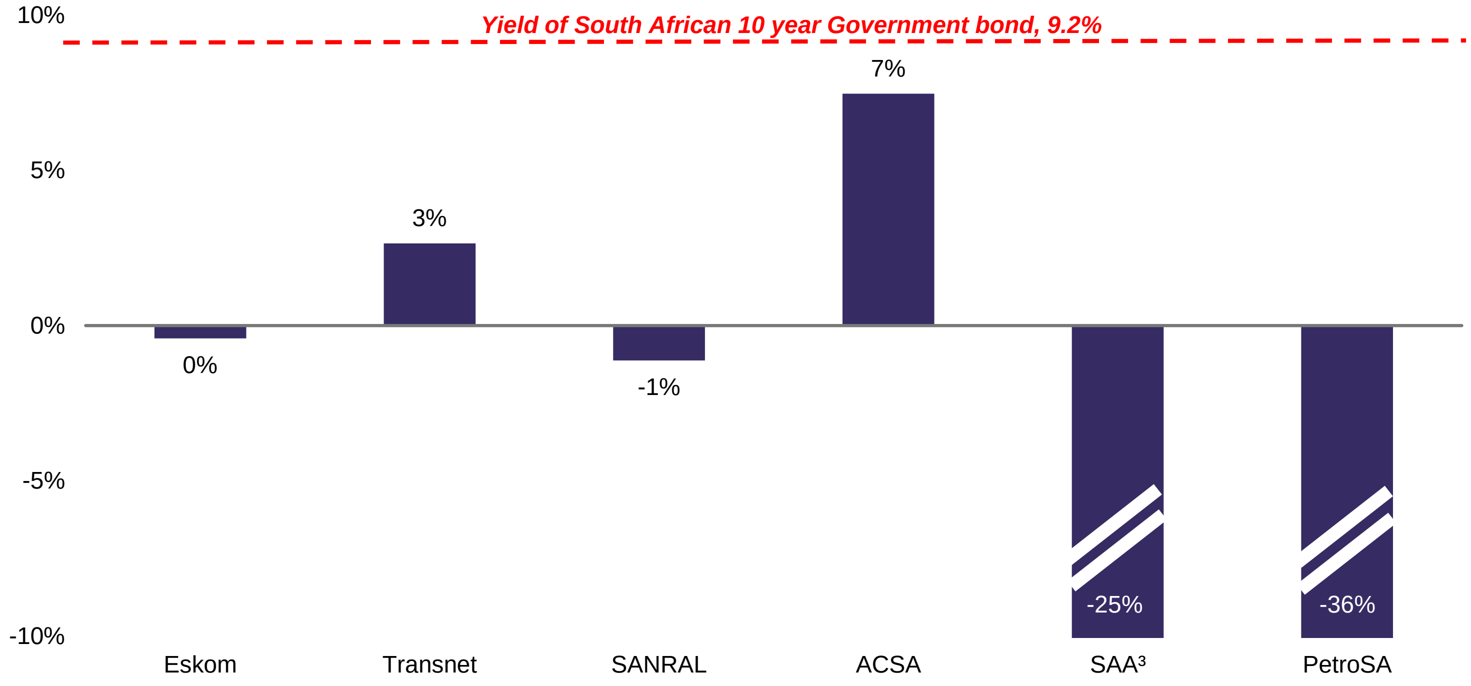
C Performance of Key SoEs (2017/18)

SoEs remain the biggest risk to sustainable public finances

SOEs[1] average return on equity[2] (%) vs long term bond yield



	Eskom	Transnet	SANRAL	ACSA	SAA[3]	PetroSA
Balance Sheet	739	370	388	32	16	17
	389	123	50	9	16	1
Income Statement	-0.7	3.8	-2.6	1.4	-3.5	-0.9

= R'bn gross asset value (first Balance Sheet row) = R'bn interest bearing debt (second Balance Sheet row) = R'bn 2 year average NPAT (Income Statement row)

- None of the large SoEs are generating returns that cover Government's cost of capital
- While recognising the developmental objective of SOEs, profitability improvements are required for SOEs to be sustainable and independent of Government funding / guarantees
- As the top 10 SOEs (ranked by total assets) generate c.95% of total SOE EBITDA, priority should be given to improving the sustainability of these entities

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Source 2017/18 SOEs annual report (most recent and publicly available)

Notes
1. SOEs selected based on asset size
2. ROE calculated as profit after tax divided by average last two years net income
3. For illustrative purposes, SAA's NAV excludes an accumulated loss of R32bn which would render the ROE calculation N/A given negative equity and losses

Proposal

- **Business remains committed to working with Government and Labour in promoting the principles set out in the 2019 Budget**
    - Continued deterioration in the debt-to-GDP ratio, exacerbated by persistent weak economic growth will lead, without intervention, to a debt crisis

- **In order to improve South Africa's growth trajectory, interventions need to be resourced and implemented immediately**
    - Reforms (either aimed at enhancing growth / revenue or reducing expenditure) have been difficult to implement and / or ineffectual
    - An investment-led growth strategy, with the support of the private sector and implementable action plans, is an imperative

- **Failure to achieve fiscal consolidation through internal reform is likely to result in an international bailout, with stringent conditionality**
    - Thereby reducing space for progressive fiscal interventions
    - Business therefore proposes a discussion with the objective of understanding reforms required (before policy space narrows further) to avoid a possible bailout

THANK YOU