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31 October 2022

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Dear Sirs and Madam

COMMENTS ON THE 2022 MEDIUM TERM BUDGET POLICY STATEMENT (MTBPS)

1. We present our comments and submissions on behalf of the South African Institute of Chartered Accountants' (SAICA) National Tax Committee on the Medium-Term Budget Policy Statement (MTBPS) released by Minister Enoch Godongwana on 26 October 2022.

2. We once again thank the Standing and Select Committees on Finance 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.

Yours sincerely

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Chairperson: National Tax Committee

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South African Institute of Chartered Accountants

CONTENTS:

ACCOUNTING FOR IMPLEMENTATION

3. We welcome the Minister's recognition of the urgent need to address the concerns of South Africans and to restore fiscal stability to the budget amidst a concerning global and local economic outlook. The global economic uncertainty has meant that markets tend to treat countries harshly that show fiscal indiscipline as demonstrated by the UK recently.

4. We also welcome the fact that the gross tax revenue estimates exceeded the 2022 Budget projections by R83.5 billion in the current year (on average R92.6 billion over the medium term) and that no further tax increases are projected.

5. However, as mentioned in our 2022 Budget Review submission, the main problem facing South Africa does not lie in the raising of financial resources, but rather how those financial resources are being applied and invested into the economy in order to generate the returns we require to achieve the desired outcomes. According to the MTBPS, the additional forecasted revenue will be applied to narrow the budget deficit and keep debt stabilisation on track. R30 billion of the excess will be provided to certain state-owned entities (Denel, the South African National Roads Agency Limited (SANRAL) and Transnet) to mitigate the economic and fiscal risks associated with these critical institutions. However, with only an estimated revenue collection, South Africa has already increased expenditure ceilings. As noted in our February 2022 Budget Review comments, ratings agencies seem to now price in our seeming inability to keep to the spending limits we set ourselves. That worrying trend has not changed in the MTBPS2022.

6. Attempts are also made to address supply constraints particularly in the energy and transport sectors. This is critical considering the impact stated owned entities (SoEs) in these sectors have on our economy. Estimated losses amounting to billions of Rands a day during the Transnet strike should, in future, be prevented by better and more timeous labour relations management.

7. Despite the above actions, what remains of serious concern, is the fact that it is admitted in the 2021 MTBPS and again in the 2022 MTBPS that **higher expenditure** by government year-on-year, has **not always been efficient or effective**. Once again, a rising public-service wage bill continues to put strain on the fiscus, yet a rise in productivity is still lacking. Furthermore, **no mention** was made of **zero-based budgeting**, however, the MTPBS states that the findings of some spending reviews are being implemented in the peace and security and general public services functions. It notes that in most cases, review findings remain under discussion or will take longer to implement because they require legislative amendments.

8. Regarding legislative amendments, one of the matters highlighted by SAICA in its submission to Parliament in May 2022, was the economic and societal risks due to the lack of progress on interventions to address the findings of the **Financial Action Task Force (FATF)** and appropriations for law enforcement.

9. Since then, various legislative amendments have been proposed, yet most of the FATF key recommendations deal with challenges in our law enforcement and not

necessarily our legal framework. In this regard, SAICA submitted that the financing of the SAPS needed to be reconsidered given the proposed medium-term budget cuts after inflation but even more importantly, the Minister needed to finance the needs of the National Prosecuting Authority (NPA) to deal with corruption cases. The NPA Head, Adv Shamila Batohi noted that the NPA needs at least another R1,7 billion to be added to their current budget of R4,9 billion to prosecute corruption cases.

10. SAICA proposed that the Police VIP Unit budget (that generally looks after the security of politicians and dignitaries) be halved from R3,4 billion to R1,7 billon to secure the funding the NPA required. This proposal transfers resources through prioritisation rather than increases overall spending which is preferred.

4 National Prosecuting Authority *Provide a coordinated prosecuting service that ensures that justice is delivered to victims of crime through general and specialised prosecutions. Remove profit from crime. Protect certain witnesses.* *Of which* *Departmental agencies and accounts* – Safety and Security Sector Education and Training Authority: Operations	4 910 265

VS

5 Protection and Security Services *Provide protection and security services to all identified dignitaries and government interests.*	3 496 325

11. This would have demonstrated that the government and the Minister were willing to prioritise the budget to address the more important needs of the country. This did not happen, although we acknowledge that the MTBPS does provide increased capacity in law enforcement and investigative agencies <u>over the medium term</u>.

12. It is our view this is too late because demonstrating, before February 2023, that we can investigate and enforce both the current and the proposed legislation changes and <u>successfully prosecute</u> people is the essence of the FATF findings. Yet that seems to be the exact matter we are procrastinating on, although we do note the positive results of enforcement thus far as highlighted in the MTBPS:

12.1 The Investigating Directorate of the National Prosecuting Authority has enrolled 26 cases, declared 89 investigations and 165 accused persons have appeared in court for alleged state capture-related offences.

12.2 The Asset Forfeiture Unit has frozen or granted preservation orders to the value of R12.9 billion and returned a total of R2.9 billion to affected entities;

12.3 The SIU has instituted four High Court cases in relation to contracts worth R62.1 billion; and

12.4 SARS investigations arising from the Commission's findings and evidence have resulted in collections of R4.8 billion in unpaid taxes. SARS is currently engaged in 18 projects involving 222 cases. 11 of those cases are recommendations explicitly for SARS to execute and 8 have been finalised and the others are under investigation,

13. Whether this will be enough is debatable considering the reports of alleged 'money laundering' that infiltrated certain banks in our country and the doubts that this raises about the due diligence of some of the frontline banks and the quality of the supervision by the South African Reserve Bank[1]. These findings seem to overshadow the remedial actions of government to date. Taking all of this into account, South Africa's grey-listing in February 2023 seems inevitable.

14. Submission: The actual conduct of government rather than its legislation, plans and policies is of critical importance in various key areas to give credibility to its commitment to these plans, policies and legislation. Keeping to expenditure ceilings set and ensuring actual enforcement and prosecution that will get South Africa moving forward, including off the grey list. Not prioritising funding to the NPA and other law enforcement agencies will not keep the country off the grey list. The eventuality of greylisting, like the Ukraine war in February 2022, does not seem to be factored into the MTBPS and could have significant impact on GDP estimates, revenue estimates and debt costs.

15. We will now discuss the certain elements of the areas discussed above, and others mentioned in the budget, in more detail.

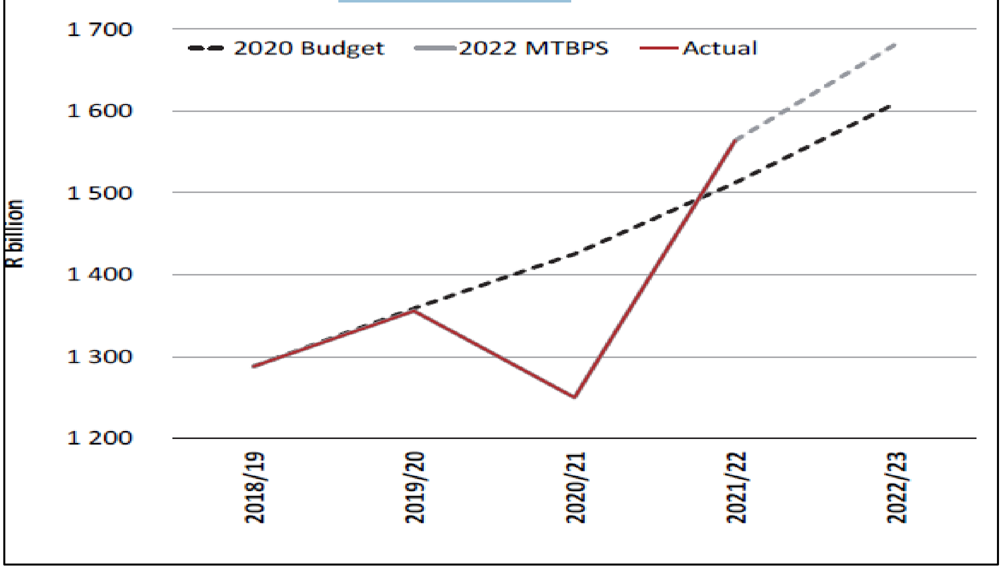
ESTIMATES OF REVENUE

Revenue estimates

16. Gross tax revenue growth over the medium term is estimated to be 6.4%, 6.6% and 6.8%, notwithstanding National Treasury's estimation that tax buoyancy will generally decrease, and GDP growth will be limited.

[1] https://www.news24.com/fin24/companies/amabhungane-the-laundry-part-1-how-shape-shifting-money-launderers-infiltrated-sa-banks-20221026

Figure 3.9 Gross tax revenue projections



17. Compared with the 2022 Budget, the projected gross tax revenue estimate for 2022/23 has been revised up by R83.5 billion (R92.6 billion higher over the 2022 medium-term). National Treasury states that the higher estimate is largely due to better-than-expected collections in the final quarter of 2021/22, upward revisions to near-term tax base growth projections and strong corporate income tax collections. The higher estimates partially reflect a **permanent increase** in revenue, most likely due to improvements in efficiencies at the South African Revenue Service (SARS).

18. SAICA, however, has some reservations as to how permanent these increases are. Much of the dividends tax increases and financial sector employees' tax increases were due to the last 2 years' COVID-19 provision reversals, not permanent increased financial performance. The downwards revision in projections for VAT also seems to align with the projected average growth in GDP of 1.6% over the medium term. Much of the strong performance on revenue collections has also been due to higher than anticipated commodity prices, which is unlikely to be sustained over the medium term.

19. Even the Commissioner seems to be slightly sceptical of realising these targets when he said: "*As SARS, we accept the challenge of the revised higher revenue estimate. While the revised <u>revenue estimate is steep</u>, we are committed to act according to what is permissible in law to meet this challenge*."

20. SAICA raised its concerns in previous years with optimistic revenue and growth projections. These concerns have been realised this year again as real GDP is projected to grow by 1.9% in 2022, compared with 2.1% estimated in the 2022 Budget. National Treasury notes this concern and has warned in the MTBPS that there is significant uncertainty associated with these projections as revenue projections have changed rapidly before, during, and after the COVID-19 pandemic. National Treasury states that any significant downward revisions will place the current fiscal strategy under pressure.

21. Submission: It is critical that the revenue estimates are as accurate as possible, as these estimations underpin the revised downwards estimations in the budget deficit and consequently the projected debt that will be needed to fund any deficit.

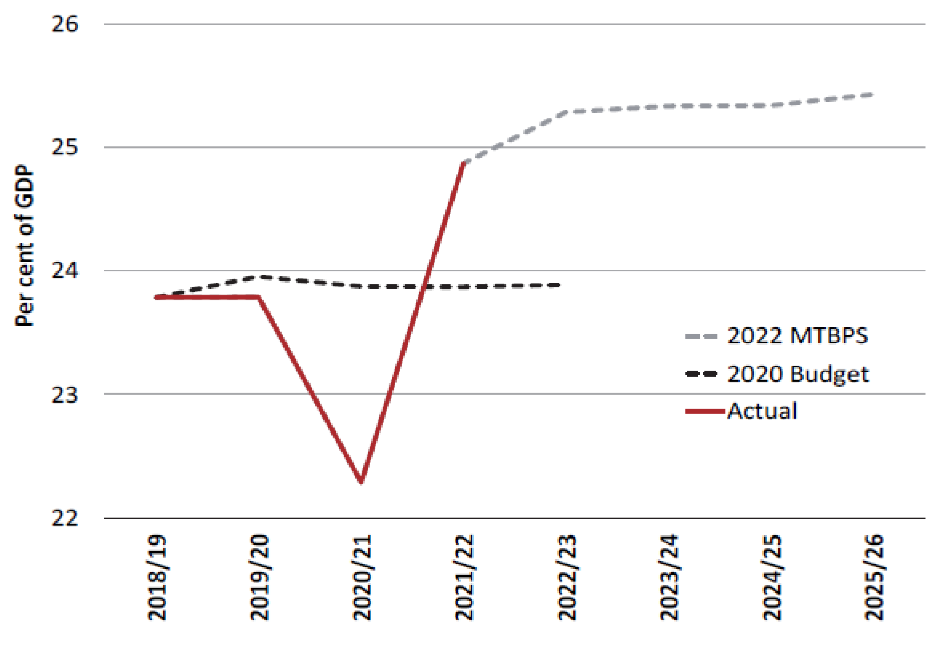
22. Over-estimating economic growth and revenue trends is not in itself disastrous when expenditure levels are not directly and closely tied to those estimates. Given South Africa's trend in these matters, together with the rising debt, it is concerning as to whether the current figures are reasonable estimates and reflections of the state of the fiscus' finances.

23. With no future tax increases being confirmed in the MTBPS and an already rising and hight tax-to-GDP ratio, failing to collect the taxes estimated in the MTBPS would result in even more debt having to be incurred. Monthly monitoring of the revenue collected should be undertaken to determine to what extent expenditure should be curtailed.

Tax-to-GDP ratio

24. The tax-to-GDP ratio is used as a measure of how well the government controls a country's economic resources and is a good gauge of a nation's tax revenue relative to the size of its economy. South Africa's ratio is estimated to increase from 24.9% in 2021/22 rising to 25.3% in 2022/23 and 25.4% in 2025/26.

Figure 3.8 Tax-to-GDP ratio



Source: National Treasury and South African Revenue Service

25. It is therefore evident that South Africa's tax revenues have (on average) been growing despite weak economic growth. A high tax-to-GDP ratio is not a problem where taxpayers are receiving good value for their money, however, this is not a reality currently in South Africa.

26. The Katz Commission in its third report recommended a set ceiling of 25% as the maximum tax-to-GDP ratio because when taxes become too high, they are damaging to an economy as theorised by the Laffer Curve.

27. As mentioned in our 2022 Budget submission, National Treasury seemed to have accepted the concept and ceiling in 1996 and the Standing Committee on Finance recommended that further evaluation be done of the 25% rate and the economic implications of higher or lower rates.

28. We are not aware of any further research on this and should the current Fiscal Policy in fact be wrong and damaging to the economy, it would be incumbent on Parliament to ensure it is properly informed of this risk.

29. Submission: National Treasury should provide Parliament with evidence of their research proving that breaching the 25% level will not result in the fiscal policy becoming detrimental to the economy.

SARS funding

30. An efficient and effective SARS is crucial to tax revenue collection. We are therefore pleased that SARS will be receiving additional resources to assist in collecting the additional revenue targets set for it. It is hoped that the resources received will be sufficient to cover its R9 billion deficit over the next three years as mentioned by Commissioner Kieswetter earlier this year.

31. As intimated by the SARS Audit and Risk Committee, one of the projects that SARS has insufficient funds for, is the implementation of GRAP. Although we acknowledge that SARS (and the rest of government), has been given extension until 8 April 2026 to implement GRAP, it is concerning that SARS is continuously afforded the opportunity to delay the implementation of GRAP with cash accounting that incentivises delaying tactics for cash already under SARS' control.

32. Regarding the structural review of the governance of SARS, it is stated in the MTBPS that SARS has largely implemented the Nugent Commission recommendations, while outstanding recommendations are currently being aligned with those of the Zondo Commission on state capture. As documented in the Nugent Commission and various other reports including the Budget Review and Tax Ombud reports, oversight over SARS has been lacking and it has become a challenge in elevating such oversight and intervention to a level that is appropriate.

33. Submission: Optimistic tax revenue targets have been set, so are members satisfied that SARS has been allocated sufficient resources to continue its drive to use high-tech systems to target non-compliant taxpayers and to deliver its services to compliant taxpayers in such a way that it will not negatively influence their tax compliance behaviour?

34. Considering that the perceived detrimental practices resulting from the non-implementation of GRAP by SARS (and the whole public sector), SARS should provide clarity on how far it is in the process of implementing GRAP and if it still has any financial constraints in this regard despite the allocation of additional resources.

Also, an explanation as to why SARS requires nearly 15 years to implement a change in accounting, should be provided.

35. Public feedback on the progress by SARS on implementing the recommendations by the Nugent and Zondo Commissions should be provided, considering that the public was not invited to comment on these proposals. In specific, the public consultation document on the governance of SARS should be issued by Treasury as previously undertaken.

ESTIMATES OF EXPENDITURE

Expenditure ceilings

36. It was conceded in previous Budget Reviews that the effectiveness of expenditure ceilings has been limited. On 23 February 2022, Fitch Ratings noted that continuing breaches of expenditure ceilings points to difficulties in containing spending and it doubts that the National Treasury has the ability to contain government spending pressures. SAICA has also raised this concern with Parliament and it is evident that this concern continues to materialise as is seen from the table below.

Table C.3 Main budget expenditure ceiling[1]

R million	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
2020 MTBPS	1 418 408	1 502 867	1 479 709	1 516 052	1 529 585		
2021 Budget Review	1 418 399	1 504 656	1 514 934	1 521 721	1 530 664		
2021 MTBPS	1 418 456	1 487 388	1 570 890	1 552 268	1 558 725	1 627 154	
2022 Budget Review		1 487 399	1 575 002	1 630 905	1 613 671	1 686 932	
2022 MTBPS		**1 487 385**	**1 566 490**	**1 667 118**	**1 665 349**	**1 744 762**	**1 832 678**

1. The expenditure ceiling differs from main budget non-interest expenditure
Source: National Treasury

37. Compared with the 2022 Budget, the expenditure ceiling has increased by R51.7 billion in 2023/24 and R57.8 billion in 2024/25. What is of further concern, is that impact of the financial support for Eskom is not included in the expenditure ceiling neither are the wage increases in 2023/24 as the next wage negotiation process has not yet begun. A compromise with unions for at 7% increase will result in unbudgeted expenditure of more than R31 billion.

38. It is conceded in the MTBPS that expenditure ceilings are too weak, and National Treasury is considering various models/policy approaches to safeguard fiscal sustainability and limit excessive deficits, for example, debt ceiling, expenditure or revenue rule.

39. Submission: Consistent breaches of expenditure ceilings are not acceptable considering the debt levels of the government. To maintain credibility, government should aim to maintain spending levels within the ceilings.

40. What is of greater importance is that keeping to expenditure ceilings, which government sets for itself, demonstrates the ability of government to control its finances as it can deliver what it promises.

41. National Treasury should be requested to provide regular feedback on its research on the most appropriate model/policy to safeguard the country's fiscal stability.

Contingency and unallocated reserves

42. The unallocated and contingency reserves cushion the framework from fiscal risks that may materialise over the medium term.

Table 1.3 Consolidated government expenditure

R billion	2022/23 Revised	2023/24	2024/25	2025/26	Average annual growth 2022/23 – 2025/26
		Medium-term estimates			
Learning and culture	447.4	455.6	473.4	496.5	3.5%
Health	258.4	256.1	267.5	279.4	2.6%
Social development	365.6	370.9	350.2	340.3	-2.4%
Community development	236.7	258.7	274.9	291.7	7.2%
Economic development	222.9	237.6	262.4	280.8	8.0%
Peace and security	227.6	226.4	235.4	246.5	2.7%
General public services	71.4	73.1	74.8	78.0	3.0%
Payments for financial assets	62.6	25.2	25.4	26.5	–
Total expenditure by function	**1 892.6**	**1 903.5**	**1 963.9**	**2 039.7**	**2.5%**
Debt-service costs	307.7	332.2	352.9	380.7	7.3%
Unallocated reserve	–	–	41.3	47.3	–
Contingency reserve	5.0	6.0	6.0	10.0	–
Total expenditure	**2 205.3**	**2 241.7**	**2 364.1**	**2 477.7**	**4.0%**

Source: National Treasury

43. According to the MTBPS documentation, the unallocated reserve is increased by R11.3 billion to R41.3 billion in 2024/25 (although Table 1.3 does not show an opening balance?). The MTBPS documentation also states that the contingency reserve has also been increased by R2 billion over the next two years to improve responsiveness to emergencies such as natural disasters (although this increase is not clear from Table 1.3 either?). However, an amount of R5 billion remains in the contingency reserve in 2022/23 as part of the funding provided for the Land Bank in the previous budget as conditions for the release of these funds have not yet been met.

44. We agree in principle that these accounts should be as reserves and "cushions" from fiscal risks. However, these allocations seem rather already earmarked for known losses (but unfunded) rather than for unrealised but anticipated fiscal risks.

45. Submission: Whether these amounts are sufficient will remain to be seen but they seem to be conservative considering the damage caused by the riots and floods over the last two years.

46. SAICA remains concerned that more than R80 billion is now being kept by National Government as conditional monies for various matters rather than outright allocations to enable recipients to properly plan and spend, especially as it relates to realised losses and risks, not unrealised or unanticipated risks.

Public sector wages

47. The social wage, totalling R3.56 trillion over the next three years (59.2% of consolidated non-interest expenses), will continue to take up the biggest share of the

budget in support of poor households. From an economic classification perspective, public-service compensation is the **largest spending item**. Over the past 15 years, the consolidated wage bill **grew significantly** and is also substantially higher than that of its peer countries and one of the highest among emerging markets.

Figure B.2 Public-sector wage bill as a percentage of GDP, 2021

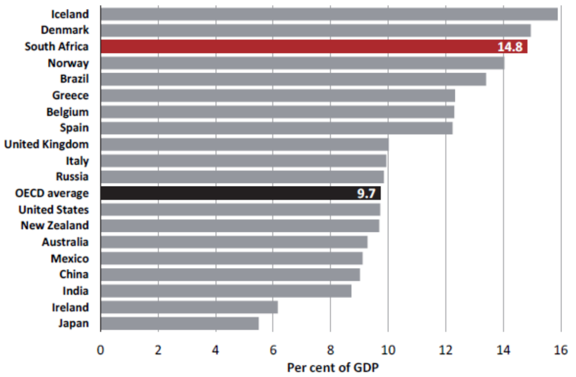
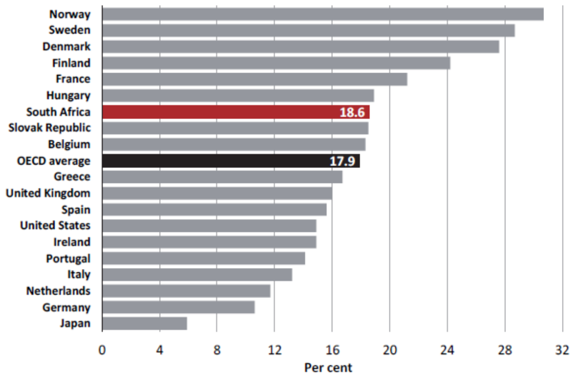


Figure B.3 Public-sector employment as a percentage of total employment, 2021



Source: OECD Data Library, 2021

48. The reason for this, as provided in the MTBPS, is mostly as a result of above inflation wage increases rather than headcount growth. The increase in the cost-of-living adjustment has resulted in some below "senior management level" occupation specific posts having surpassed the remuneration levels for "senior managers" over the years.

49. The Minister stated that future wage negotiations will aim to strike a balance between remuneration increases and the need for additional staff in services such as education, health and police (the latter sector and the defence sector having seen a reduction in the head count of 1.2% and 1.4% respectively since 2015/16).

50. It is further noted in the MTBPS that in order to avoid pre-empting the wage negotiation process, **no provisions** have been made for **wage increases in 2023/24** although increases will need to remain within the available fiscal resources so as not to compromise other spending priorities.

Table B.5 Public-service wage bill projections[1] over the 2023 MTEF period by sector

R million	2022/23 Revised baseline	2023/24	2024/25	2025/26	Average annual growth 2022/23 – 2023/24	Average annual growth 2022/23 – 2025/26
		Medium-term estimates				
Education	218 047	224 888	232 119	243 375	3.1%	3.7%
Health	149 566	148 421	154 990	162 085	-0.8%	2.7%
Police	79 137	78 431	84 352	89 158	-0.9%	4.1%
Defence	30 984	29 839	30 918	32 303	-3.7%	1.4%
Correctional services	17 855	16 929	17 689	18 481	-5.2%	1.2%
Other	110 121	109 608	114 065	119 123	-0.5%	2.7%
Total	**605 711**	**608 116**	**634 132**	**664 525**	**0.4%**	**3.1%**

1. Excludes provisional wage negotiation adjustment allocations
Source: National Treasury

51. The government has offered to pay an increase of 3% and a R1 000 monthly cash allowance and had increased that offer to an aggregate increase of 7,5%, while unions are demanding increases of between 6.5% and 10%. As mentioned earlier, a compromise with unions of 7% will result in unbudgeted expenditure of more than R31 billion. National Treasury noted that the materialisation of a public service wage agreement in excess of available resources would mean **additional fiscal measures** or **reductions in headcounts** would be required to contain overall compensation spending.

52. In an attempt to address this, the Department of Public Service and Administration, working with the National Treasury and other national departments, is **reviewing remuneration policies across government**. The aim is for the public sector (excluding SoEs) to move towards ***a single remuneration framework*** in line with the principles of fair, equitable and sustainable remuneration. This will reduce current remuneration inequality for employees performing similar tasks in different spheres of government.

53. The Budget is, however, materially incorrect if the largest expenditure item is understated and government did not even budget for the revised offer they did table to unions. Using the budget as a negotiation tool is an unwise and dangerous practice and questions should be posed as to the maturity of the labour relations practices in this regard. Budgets are not entitlements and merely seek to ensuring that the most probable financial reality is catered for.

54. Submission: The move towards a single remuneration framework is welcomed, but in order to ensure a sustainable wage path, the structural mix (composition of employees) needs to be addressed - fewer bureaucrats and more staff at the coal face of delivery are needed.

55. Furthermore, remuneration policies without a **link to individual performance** by the public sector workers, will not achieve the desired outcome. For instance, teachers have been the main contributors to growth in the headcounts, yet our education system is not producing the desired output[2]. The Minister's Performance Agreements have also have not borne any fruit judging from the Auditor General's yearly reports.

56. Labour will have to start agreeing on measures that enhance accountability and productivity from its members. Civil society, Business and Government need to agree on accountability measures and interventions for overseers and leadership who have often failed this country.

57. We strongly believe that there are pockets of excellence in government and those persons should be remunerated accordingly. However, there are even greater pockets that lack the required performance and those persons should not be rewarded for such conducted. By blanketly rewarding everyone the same, we create

[2] https://mybroadband.co.za/news/trending/430816-south-africas-real-matric-pass-rate-53.html

budget constraints to reward individual excellence and enhance productivity across government.

58. We thus welcome the Cabinet's approval on 19 October 2022 of the National Framework towards the implementation of **professionalisation of the public sector**. The Framework provides that only qualified and competent individuals be appointed into positions of authority. However, qualified and competent persons will not be motivated by a remuneration system that equally rewards and equates their skills and performance to those who do not equally show and demonstrate same.

59. Although we note that the National Treasury is hoping to align negotiations and budget determinations, this still has a long way to go, and until this does realise, the budget is clearly understated in this regard and continues to pose a substantial risk to the fiscus.

State-owned entities (SoEs)

60. In the 2022 Budget Review, SAICA warned that the guarantees to SoEs were more likely than not already a state debt and not just contingent liability through guarantee. Though it had already realised for many SoEs, it is starting to realise for many more including Eskom. The Minister concedes as much and states "however, the quality of the existing exposure is still very poor.".

61. These guarantees will continue to have a significant impact on the budget going forward yet very little provision seems to be made for it.

62. We welcome the Ministers undertaking that Treasury will now enforce the minimum criteria for state guarantees and that it has shown impact, hence none have been received. However, the horse has already bolted with R758 billion in guarantees already in place.

63. <u>Submission</u>: Parliament should request Treasury to prepare a risk-based schedule of all guarantees and a reasonable estimate of the risk of each realising in the medium term to properly inform Parliament of the likelihood and extent of realisation for each guarantee.

Eskom

64. Eskom is the biggest known risk to the economy and public finances as it does not generate sufficient revenues or control its costs. Financial support for Eskom amounts to R224.6 billion from 2019/20 until 2025/26. To ensure Eskom's long-term financial viability, government plans to **take over a portion (one to two thirds) of the entity's R400 billion debt**. **How this will be done** has **not been specified in the MTBPS**, other than the debt relief program specifics, including the selection of the relevant debt instruments and the method of effecting the relief, are still being finalised. The programme will include strict conditions that will be informed by an independent review of Eskom's operations.

65. Submission: A rough estimation of the debt or at least the interest on the debt should be provided for in the MTBPS, as not doing so, undermines the credibility of the budget.

Other SoEs

66. Government is allocating R30 billion to **Denel**, the South African National Roads Agency Limited (**SANRAL**) and **Transnet** in the current year. SANRAL is allocated R23.7 billion to settle maturing debt and debt-related obligations. A total of R5.8 billion will be allocated to Transnet – half of which is shifted funds to repair infrastructure damaged by the recent floods, and half to repair and maintain freight rail locomotives. Denel will be allocated R204.7 million to reduce contingent liabilities arising from its weak financial position and R3.4 billion – if set conditions are met – to complete its turnaround plan.

67. The **Land Bank** remains in financial distress and the process to finalise a solution is ongoing. An amount of R5 billion remains in the contingency reserve in 2022/23 as part of the funding provided for the Land Bank in the previous budget. Conditions for the release of these funds have not yet been met.

68. The **Road Accident Fund** remains a **significant contingent liability** despite receiving a growing share of fuel tax revenues. It is estimated that the accumulated deficit will grow by an annual average rate of 7.5%, from R385.5 billion in 2021/22 to **R479 billion** in 2024/25.

69. **South African Airways** exited business rescue in April 2021 and no further allocations have been made to it in the budget, yet Minister Gordhan seems to indicate that a further R3 billion will be required for the sale of the airline.

70. No further clarity was provided on the **Post Office** or the **SABC**.

71. Government, in the MTBPS, reiterated that it continues to enforce minimum criteria before guaranteeing the debt of SoEs. Over the past year, no guarantee requests that met the criteria were received. However, of further concern, is the admission in the MTBPS that financial distress, weak governance and unsustainable operations in many of these companies remains unaddressed. No further solutions to these problems were proposed other than the Presidential State-Owned Enterprises Council that has developed a **draft framework to guide decisions on disposing of and retaining state-owned companies**. To complement this work, the National Treasury has begun developing a **SoEs funding framework**, which will be finalised in 2022/23.

72. Submission: The materialisation of the contingent liabilities is highlighted as one of the risks to the fiscal outlook. These risks are slowly materialising and considering that by 2024/25, contingent liabilities are expected to exceed R1 trillion – the decisions about retaining or disposing SoEs should have been done many years ago.

73. Providing conditions that the entities will not be able to meet is also not a solution as the country unfortunately does not have the finances to wait this long for decisions on

the viability of these entities. Public private partnerships need to be escalated to avoid any further liabilities from realising and to ensure continued services to the public.

Infrastructure

74. Spending on buildings and fixed structures will **increase** from R66.7 billion in 2022/23 to R112.5 billion in 2025/26, at an annual **average of 19%** over the medium term. The 2023 Budget will propose funding to support project preparation – what exactly this means is not clear but National Treasury noted the lack of readiness of projects for current year and that these were thus taken out of budget but noted that over the medium term there are better quality projects and the 2023 Budget Review will include a list of projects and amounts allocated to each.

75. It is also noted that the South African National Roads Agency Limited will spend R61.8 billion to build new roads infrastructure and **rehabilitate** key transport routes serving the economy, mainly on the non-toll network, where over 85 per cent of roads are beyond their design life. The Passenger Rail Agency of South Africa plans to spend R23.6 billion to **rehabilitate** vandalised and stolen rail infrastructure and to continue the modernisation programme, which includes renewing the fleet of rolling stock.

76. In 2017, SAICA cautioned that what Treasury is defining as "Infrastructure" for many of its graphs etc does not actually constitute infrastructure and is misleading. We reiterated this concern in 2018 to the Standing Committee on Finance (SCoF).

77. In 2017 Treasury noted the below definition and graph:

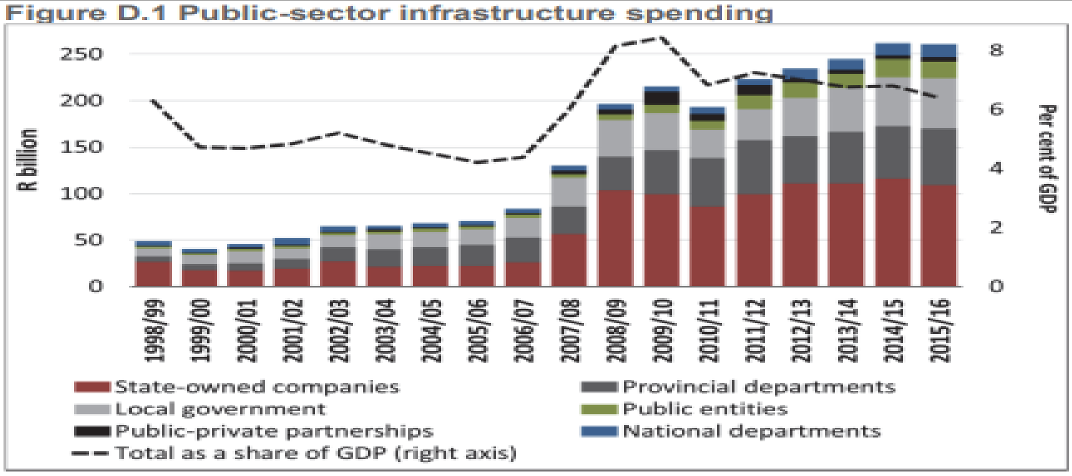
Definitions of infrastructure spending

The annexure presents estimates of infrastructure spending across the public sector, which includes national, provincial and local government, as well as state-owned companies and other public entities. Public funds allocated to public-private partnerships are also included.

The data in this annexure may differ from infrastructure or capital expenditure estimates presented elsewhere in the 2017 *Budget Review*. Here, "infrastructure" is defined broadly, including spending on new assets, replacement assets, maintenance and repairs, upgrades and additions, and rehabilitation, renovation and refurbishment of assets. Capital and interest payments are also included in the definition. In contrast, "capital spending" typically excludes maintenance and finance charges.

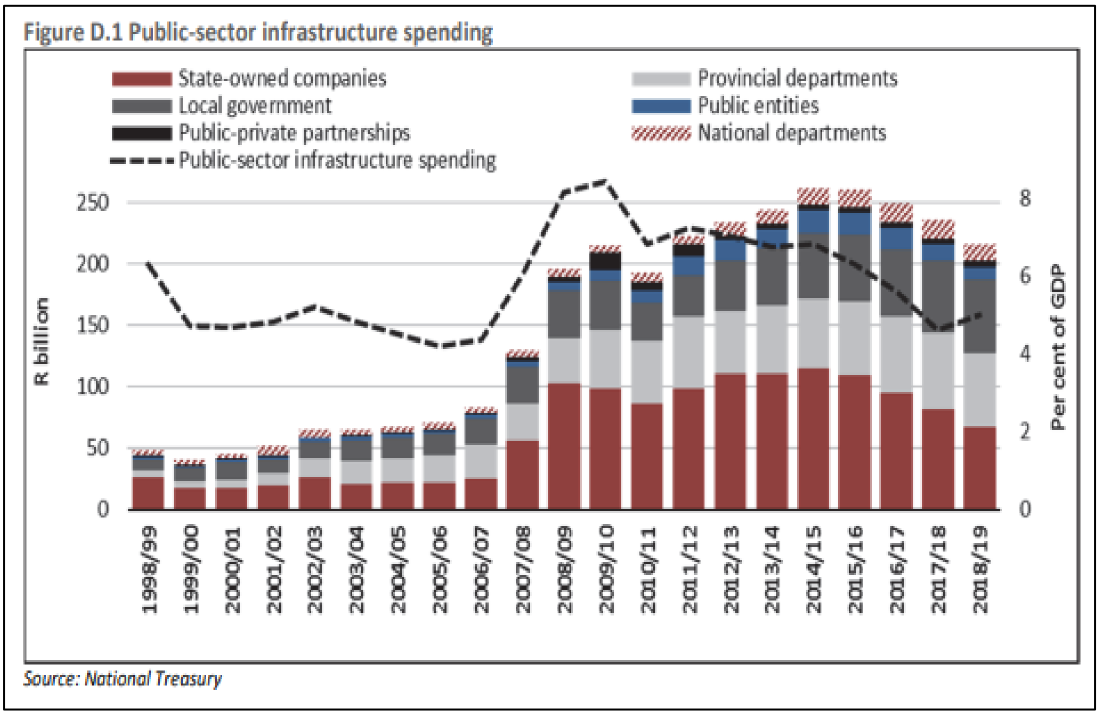
The annexure also includes expenditure on public housing as part of infrastructure spending. In accounting terms, housing subsidies are usually defined as transfers rather than capital spending.

Figure D.1 Public-sector infrastructure spending

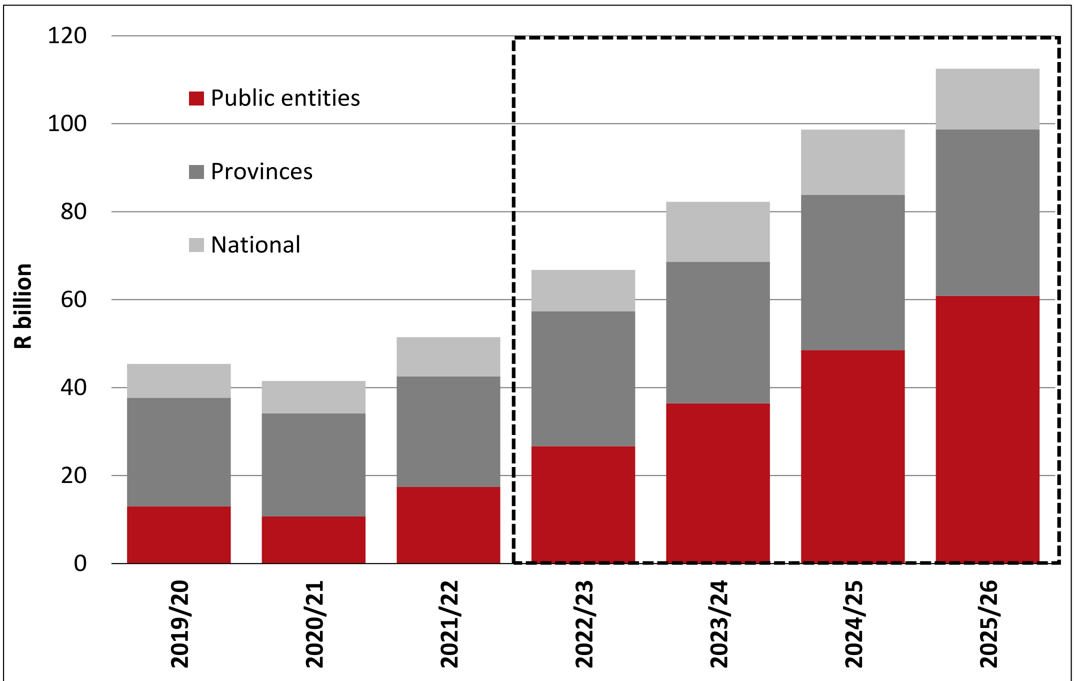


Source: National Treasury

78. A similar graph would be used in the 2020 Budget Review to represent public infrastructure spend:



79. We are, however, pleased that Treasury seems to have sanitised most other costs from the below graph in 2022 MTBPS to represent a more factually correct picture.



80. However, the MTBPS still notes that this budget includes cost to "rehabilitate" infrastructure.

81. Submission: SAICA expresses reservations on the infrastructure figures, given that not only has infrastructure figures previously disclosed in the budgets included repairs and maintenance but the current MTBPS includes rehabilitation under infrastructure spend.

82. Repairs and maintenance are not infrastructure spend as it is not outright capital infrastructure expansion – it's not building something new, it is fixing what already exists. A reallocation to repairs and maintenance should be done to expose the true extent of infrastructure spend that the country so desperately needs.

83. To obtain a proper understanding of infrastructure investment, it is submitted that SCoF should request Treasury to clearly split out "repairs and maintenance", "rehabilitation and replacement" and actual "new infrastructure not previously existing". This will enable SCoF to better understand the true investment in infrastructure government is budgeting for.

Municipalities

84. By the end of the third quarter of 2021/22, 43 municipalities were experiencing financial and service delivery crises as defined in the Municipal Finance Management Act (2003). There are many municipalities that owed creditors more money than what was available in the bank. As a result, these municipalities had to dig into their next year's budget to cover the current year's expenditure. The total deficit in local government per the Auditor General Report 2020/21 was R7,44 billion, and expenditure exceeded revenue at year-end at 55 municipalities.

85. National Treasury noted that to date, interventions to prevent this from happening have been ineffective largely because of poor coordination among stakeholders, reluctance to address dysfunctional councils, ineffective monitoring and implementation of financial recovery plans, and incorrect application of the framework in section 139 of the Constitution.

86. In response to municipalities' financial weakness, the National Treasury is working to **strengthen its early warning system** to **improve oversight** and **timely assistance**. An update on the progress will be provided in the 2023 Budget.

87. Submission: Allocating more resources to departments/municipalities that are unable to operate within their budgets can no longer be acceptable. Disciplinary actions need to be enforced at all levels, starting from the top with Accounting Officers held liable for complying with their duties under sections 38-42 of the PFMA and sections 60-79 of the MFMA as relates to budgetary control and expenditure management.

ESTIMATES OF DEBT

Debt levels

88. Despite the MTBPS's assertion that there is debt stabilisation in 2022/23, gross loan debt is expected to increase from R4.75 trillion in 2022/23 to R5.61 trillion in 2025/26. The use of foreign loans also increases over the medium term, exposing the country to currency fluctuations and a weakening Rand.

Table 3.8 Total national government debt

End of period R billion	2021/22 Outcome	2022/23 Revised	2023/24	2024/25 Medium-term estimates	2025/26
Domestic loans[1]	**3 865.4**	**4 192.8**	**4 474.7**	**4 763.0**	**5 043.1**
Short-term	448.1	444.9	477.9	513.9	548.9
Long-term	3 417.2	3 747.9	3 996.8	4 249.1	4 494.2
Fixed-rate	*2 563.8*	*2 765.4*	*3 008.0*	*3 261.4*	*3 381.8*
Inflation-linked	*853.5*	*982.5*	*988.8*	*987.7*	*1 112.3*
Foreign loans[1]	**412.1**	**559.1**	**527.4**	**533.1**	**564.8**
Gross loan debt	**4 277.5**	**4 752.0**	**5 002.2**	**5 296.1**	**5 607.8**
Less: National Revenue Fund bank balances	-266.4	-243.7	-152.7	-105.2	-94.5
Net loan debt[2]	**4 011.1**	**4 508.3**	**4 849.4**	**5 190.8**	**5 513.4**
As percentage of GDP:					
Gross loan debt	*68.0%*	*71.4%*	*70.8%*	*70.4%*	*70.0%*
Net loan debt	*63.8%*	*67.8%*	*68.7%*	*69.0%*	*68.8%*

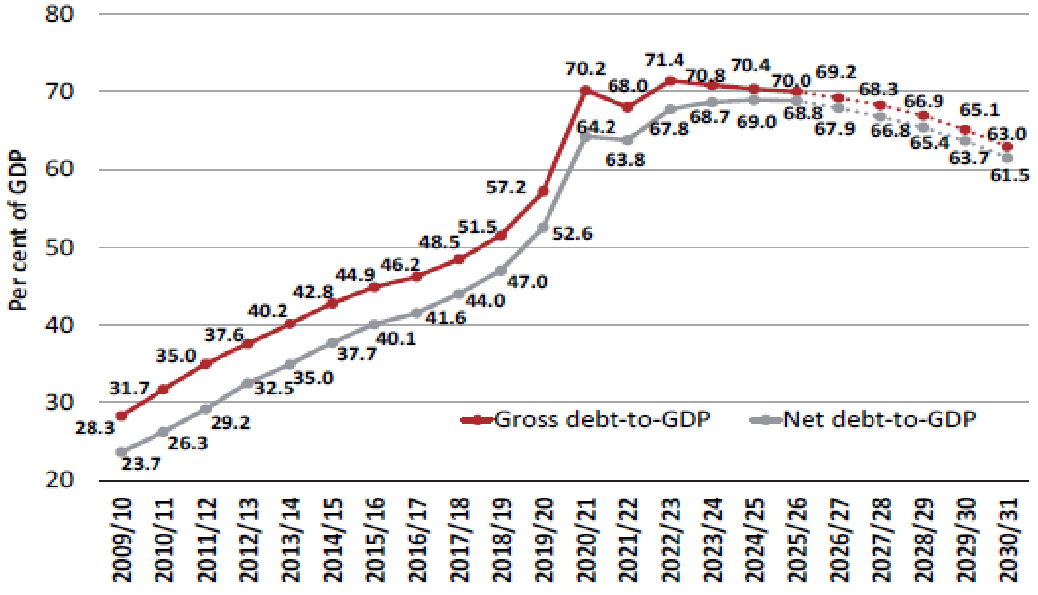
1. Estimates include revaluations based on National Treasury's projections of inflation and exchange rates
2. Net loan debt is gross loan debt minus the bank balances of the National Revenue Fund
Source: National Treasury

89. It is important to note that debt -to-GDP stabilisation does not indicate a reduction of debt or even a stabilisation of the amount of debt. “Stabilisation” merely means that the rate at which debt grows is estimated to be the same as the growth in GDP at the current debt level ratio.

90. The below graph in figure 1.4 can therefore sometimes be misleading as to indicating a stabilisation of actual debt amount.

91. The key drivers of this increase remain the budget balance and fluctuations in the interest, inflation and exchange rates. Net loan debt (gross loan debt less cash balances) will only stabilise in 2024/25 at 69% of GDP as is seen below.

Figure 1.4 Gross and net loan debt



92. This is more clearly indicated by the debt service costs increasing from R204 billion (2000) to R380 billion (2026) over the same period that the debt is “stabilising” i.e. debt service costs nearly doubles given that debt has grown, not stabilised, just the ratio has stabilised.

93. Of even more concern with the above graph in Figure 1.4 is how we are managing cash on hand. Net loan debt is gross loan debt less cash balances.

94. In 2010 our NRF bank balance was R106 billion. As seen below, by 2026, we will be at R94,5 billion and decreasing rapidly:

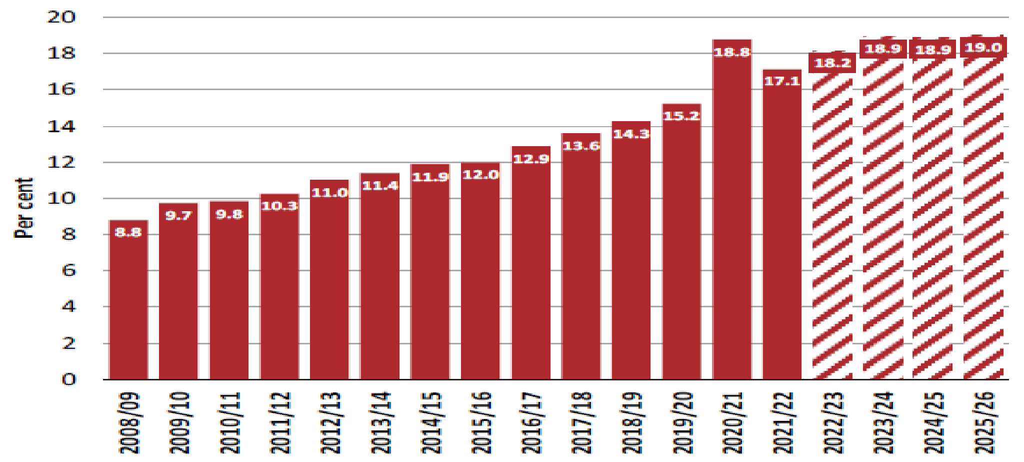
Gross loan debt	**4 277.5**	**4 752.0**	**5 002.2**	**5 296.1**	**5 607.8**
Less: National Revenue Fund bank balances	-266.4	-243.7	-152.7	-105.2	-94.5
Net loan debt[2]	**4 011.1**	**4 508.3**	**4 849.4**	**5 190.8**	**5 513.4**

95. <u>Submission</u>: As net and gross debt are so closely aligned, should the government urgently require cash, this may be difficult to achieve. The ratio of cash on hand versus GDP clearly shows government plans are flying very close to the wind. Every small and big business knows, cash flow is king and many a study has shown it to be the number one reason for business failure. It should never be the reason for fiscal failure and Treasury should explain to the SCoF why their cash flow management plans are not putting South Africa’s fiscal and economic affairs at risk.

96. We also submit that debt is not stabilising, rather the projected ratio of debt-to-GDP is stabilising – meaning that the current debt will grow at the pace of GDP at its current levels. However, if the GDP numbers do not realise or the FATF risk not budgeted for does realise, then the debt ratio will grow accordingly.

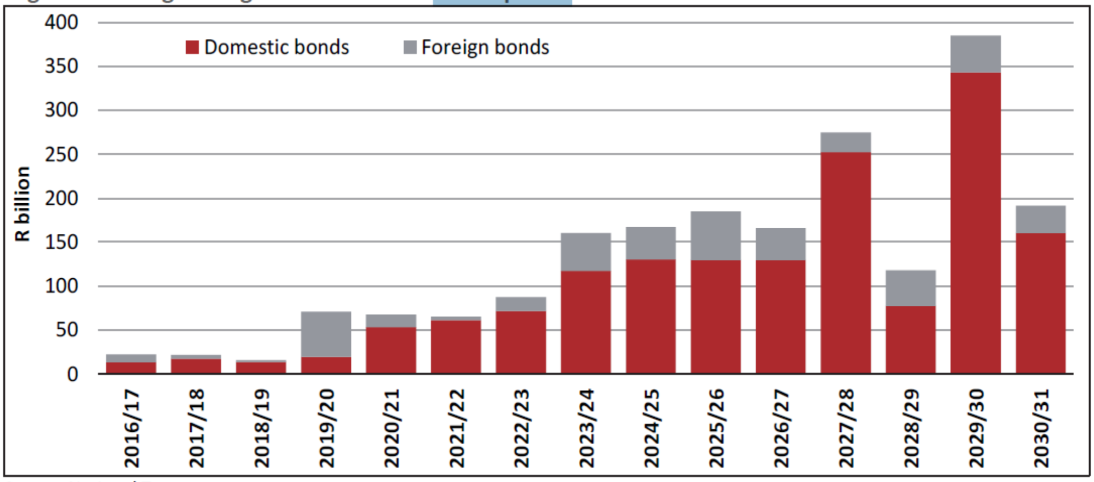
97. As debt is increasing, debt-service costs will thus also continue to rise over the medium term and are projected to peak as a proportion of revenue in 2025/26 as is seen below, crowding out other necessary expenditure.

Figure 3.2 Debt-service costs as a share of main budget revenue



98. Debt redemptions will be elevated (averaging R192.8 billion per year from 2022/23 to 2030/31) and it is noted that a portion of the maturing debt will have to be refinanced, which places significant pressure on capital markets, raising borrowing costs across the economy. It is assumed that the remainder will have to be repaid by **reducing non-interest expenditure**, something government has been poor at achieving.

Figure A.4 Long-term government debt redemptions



Source: National Treasury

99. Submission: Debt reduction will only occur if budget surpluses are realised in the consolidated budget. Government's commitment to reducing expenditure in order to achieve this is essential. This commitment has not been evidenced over the last 12 years, and we do hope that our Finance Minister will be able to stick to these commitments and curtail the need to obtain more debt.

100. Unfortunately, promising a Primary Budget Surplus means nothing when the country's largest expense (and fastest growing expense) is excluded.

UNBUDGETED EXPENDITURE

101. Unbudgeted items remain a significant risk to the credibility of the budget. SAICA noted these in its 2022 Budget Review and Appropriations Bill submissions and these included: SoEs contingent liabilities that are fast becoming government debt, financial support for municipalities that are in a precarious financial health situation, costs to fix the dilapidated water and sanitation infrastructure, costs needed to appoint 12 000 new police recruits as promised by the President in the 2022 SONA as inflation will erode the increases given to the Police Department in the 2022 Budget, IRBA's financing needs and the potential underfunding of the long-term funding requirements of the GEPF.

102. The perilous state of SoEs and municipalities are concerning and of alarming concern is that **access to clean water** is under threat, yet the Department of Environmental Affairs does not appear to have done much to address the destruction of our river systems and COGTA has not acted against municipalities breaking the law.

103. We thus welcome the infrastructure spend on **water-related projects** totalling R8.1 billion and the investment by public entities of R33.3 billion in the water sector. It is

encouraging to see that the water boards will spend R27.7 billion over the MTEF period to provide bulk infrastructure, including upgrading the capacity of the pipelines in Rand Water service area considering the water shedding that is taking place in Gauteng, despite the dam levels being near capacity.

104. Submission: We do still propose that the National Water and Sanitation Master Plan allocate responsibilities and quantify financial resources required at all three tiers of government where the primary responsibilities lie. It is recognised that this may require public, private partnerships as communities have already started taking over maintenance and repair functions.

105. It is noted in the MTBPS that provincial health departments continue to face a high level of **medico-legal claims**. The contingent liability associated with these claims – in other words, the potential loss incurred by the state if all claims are to be paid out – increased from R106.3 billion in 2020/21 to **R109 billion** in 2021/22, while payment of claims declined from R1.7 billion to R1 billion over the same period. These figures are alarming.

106. As mentioned earlier, **Eskom's debt** (and the impact on debt service costs) and the **wage increases in 2023/24** have also not been included in the budget and this poses serious financial risks for the fiscus and affects the credibility of the MTBPS.

107. Submission: The perilous state of SoEs and municipalities and access to clean water is under threat, yet many of these concerns have only partially been addressed in the MTBPS.

108. We urge Parliament to exercised proper oversight when amounts that clearly should be budgeted for are either not adequately/not budgeted for at all.

IMPLEMENTATION ACCOUNTABILITY

109. South Africa's policies are generally sound, but it's the implementation of these policies that is lacking.

110. This concern is evidenced by the yearly Auditor General Reports that continue to show a dismal picture of implementation of policies across the provincial and municipal sectors as well as by FATF in its review of South Africa's anti-money laundering rules.

111. Submission: An example should be set at the top and the Presidency should be annually reporting on Ministers' progress in implementing performance contracts and interventions should be taken against non-performing Ministers. Those found wanting should be held accountable and disciplined accordingly.

112. The urgent implementation of the framework to professionalise the public sector is critical but we still believe that a 'public sector productivity pact' as recommended by BUSA should be entered into between the government and public sector workers where they agree to minimum standards for both wages and productivity.

113. National Treasury should step up its enforcement of fiscal controls. Lastly, Parliament and its committees (e.g. SCOF, SCOA, SCOPA) should also acknowledge and fulfil their role in oversight and consequence management.

114. As proper and credible oversight of future estimations cannot be made without being properly informed as to historical actual spending and performance which should be reviewed prior to the budget by Parliament and its committees, we recommend that Parliament review its committee mandate concerning the separation between SCoF, SCoA and SCoPA to ensure that oversight obligations don’t fall in-between the cracks and that Parliament is effective as a single collective arm of government.