South Africa’s fiscal challenges:
Key issues from the Medium-Term Budget Policy Statement

November 2019

The Medium-Term Budget Policy Statement was delivered amidst pressure for the South African government to set out a clear reform agenda that would boost confidence in the economy, attract more investment, and have a positive effective on GDP growth rates. One factor that has always been singled out by the business community, external agencies such as the International Monetary Fund and the World Bank, and Credit Rating Agencies as requiring greater attention is policy certainty. Without policy certainty it will be difficult for South Africa to attract significant investment on a long-term basis. If investment is weak, growth will be low and employment outlook bleak.

In August this year, the National Treasury issued a draft economic policy strategy document that sets out the National Treasury’s thinking on macro-economic and sectoral reforms. The paper has recently been revised but retains much of the content of the earlier version. The proposed measures range from those targeting energy, telecommunications, transport, water, agriculture and removing barriers to for small and medium enterprises, as well as defining support measures towards greater economic inclusivity. The substance of the economic policy draft would inform much of the thrust of the Medium-Term Budget Policy Statement (MTBPS). There is a general sense that these measures lack focus and may not be enough to turn the economy around.

Apart from the challenges set out above, there are various complicating factors that confront government as it navigates South Africa’s growth path. Below we set out some of these challenges.

Macro-Economic Challenges and Socio-Economic Strains

South Africa’s economic performance has not lifted up in the last decade or so. This is also against a backdrop of declining global growth and weak confidence on the back of the global financial crisis of 2008 and 2009. The global economic outlook remains bleak. Even emerging economies such as China and India that have in the past acted as engines of global growth are experiencing a slowdown in GDP growth to 6.1% in 2019. Other peers in emerging economies such as Brazil, Argentina, Mexico, and Turkey are going through socio-economic pressures and their growth is in the doldrums. Unlike South Africa, countries such as China and India have in the past undertaken reform measures that have reduced poverty and closed inequality gaps. This has taken place on the back of impressive GDP growth.

While growth is also flat in Sub-Saharan Africa, the 3.6% projected average in 2019 is more impressive than South Africa's performance, where growth contracted by 3.1% in the first half of 2019 on a seasonally adjusted and annualised basis. In the second quarter of 2019, growth rebounded to 3.1%, which essentially means that the two quarters cancelled each other out. The economy is forecasted to grow at 0.5% in 2019 compared to 1.5% in February this year. This, according to National Treasury's projection, will rise gradually to 1.7% in 2022 on the back of household consumption and private sector investment. It is not clear what the basis of faith in rising consumer spending and private sector investment is in the context of economic strain faced by many households and policy uncertainty that confronts the private sector. These growth projections will not be enough to stem unemployment, which has been increasing in recent times, and the unacceptably high levels of inequality. Under such tough economic conditions, consumer spending is inhibited, and economic activity declines further in response to subdued consumption.

Growth is important since in its absence, jobs cannot possibly be created. Weak growth is evidence of low levels of economic activity. There has been much talk about looking beyond GDP growth, which is sometimes wrongly articulated to mean that GDP is not important, when what this should actually mean is that GDP growth is necessary but insufficient. It has to be both labour absorbing and capture innovation in the economy. The quality of investment and economic activity are also key to promoting a particular trajectory of growth that is innovation led, labour absorbing (especially in manufacturing) and should enhance quality of life. South Africa is still grappling with high levels of poverty, unemployment and inequalities, and any suggestion that GDP growth is not important is as dangerous as is misleading. GDP growth is an important starting point for expanding economic activity and creating jobs.

Further, economic growth, supported by sound social policy framework, infrastructure development, sound industrial policy, promotion of small and medium enterprises, redistributive measures, and approaches aimed at overcoming spatial inequalities, can promote greater social and economic inclusion. The National Treasury economic policy paper as noted earlier, has sharpened its focus on sectoral intervention.

On the macro-economic front, government has set out to ensure sustainable fiscal policy to reduce macro-economic risks, lower borrowing costs, and ensure that government builds up intergenerational equity in the future. In the current macro-economic environment, this remains bleak. South Africa's tax base is thin, and without growth it may be harder to support future generations. As set out by the Minister of Finance during the MTBPS, tax revenue collection will be R5bn or 4% less than expected, and this will raise the pressure to cut expenditure.

South Africa's unemployment rate is at 29%, with 50% of the youth unemployed. As the *Quarterly Labour Force Survey* has shown, in the third quarter the number of employed individuals increased by only 21 000 (to 16.3m). The number of unemployed also increased by 455 000 (to 6.7m) compared to Q1 2019. The unemployment rate increased by 1% compared to Quarter 1, with a year-on-year comparison showing a 9.4% increase in unemployment. Formal sector job losses are largely driven by mining, transport, construction, trade, finance and other business services. It is community and social services that registered the largest employment gains. The latter, however, is a sector that does not seem to be valued highly, and where wages are low. Crucially, informal sector has seen gains in employment growth by 114 000 compared to Q1 2019. The latter sector does not generate tax revenues for government. What this story tells us is that the formal sector is shrinking, and the informal sector is growing – not by choice but by necessity, and with it the tax revenues may shrink further in future.

Medium-Term Budget Policy Statement

Is the medium-term budget policy statement equal to the task at hand? As we have noted above, tax collection will be lower than initially projected, which means a curtailment in government expenditure, especially if government is serious about reigning in debt levels, which will surge to 70% by 2022. Various factors have undermined the fiscal framework, according to minister Mboweni. These include the R26 billion in additional financial support to Eskom, R11 billion to several smaller state-owned companies that are in financial distress, and R430 million that has been approved through Budget Facility for infrastructure student housing. These will, to some extent, be offset by unspent funds and partly through reserves. Eskom, in particular, has been a major factor in the sudden increase in government spending, which places government against the wall and forces it to find areas to cut spending. The PSA is on record in calling for a moratorium on cuts in the public sector wage bill or a freeze in the salaries of public servants. These issues will need to be brought before the Public Service Coordinating Bargaining Council rather than be unilaterally determined. Government should be careful not to conduct its negotiations through public platforms without engaging unions as this could make the formal bargaining process frosty. In the absence of a fair social compact, public servants cannot be expected to absorb pain through salary freezes or a reduction of the public service head count.

On other areas of the MTBPS, government's social priorities have not shifted much, with education, social development, and health topping the charts. Combined, these will receive R3 trillion over the next three years. To defend these priorities while also stemming the rise in country's debt as a proportion of the GDP, government has earmarked cuts amounting to R21 billion in 2020/2021, and R29bn in 2021/22. Needless to say, these will not be as nearly enough to keep a tight lid on debt. Government has identified what it considers to be low hanging fruit (or soft target) as cuts in the public sector wage bill, state-owned companies, executive remuneration and benefits, and fiscal leakages.

As already noted, the absence of an agreed upon social compact between government and the unions, this sets the stage for future confrontations between government and the unions. The wage bargaining framework between government and the unions will likely come under strain in the coming years. At the moment, it is not clear what government means by reducing the wage bill. It is yet to make its case clear to various parties in the public sector. If this refers to restructuring of the public sector to include retrenchments and de-establishment of certain departments, such a package of reforms would need to be tabled at the bargaining chamber, be negotiated, and a resolution be agreed upon.

The head of National Treasury's budget office, Ian Stuart, is reported to have said that cuts in the wage bill can be factored in later at a higher level.[i] Stuart has suggested that such a settlement is likely to be after the February 2020 Budget Vote. Public sector trade unions would have to start thinking through what this could possibly mean, its implications for the structure and conditions of work in the public sector, and how such an exercise in the reduction of wage bill may likely impact future public sector wage bargaining, as well as the structure and substance of the public sector wage bargaining mechanism. There is no indication yet that the state could take unilateral decision on restructuring. What is apparent is that this will be presented to the bargaining council, which makes it all the more urgent for public sector trade unions to be in a state of readiness and consolidate their positions. Government has signaled its future negotiating approach by indicating that "In principle you could leave the current wage agreement in place and then aim to reduce the spending growth of the wage bill to the outer years of the framework."[ii] Trade unions should consider negotiations to have begun, even if not formally so.

Apart from the proposed skeletal thought on the wage bill for public servants, government has also indicated that salaries of members of Cabinet, Premiers, and MECs will be frozen at current levels, that the cost of official cars are capped at R800 000 VAT inclusive, and also indicated that various measures aimed at cost-containment will be applied on travel and on other privileges enjoyed by politicians. These will, again, not be enough to get the economy out of the woods. More than anything else, these are signaling mechanisms. They are also nothing new since Minister Pravin Gordhan announced similar measures when he was at the helm at the National Treasury in 2013, but with no marked change in how government functions. Much of what the MTBPS had to announce were more aspirational than firm commitments, especially on steps to be taken by National Treasury on SAA, Eskom, E-Tolls and infrastructure plans, since these are within the authority of various ministers.

Conclusion

There is no end in sight to South Africa's economic challenges. The battles on the direction of economic reforms as well as on institutional restructuring in the public sector lie ahead. The major obstacles to reform are political management, institutional capacities, government coordination, and ambiguous locus of authority to take major decisions. It is not clear who really drives the proposed reform agenda, and what are the timelines for action on various aspects of this agenda as set out in the National Treasure Economic Policy draft paper.

Whatever the case may be, there is a need for trade unions to develop their own perspectives on the key challenges confronting the economy and on the appropriate policy tools and levers required to promote growth and overcome socio-economic challenges. In the immediate, the attention should be focused on the meaning of government's thinking on reducing the wage bill. From the Union's perspective, such discussion will need to defend the integrity of the wage bargaining mechanism, affirm co-determination on restructuring, and put forward well-thought counter-proposals that include the need to strengthen rather than weaken the public sector, as well as to defend public sector jobs in a very tough economic climate.

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[i] Linda Ensor, "Treasury says wage agreement with public-sector unions not urgent", *Business Day*, 11 November 2019

[ii] Ibid.