OUTA

ORGANISATION UNDOING TAX ABUSE

22 November 2019

OUTA comments on the 2019 MTBPS and Adjustments Appropriation Bill

Submission to the Standing and Select Committees on Appropriations

Submitted by:
Godfrey Gulston
Chief Financial Officer
OUTA
godfrey.gulston@outa.co.za

Queries may be sent to:
Matt Johnston
Parliamentary Engagement Manager
OUTA
matt.johnston@outa.co.za

Introduction

The lion's share of the 2019 Adjustments Appropriation Bill goes to the state-owned entities (SOEs) which report to the Department of Public Enterprises and the Department of Communications. In the succinct description of the Financial and Fiscal Commission:

"The challenges facing SOCs are a by-product of poor leadership, mismanagement, governance, corruption and revenue deficits." [1]

The crux of the matter is how the ongoing financial collapse of SOEs are exacerbating a seemingly unassailable mountain of sovereign debt. In simple terms, the cost of servicing Government's net loan debt is increasing at a rate that threatens to push aside targeted social expenditure.

We welcome the MTBPS stated intent of achieving a main budget primary balance by 2022/23, although this excludes support for Eskom[2].

The big expenses: SOEs and debt

The gross loan debt government is set to owe in 2021/22 is estimated at R3.591 trillion, 64.9% of projected GDP[3]. In addition to this, contingent liabilities will reach an estimated R1.015 trillion in 2021/22. This includes guarantees to SOEs; these guarantees already reach about R390bn for 2019/20[4].

The annual cost to Government simply to pay the interest on existing net loan debt is growing much faster than the stagnant economy and fiscus.

South Africa is forced to pay more and more interest on the debt it incurs. This is due to several factors, but international ratings agencies primarily attribute their gradual downgrade of South Africa's potential to yield returns for investors to political instability and concomitant policy uncertainty. But, most of all, they attribute their perceived inability of South Africa to yield returns on investment to the spiralling fiscal crisis. This crisis is not as simple as the fact that we "spend more than we earn" – as the Minister stated in the 2019 MTBPS – but also because world-class economists explicitly

[1] FFC submission on the MTBPS, page 25
[2] MTBPS page 3
[3] MTBPS table D.2 Main budget framework and financing requirements
[4] Budget Review 2019, Statistical Tables, Tables 11

understand that our prospect of generating more tax revenue is extremely limited. With that in mind, we are concerned about how realistic the proposal is for apparently new tax policy measures aimed at raising R10bn, due to be announced in Budget 2020[5].

Bailouts to SOEs absorbed 80% of the unexpected upward revision of expenditure announced in the 2019 MTBPS – a total of about R36.8 billion[6]. Adding this year's initial Eskom bailout of R23bn takes the bailouts for 2019/20 alone to R59.8bn. This is more than the entire Health Department budget for 2019/20, is more than double the Basic Education budget, is higher than the budget for Defence and is more than the combined Human Settlements and Water and Sanitation budgets[7]. Imagine what we could have spent those bailout funds on instead.

We already "spend more than we earn", so, without any immediate action to reduce the financial haemorrhaging of major SOEs (for example, liquidating them, winding them down or bringing in strategic equity partners) the prospect of an irreversible fiscal crisis is very real and very near. We welcome the stated intention to "merge and consolidate entities and regulatory agencies, as well as consider salary controls at a wider range of public entities"[8].

What is most alarming about the dismal SOE situation is that whilst this demands capital injections to retain their going-concern status, there is no indication that the underlying causes of their technical bankruptcy are being effectively addressed. OUTA applauds those spheres of government that are clearly doing their best to address known issues, but if these efforts prove to be fruitless or bound to fail for whatever reasons, drastic measures must be taken without delay.

The recent Special Appropriations Bill – the Eskom R26bn bailout for this year – is commendable in that National Treasury and Parliament demanded that additional money may only be appropriated to Eskom on certain conditions. We understand that the SABC similarly had to meet conditions to receive its bailout. However, we are not aware that conditions were attached to the bailouts to other entities. This requires transparency. Where bailouts are unavoidable, it is essential that there are harshly regulated conditions attached and these are made public.

The fiscal woes of growing debt and collapsing SOEs now affect social spending aimed at upliftment, such as fee-free higher education and the proposed National Health Insurance scheme. If these are to

---

[5] MTBPS page 23

[6] R300m for SA Express, R5.5bn for SAA, R1.8bn for Denel, R3.2bn for SABC and R26bn for Eskom. The R26bn Eskom bailout was in the Special Appropriation Act; the initial Eskom bailout of R23bn was already in Budget 2019.

[7] Health Department budget for 2019/20 is R51.461bn; Basic Education is R24.505bn; Defence is R50.513bn; Human Settlements is R33.879bn; Water and Sanitation is R16.440bn (ENE 2019)

[8] MTBPS page 7

be implemented over the medium term, the pressure on the fiscus can be expected to tip over a critical threshold of sustainability. We note the hint of reassessing the policy of fee-free higher education[9]. We understand the cost concerns but would like there to be substantial public participation on any changes in policy on this.

Better financial management and oversight is needed

Better financial management and strict, effective oversight is needed on government finances. Effective oversight would mean that wasteful programmes would be more easily identified, corrupt payments would more easily blocked, Government finances would improve, and taxpayers would feel less aggrieved over the wastage and having to fund bailouts.

Audit outcomes are a good way to measure the movement of financial management trends in organs of state over time.

The Auditor-General of SA's report on national and provincial government finances[10], and on some of the big SOEs, underlines the appalling state of government finances. This is documentary evidence of widespread and entrenched financial mismanagement and dishonesty. It also underlines the failure of national and provincial executives, Parliament and provincial legislatures to carry out effective oversight.

Virtually all the SOEs listed in the 2019 Adjustments Appropriation Bill have received poorer audit outcomes in 2017/18 than the previous financial year. SAA, Denel, the South African Nuclear Energy Corporation and SA Express did not provide the necessary financial statements on time for the Auditor-General of South Africa's office to complete its audits of these entities on time. The SABC, the SA Post Office as well as the Petroleum Oil and Gas Corporation indicated that they will not be able to sustain operations without financial assistance in the future.

None of the SOEs audited achieved a clean audit.

The report notes irregular expenditure totalling R62.6bn (which excludes the Eskom and Transnet total of R56.5bn as they were not audited by the AG), unauthorised expenditure of R1.4bn and fruitless and wasteful expenditure of R849 million.

---

[9] MTBPS page 54

[10] Auditor-General of South Africa, "Consolidated General Report on national and provincial audit outcomes", published 20 November 2019. https://www.agsa.co.za/Reporting/PFMAReports/PFMA2018-2019.aspx

While irregular expenditure is often dismissed as spending which probably went to the right place and wasn't actually stolen, irregular expenditure covers non-compliance with legislation including supply chain management processes. Thus, irregular expenditure may include substantial amounts of funds spent on corrupt contracts which did not go through proper tender processes and may have been awarded at substantially inflated prices to contractors who may not have delivered. That R62.6bn in irregular expenditure would have covered all this year's bailouts to SOEs.

OUTA has been vociferous in its call for government to intervene in the leadership and management of major SOEs.

Structural reform at SOEs has been on the Presidential table for more than 10 years. The Presidential SOE Review Committee was announced by former President Zuma in May 2010. The final PRC report was completed in March 2012. Among the principles guiding the review was that SOEs (commercial entities, agencies, regulators and other relevant forms) should be reviewed. Instead of reform that benefitted the agenda of our developmental state and promoted economic growth, the past 10 years have been characterised by systemic looting, financial incompetence and persistent maladministration. This observation is no longer in dispute – so why are we not seeing any consequences for those who were at the helm of targeted SOEs over this period? OUTA requests that Parliament leverage its power to ensure that consequences are enforced with immediate effect to initiate a culture of discipline and compliance with public finance management legislation at all levels of Government.

For current oversight, Parliamentary committees like this can demand in-year financial reporting for those SOEs considered essential for the public interest. Those entities that are not essential, or simply cannot be turned around, must be strategically foreclosed or wound down. Since there is an increasingly obvious limitation to the tax revenue the Government can squeeze from the population, these financial black holes can serve as strategic cost-cutting avenues. This may increase our prospect of fiscal sustainability and economic sovereignty.

Sale of assets

We'd like to know which non-core assets Government is considering selling to raise R7bn towards the SOE bailouts[11].

[11] MTBPS pages 28 and 65

Cuts and additions to budgets

The Adjustments Appropriation Bill shows additions of R17.924bn (mostly for the SOEs) and cuts of R3.056bn. These are cuts due to the SOE bailouts.

Cuts

We would like explanations for some of these cuts, particularly:

- R15m from compensation of employees in CoGTA's Community Work Programme.
- Transfers for R157.225m from National Treasury to the Government Technical Advisory Centre for job creation initiatives.
- R140m from Basic Education's School Infrastructure Backlogs Grant. We regard this cut as inexcusable, given the urgent need in this sector.
- R350m from DHET's university infrastructure grants and R400m from DHET's Infrastructure Efficiency Grant.
- R250.9m from Social Development's Child Support grants.
- R70m from Social Development's social worker scholarships. SA has an urgent need for social workers, given the ongoing problem of entrenched violence and trauma.
- R764.429m from the SAPS's Detective Services. There is an urgent need to improve such services which are essential in the fight against corruption and crime in general.
- R300m from the Department of Small Business Development's small business and innovation fund.
- R20m from the Department of Transport's Taxi Recapitalisation programme.
- R51.218m from the Department of Water and Sanitation's Water Planning and Information Management programme. Given the widespread drought crisis, this seems inexplicable.
- R225.054m from the Department of Rural Development and Land Reform's stipends for the National Rural Youth Service Corps.

Additions

- We are concerned to see that Public Works' Prestige Policy programme gets an additional R4.5m. Although this is a small amount, this fund is used to repeatedly renovate ministers' houses and seems to fly in the face of the MTBPS statement that benefits received by political office bearers will be better managed. We would like to know exactly what this is for.
- The Department of Defence receives R385.140m for weapons, all of which goes into the Special Defence Account. This account is secret, so taxpayers have no idea how much is in this or whether the funds are really spent on what the Budget says. This is of concern.
- The Minister of Finance's MTBPS speech and the MTBPS[12] included an additional R1.3bn for the National Prosecuting Authority and R1bn for SARS for 2019/20 to 2022/23 to combat corruption and improve revenue collection. We regard both these matters as urgent priorities. However, we note that the Adjustments Appropriation Bill adds just R102.429m to the NPA for 2019/20 and nothing for SARS. We hope to see these amounts in Budget 2020.
- The Department of Water and Sanitation receives an extra R5.489m for the Orange-Senqu River Commission. This Commission's work appears to be secret; it is involved in negotiating a water pipeline from Lesotho across South Africa to Botswana but doesn't appear to have run any public consultation on this. We can't find this in the Department's budget for 2019/20. We'd like some clarity on this.

SANRAL

We note that the MTBPS refers to SANRAL's financial problems, with annual losses of R1bn blamed on insufficient cash from its toll portfolio. The MTBPS says this: "To enable SANRAL to pay these obligations, government will implement direct user charges as outlined in the White Paper on National Transport Policy"[13]. OUTA's opposition to the Gauteng e-tolls is well known. This appears to be an attempt to entrench the Gauteng e-tolls, despite six years of proof that this is a failure as a revenue-collection scheme. Taxpayers are already paying for roads, particularly urban roads. We have repeatedly called on Government to investigate the inflated Gauteng Freeway Improvement Project construction costs and the collection contract in the Gauteng e-toll scheme. It makes no sense to

[12] MTBPS page 7
[13] MTBPS page 52

retain a failed user-pays scheme that has been rejected by the public and is unenforceable, especially when alternative efficient options are available to government.

OUTA intends to make a substantive submission soon to the Standing and Select Committees on Appropriations and the Committees on Transport on the subject of SANRAL's financial model.

The Vaal River System clean-up

The Adjustments Appropriation Bill shows an additional R241.927m for the Regional Bulk Infrastructure Grant for emergency work on the Vaal River System and an additional R65.373m through the Sedibeng Water Board for the Sedibeng Bulk Regional Sewerage Scheme.

These funds have been long awaited. However, there has been a great deal of confusion over this funding. The SANDF was deployed to the Vaal region in October 2018, following the Minister of Finance's announcement of funding for this, but this funding apparently failed to materialise and the one-year deployment is up. The Division of Revenue Amendment Bill refers to that R241.927m for the emergency work as being "rolled over". Why wasn't this money spent if it was available last year?

The intervention to address the Emfuleni sewage spillages into the Vaal is essential, for those who live in Emfuleni but also for those who rely on the Vaal for water security. Government is pouring billions of rand into the Lesotho Highlands Water Project to fill up the Vaal Dam, but seems to regard pollution of the Vaal as a minor problem.

We ask the Committees to investigate the Vaal River System clean-up promises, the funding arrangements and the progress of the work.

Local government

The MTBPS refers to the imminent tabling of the Municipal Fiscal Powers and Functions Amendment Bill, which "will standardise the regulation of development charges"[14]. This refers to enabling municipalities to "recover the capital costs of connecting new developments to infrastructure for water, roads, electricity and other services", says these charges are currently below cost and that this could increase municipal revenues for capital spending by R20bn a year. We would like to see the

[14] MTBPS page 43

research on which the motivation for this proposed Amendment Bill is based as we are concerned that municipalities already charge for these costs and, in some instances, levy duplicate charges. It is already clear that consumers are overburdened with municipal service charges; adding to this is unlikely to improve the financial stability of municipalities.

The MTBPS refers to 126 municipalities which passed unfunded budgets for 2019/20 and the National Treasury's instruction to these municipalities to remedy this situation by 15 November or face withholding of future transfers of the equitable share. We welcome National Treasury's improved oversight in this regard. As this deadline has already passed, and the next equitable share tranche is due on 2 December, we would like an update on the results of the Treasury's instruction on those 126 municipalities. We are also concerned that some of these municipalities have passed updated budgets which fail to budget adequately for Eskom and water board arrears, or even for current payments.

Conclusion

OUTA generally supports the 2019 MTBPS in that it prioritises the need to lower our sovereign debt, narrow the budget deficit and increase the impact of targeted expenditure.

The latter point is extremely important as spending taxpayers' money blindly does not satisfy the developmental needs of the South African population. Much more meaningful consultation with the public is needed to better understand which portions of current expenditure are worth preserving, which should be abandoned and which should be restructured to ensure that we get value for money.

Policy and implementation certainty are the main barriers between Government and fiscal sustainability. With regards to the Economic Strategy paper recently published by National Treasury, for example, international ratings agencies were optimistic about its content but unconvinced that there is adequate political consensus in Government to implement it. OUTA contends that a show of strength and determination by parliamentary Committees like these by demanding that known suspects of state capture be tried immediately can go a long way in bringing about a mind shift among public officials who are uncertain as to what side of the fence is the right side.

OUTA largely rejects the Adjustments Appropriation Bill's apparently unconditional injection into Denel, SA Express and SAA. These entities have not undergone any significant change since their financial metrics started deteriorating rapidly. The fundamental revision of appropriations to these entities should set a new precedent in government that money will NOT simply be poured into leaking

buckets to retain the image of sustainability. These entities are placing South Africa's economic sovereignty in serious jeopardy – and if no extreme and immediate interventions are implemented, Government runs the risk of losing control of our economic affairs to our international creditors.

We strongly recommend that the Standing and Select Committees on Appropriations demand that these allocations are only approved on the grounds of similar conditions as are attached to the Special Appropriations Bill. These committees, in cooperation with law enforcement agencies, civil society institutions, National Treasury and the Department of Public Enterprises should enforce adherence to such conditions with harsh and explicit consequences for non-compliance.