OUTA

ORGANISATION UNDOING TAX ABUSE

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Budget 2019: OUTA submission to the Standing and Select Committees on Finance

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Background

After the 2018 MTBPS, OUTA submitted a comprehensive alternative budgetary strategy for the consideration of lawmakers and National Treasury.

In the main, we advocated for a substantial expenditure reduction programme that would see the winding down of organs of state and substantively reduce or eliminate current costs in Government that no longer confer a direct benefit on the public. The so called "Golden Rule" in public investment was proposed as a potential fiscal policy that could salvage the ailing public sector without sacrificing necessary capital investment or the prospects of increased economic growth. This means limiting borrowing only to invest and not to fund current spending on budget items that are not expected to yield returns or growth in the future.

A bleak economic outlook, combined with increasingly burdensome sovereign debt servicing costs and a worsening debt-to-GDP ratio, caused concern when the 2018 MTBPS was announced – and these figures have become bleaker.

Now, more than ever, the risk of becoming trapped in a debt spiral must be addressed. OUTA conveyed the potential consequences that could follow if the nation's debt is not properly managed in coming years. The ultimate outcome could be a loss of our economic sovereignty, the imposition of Structural Adjustment Programs and the forced elimination of expenses on social and developmental programmes.

Even in the European Union, where public finances are generally more favourable than they are in South Africa, the need for re-strengthened fiscal policy as a macroeconomic policy instrument is known.

2. Core adjustments

Budget framework

- Over the medium term, spending reductions amount to R50.3 billion, 54 per cent of which comes from compensation budget adjustments.
- Provisional allocations of R75.3 billion are budgeted over the 2019 medium-term expenditure framework (MTEF) period, mainly to assist Eskom and its reconfiguration plan.

- Since the 2018 Medium Term Budget Policy Statement the contingency reserve has been increased by R6 billion in 2019/20 to respond to requests for fiscal support from smaller state-owned companies. Additional support will be financed by selling non-core assets.
- The consolidated budget deficit is projected to narrow from **4.5%** of GDP in 2019/20 to **4%** in 2021/22.
- Gross debt is expected to stabilise at **60.2%** of GDP by 2023/24.
- **Real growth in consolidated non-interest expenditure** will average 2 per cent over the next three years.

Spending

- The expenditure ceiling is increased by R16 billion over the next three years, mainly due to provisional allocations for reconfiguring Eskom, which amount to R69 billion.
- **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 R27 billion reduction in compensation.
- Funds amounting to **R33.4 billion** have been reprioritised over the MTEF period, mainly for service delivery and infrastructure.

Tax

- No changes will be made to personal income tax brackets, while the tax-free threshold increases from R78 150 to R79 000. By not adjusting the income tax brackets for inflation, government will raise R12.8 billion.
- The **carbon tax** will be implemented on 1 June 2019.
- Increases in alcohol and tobacco excise duties will raise revenue of R1 billion.
- The eligible income bands for the employment tax incentive will be increased from 1 March 2019.

3. State Owned Enterprises

OUTA strongly agrees with the principle guiding the introduction of conditional support for ailing state-owned enterprises like Eskom, SAA, Denel and others. The financial underperformance of such critical institutions has persisted long enough to solicit serious interventions in their operations and financial planning. However, this is a soft approach that is only understandable in the context of

upcoming national and provincial elections. In its submission to the joint committee on finance post MTPBS 2018, OUTA recommended that organs of state that no longer confer a direct benefit to the public, especially if their services can be augmented or substituted by business, should be privatised in full or partially, or wound down entirely.

Despite the Minister of Finance's Budget speech containing a very similar sentiment, the feasibility and likelihood of such strong reconsideration and decisiveness seems distant. Borrowing from the private sector's modus operandi, Chief Restructuring Officers (CROs) will be deployed into those SOEs that persistently require financial support from central government and taxpayers. This may have an impact over the short term, but the terms of reference and powers of such a person are to be seen. More importantly, the sustainability and magnitude of financial cushioning this will provide for national government may be negligible as compared to the current scale and pace of accruing debt in the most troublesome SOEs.

Even though operational and financial mismanagement, large-scale corruption and general poor governance can be called the main culprit in bringing us to this point – the capacity and clout of a single individual to fundamentally restructure large, long standing state-owned entities is questionable. Nevertheless, political reality must be observed. Strong institutionalised opposition to ideological movements in favour of free-market principles and a deflated government might explain the cautious approach. OUTA supports the move toward improved cooperation and cross pollination between the public and private sectors – since this may be mutually beneficial if done lawfully and transparently. The legacy of state capture should remind us of the importance of ethical and sound governance at the intersection of big business and government.

The Ministers of Finance and Public Enterprises will select these individuals, but will the CRO be left to make structural changes without fear or favour – so to speak? Only time will tell. Minister Mboweni's speech indicated that the mandate of this position will be to implement the recommendations of the Presidential Task Team – which was appointed in December 2018. Its members are: Anton Eberhard, Brian Dames (a former Eskom CEO who subsequently resigned from the Task Team) Tsakani Mthombeni, Sy Gourrah, Grové Steyn, Frans Baleni, Mick Davis and Busisiwe Vilakazi. OUTA is hopeful that this effort, amidst others, will come to fruition and result in real structural changes that can turn the ship around. Continuous financial losses and massive bailouts or tariff increases to compensate for Eskom's dire financial situation, which simply cannot be sustained. However, this problem is not new, and a very similar solution was proposed between 2010 and 2013 which was to appoint a Presidential Review Committee, led by Riah Phiyega.

The report was filed in 2013 and suggested important changes to the way they were run. In the end, though, as many times before, the report was simply ignored and the SOE report's

recommendations died. This simply cannot be allowed to happen again. One important aspect of SOE governance that will not be addressed by this measure is the relationship between national government and the boards of SOEs. OUTA calls for the Government Shareholder Manager Bill to be revived to restructure and formalise transparent and ethical relations between the governance structures of individual SOEs like Eskom and that of the Department of Public Enterprises or whichever department is responsible for its oversight.

On alternative funding, OUTA supports the prospective sale of non-core assets in several SOEs. National Treasury notes that several entities are struggling to meet their debt obligations, with overall return on equity deteriorating to -0.3% in 2017/18. This reflects weak revenue growth and high cost structures. Growing debt-service costs from a decade-long debt accumulation phase also weigh heavy on profitability. This debt accumulation period cannot be divorced from the so called "wasted decade" of state capture and poor governance under former President Jacob Zuma – and OUTA urges new leadership to remain steadfast in the fight against corruption and racketeering in the upper echelons of government despite infighting and internal resistance to change. We are encouraged by government's pledge to initiate reforms to strengthen the governance, financial management and operations of retained SOEs; but the realisation of this promise cannot be delayed any further. Urgent action is needed immediately.

4. Consolidated fiscal framework

According to National Treasury, the Budget's main fiscal objective is to ensure sustainable finances by containing the budget deficit and stabilising public debt.

It is well known by now that economic growth is even weaker than was expected in October 2018, public debt and its servicing costs have accelerated, and governance and operational concerns are widespread in the public sector.

To narrow the deficit and stabilise our debt-to-GDP ratio, expenditure reprioritisation has been implemented, albeit limited. Baseline reductions of **R50.3 billion** will be implemented, with about half of this amount relating to employee compensation in the public service. Unfortunately, these reductions are offset by Eskom's conditional allocations of **R23 billion** per annum for the next three years. This means that the debt-to-GDP ratio has been revised upward slightly in relation to 2018 MTBPS estimates – where debt is expected to stabilise at **60.2% of national Gross Domestic Product in 2023/24**. This is disappointing because more severe cost-cutting measures, sale of non-core assets

or winding down in loss-making or redundant organs of state can compensate for limits to revenue collection at this time. However, OUTA supports National Treasury's decision not to increase direct taxation on individuals and corporations because the way government spends hard-earned taxes must first be fixed. OUTA's research found that a 1% increase in taxation produced only a 0.05% increase in additional real tax revenue (at tax levels prevailing between 2014 and 2017). It appears as though the limits to productive taxation have been reached and Government is recognising this in the 2019 Budget.

The rule of law and unconditional compliance with core financial legislation such as the PFMA, MFMA and PRECCA must become the new normal at all levels of government – be it in SOEs, law enforcement agencies, national or provincial departments, municipalities etc.

OUTA strongly supports the move to reduce total compensation costs since the historical decline in public service delivery's quality and its bloated headcount cannot be reconciled. Bolstered private sector growth may absorb job searching youths more sustainably than government without tapping into already constrained tax revenue if it is incentivised to do so inclusively with due observance of transformation objectives. For this reason, OUTA supports the Employment Tax Incentive (ETI) aimed at doing precisely this. Still, more of the same is needed in an environment that is not over-taxed and incumbered by complicated regulations and red tape – reducing the ease of doing business in South Africa (which has drastically decreased over the past decade).

For those public officials who remain in service, OUTA recommends that some form of performance-related compensation schemes be implemented in all organs of state to ensure that the quality of public service delivery is improved despite early retirement of more experienced employees. One hard-working, disciplined and competent public official can do more than a few who expect ever-increasing compensation regardless of performance.

5. Expenditure programmes

The categorical allocations of consolidated government spending by function are mainly as outlined in the introduction. What is not listed there is debt-servicing costs, which amounts to **R202.2 billion** for 2019/20 alone.

This is the fastest-growing expenditure item in the budget over the MTEF, amounting to nominal growth of 10.7% over that period. Between 2019/20 and 2021/22, government will spend more on debt servicing costs **(R674 billion)** than economic development **(R665 billion)**, and three times as

much as it will spend on the delivery of general public services **(R210 billion)** over the same period. This is seriously problematic and more austerity measures need to be implimented to curtail this situation. More expenditure should be allocated to capital investment and the delivery of general public services – without increasing the total cost of compensation. At the same time, winding down redundant or financially ailing SOEs and other organs of state that pose continuous liabilities for government can loosen up funds without resorting to tax increases. But, again, OUTA asserts that strict compliance with the Public Finance Management Act and the Municipal Finance Management Act (and consequences for those who do not adhere to their prescripts) in all spheres of government will ensure significant savings that would otherwise have been wasted or misappropriated.

This may appear to be an oversimplification of the human resource challenges in public institutions, but sound leadership to set an example, and publicly visible prosecution of those who have contravened the law, will incentivise a culture of law-abiding public officials from the Presidency to Eskom to the smallest rural municipality.

Such savings can be used to reduce annual debt-servicing costs by narrowing the budget deficit and lowering the debt-to-GDP ratio incrementally year-on-year. OUTA contends that if this is done with far more zeal and commitment, the deficit can be substantively reduced or even eliminated within a few years. In 2018, we advocated for a significant reduction in state expenditure. Again, this needn't undermine the state's important socioeconomic development budget items because it can be done by eliminating unnecessary activities or entities and improving efficiency in retained spending. Much bigger savings can be incurred if this is done in addition to natural attrition and performance management of employees in the public service.

On the division of revenue, OUTA supports the relative increase in allocations to local government from 8.8% of the total budget in 2018/19 to 9.2% in 2021/22 – conditional on serious steps being taken to ensure that such allocations are well spent on the maintenance of infrastructure and effective delivery of basic services such as electricity, transport and water instead of irrationally high levels of remuneration for underperforming officials. Over the MTEF period, after budgeting for debt-service costs and the contingency reserve, 47.9% of nationally raised funds are allocated to national government, 43% to provinces and 9.1% to local government. If OUTA's expenditure reduction recommendations are seriously considered, this proportion may change to better serve local governments that are lacking in skills, efficient utilisation of resources and sound managerial practices.

OUTA extends its sincere gratitude to those Government officials who do take our input with the seriousness intended. We trust that all endeavours will be made to rectify the poor fiscal decisions

made over the past decade and hereby extend our support for meaningful turnaround strategies that go beyond that which are currently being undertaken or even those suggested by OUTA.

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