Auwal Socio-Economic Research Institute
ASRI
Applied Policy Research | Advocacy | Prototyping

ASRI NPC - 2015/070721/08
18 Walton Avenue, Auckland Park, Johannesburg, 2092
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Attention: The Chairperson,
Parliamentary Oversight Committee of Finance,
The National Assembly of the Republic of South Africa

Dear Honourable Members of the Committee,

WRITTEN SUBMISSION ON THE MTBPS, OCTOBER 2018

The Auwal Socio Economic Research Institute acknowledges the 2018 Medium Term Budget Policy Statement and the commitment it displays to furthering the socio economic development of the country, whilst attempting to ensure a sustainable trajectory and prudent management of public finances.

South Africa's triple challenges of poverty, unemployment and inequality require efficient and effective allocation of state resources to address dire poverty and create a conducive environment for economic growth and employment creation.

There are however several aspects of the 2018 Medium Term Budget Policy Statement and the country's approach to the management of public finances that warrant particular attention from the National Treasury and government more generally for purposes of more effective and efficient management and allocation of public resources.

1. Fiscal Policy Stance and its Implications

The South African government adopted a counter-cyclical fiscal stance in 2001, and has since attempted to "push against the cycle" through accelerating expenditure growth during economic slow-downs, and slowing-down expenditure growth during the upswing of the business cycle.

This has been especially pronounced in the years following the 2008 financial crisis, when the South African economy entered a recession (2009). With growing debt and slow growth, **the government noted in 2013 that its counter-cyclical fiscal policy approach had "reached its limits", requiring fiscal consolidation**.

These developments, followed by the introduction of (non-interest) expenditure ceilings and a repeated reference to "fiscal consolidation" in subsequent Budget and MTBPS documents and speeches, suggest that "fiscal consolidation" has replaced "counter-cyclicality" as the country's fiscal policy.

Recommendations:

I. It is critical that the National Treasury indicate **whether "fiscal consolidation" has indeed replaced "counter-cyclicality" as the country's fiscal policy**

(primary objective), such that its actual fiscal stance (rather than stated) be correctly assessed and evaluated.

II. The National Treasury has been progressively more transparent in publishing its growth and revenue forecasts, together with underlying assumptions. Whilst this is welcome, it does not publish its "potential GDP" estimates. In the interest of transparency it would be **prudent for the Treasury to provide its "potential GDP" estimates** as these are necessary to assess the actual fiscal stance of the government.

III. Given the active pursuit of fiscal consolidation, defined as a stabilisation of debt as share of GDP through the pursuit of primary surpluses, it is necessary for the National Treasury to indicate the **"cost to GDP" arising from the moderation in government expenditure (consumption and investment) under "fiscal consolidation"** compared with a typical counter-cyclical public expenditure path.

2. GDP Growth and Growth Policy

Strong economic growth is critical to address the country's socio-economic challenges. However, South Africa's recent economic growth has been poor and has lagged fellow emerging-market and developing economies. Many other economies that have realised **strong and consistent economic growth** have done so **through pursuing active growth policies**, such as large-scale infrastructure investment, effective upskilling of labour, large-scale public works programs, attracting targeted FDI, an so forth.

South Africa does not appear to have pursued or is currently pursuing a particular growth policy. Budget Review and Medium Term Budget Policy Statement documents suggest that higher GDP growth over the medium-term will be realised through **business as usual** subject to an improved global economic environment, combined with initiatives to improve the business environment and consolidate public finances.

This approach has to date seen **GDP growth continuously fall short of government's projections**. In addition, the **country's fiscal goals are also continuously missed** (fiscal slippage), whilst the state's ability to meet its socio-economic responsibilities and support economic growth is constrained.

Recommendations:

I. The **credibility of government's "growth projections" and "growth story"** warrant particular interrogation from civil society and law makers.

II. Government, and in particular the Presidency, the National Treasury and other economics departments should **clarify the country's actual economic growth policy**, and the risks associated with its approach.

III. The emphasis on infrastructure investment and promoting FDI in this year's MTBPS is a welcome and credible departure from previous years, and is likely to support economic growth over the medium term.

3. Budget Adequacy and Fiscal Sustainability Warrant Effective and Efficient Management of Public Finances

Whilst it is a reality that public budgets, by definition, are inadequate to meet all socio-economic demands of a country and that public finances must be managed prudently without prejudice to future generations, South Africa's **large socio-economic needs warrant careful allocation of public resources**.

With more than 1/3rd of the population in poverty (IMF, 2018), the dependency of the population on government to alleviate abject poverty through social transfers and targeted spending, provide basic services and improve development prospects is acute.

This, combined with the socio-economic rights enshrined in the constitution confers on government significant socio-economic mandates. However, with resources inadequate to concurrently meet all socio-economic mandates, the need for effective and efficient allocation and spending is critical.

Recommendations:

I. The National Treasury together with line departments should indicate **the extent (in Rands) of under-funding of key socio-economic functions** (e.g. health, basic education, higher education, water and sanitation, school feeding schemes, policing etc.).
II. The National Treasury together with line departments should indicate what measures have been effected to compensate for budget inadequacy to improve the efficiency and effectiveness of current expenditure on these key socio-economic areas.
III. Several clear cases of poor expenditure allocation are apparent, and **necessitate attention to free-up resources for priority areas**. (e.g. The bloated size of cabinet, large adverse findings by the Auditor General, and above-inflation public-sector wage settlements)

4. The Collective Bargaining for Public Sector Wages Presents a High Cost to the Realisation of the Country's Socio-Economic Rights

The 2018 MTBPS laments the **materialisation of the fiscal risk of an above-inflation wage settlement**, putting pressure on an already strained fiscus. The 2018 public sector wage agreement over the medium-term expenditure framework exceeded the R212.5 billion budgeted-for increase by a significant R30.2 billion.

The higher than-budgeted-for public sector wage bill (35% of consolidated expenditure) has **reduced the budget available for other expenditure**, including goods & services (e.g. medication, textbooks, school feeding schemes), capital spending (e.g. schools, roads, libraries, clinics), and increasing employment in key service delivery areas (e.g. doctor, nurses, policemen, teachers).

The provision for collective bargaining in South African legislation is essential to ensure that workers are not exploited, their rights are protected, and allows for greater parity in an otherwise unequal relationship between employer and employee.

In the case of private business enterprise, employers consider workers' demands in relation to firm profitability and shareholders' requirements. Unsustainable demands result in continued negotiation, a change in firm production structure (i.e. firms may substitute capital in the place of labour – as has been the case in agriculture, import instead of producing locally – as has been the case in clothing) or firms closing down.

This however does not hold in the case of the South African public sector. Otherwise **unsustainable demands by public sector unions are accommodated by government** as it is generally not possible for government to readily change its production structure, and industrial action by government employees is socially unsustainable.

This has resulted in public sector wage settlements generally exceeding that of the private sector, and the public wage bill growing as a share of total expenditure.

Recommendations:

I. It is critical that government consider alternate approaches to public sector wage-settlements to ensure that the government wage-bill remains sustainable without prejudicing service delivery, growth, the sustainability of public finances, and the rights of public sector employees.

5. The Limits of Using VAT Zero Rating to Cushion Low-Income Households from VAT Increases

Following strong and vocal opposition to the announcement of a 1 percentage point increase to the VAT rate in the 2018 Budget, government commissioned a panel to look into VAT zero rated goods as a means to protect low-income households from the VAT increases.

The commission identified a range of goods not currently VAT zero-rated that should be considered for zero-rating to protect low-income households. Following the findings of the panel's work, the 2018 MTBPS proposes additional products be zero-rated (white bread and cake flour, and sanitary pads) in 2019.

Increasing the basket of VAT zero-rated goods has direct costs to the government in terms of foregone revenue. There is currently uncertainty as to how much the inclusion of new products into the zero-rated basket will cost the government, with the Treasury claiming that the panel has underestimated costs.

In addition, zero rating products consumed by both low and high income households (white bread and cake flour, and sanitary pads) also reduces the VAT paid by high income households which is not the intention of zero-rating.

Recommendations:

I. Increasing the basket of VAT zero rated items, whilst a welcome initiative, is **not the most efficient or effective means to protect low-income households** as households not purchasing zero-rated items do not benefit from zero-rating, whilst high income households (able to pay VAT) benefit from zero rating, whilst reducing the VAT collected by government.

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Mission

ASRI conducts research and advocates for laws, policies and programmes, inspired by Constitutional Values, at a National, Provincial and Local level to achieve a Just and Prosperous society.

Founding Principles

1. ASRI is founded on the values of Justice, Equality, Freedom, Truth, Integrity, and Peace.
2. ASRI is non racial, non partisan and pluralist in all its activities
3. ASRI is open to all Citizens on all levels who subscribe to its values
4. ASRI engages with any willing citizen, organization, or institution regardless of race, religion, political ideology, or political affiliation
5. ASRI is independent, where funders, political parties, individuals or interest groups do not have influence or control over the Institution, its activities, research directions and outcomes.
6. ASRI is measured based on its impact on society
7. ASRI acts consistently in the Public Interest to achieve its mission and all policy proposals must abide by the core values of the Institution.
8. ASRI brings together South Africans from all sectors of the State and Society for dialogue to achieve its mission.

Activities

- Research and Applied Research in the areas of policy focus within a Values based framework
- The hosting of Conferences, Seminars and Round Tables with Politicians, Unionists, Civil Servants in Local, Provincial and National Government; NGO's and broader civil society within the areas of focus.
- Provision of experts to contribute to policy debates and analysis in the media within areas of focus
- Initiation of research that preserves the Heritage and History of black communities in South Africa and the celebration of their contribution to Social Justice and Freedom.

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