

NEDLAC: DRAFT BUSINESS RESPONSE TO THE 2018 NATIONAL BUDGET

23 February 2018

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1. Summary messages

- Business cautiously welcomes the 2018 Budget, recognising that difficult trade-offs were required to place South Africa's fiscus on a sustainable basis over the medium term. We believe Government has presented a balanced budget that has struck the right note in identifying key priorities whilst seeking to reduce or eliminate unnecessary expenditure. Critically, it is a central pillar in the collective building of confidence to underpin inclusive and sustainable growth.
- As Business, we have consistently maintained that education and skills development is the foundation stone to addressing poverty, inequality and unemployment. Sustainable increased allocations towards education (particularly higher education and training), as well as health and social support are an investment in our collective future. We are therefore supportive of the increased allocations towards these areas announced in the Budget.
- The success of government's programme will depend on achieving the envisaged cuts in expenditure, budget deficit targets, revenue collection and economic growth. The Budget is a credible plan to place the economy on a more stable footing, provided the administration adheres to the targets that have been set. We acknowledge that implementation of these proposals requires an integrated, aligned and capable approach from all relevant government departments.
- Business applauds the Minister for his acknowledgment of the role of social partners and in particular that of the Nedlac Public Finance & Monetary Policy Chamber, as well as Treasury's engagement with social partners in the build up to the Budget, that greatly enriched the Budget Process. We would like to reinforce our commitment to Nedlac processes, including the Sovereign Ratings Downgrade Task Team established here by President Ramaphosa and the Minister of Finance.

2. Fiscal consolidation

- The decisive fiscal action articulated by government is critical. Although debt service costs are set to increase by 9.4% annually over the medium term, this is an improvement on the 2017 Budget's projection of 10.5% annual growth. Containment of both the debt service and absolute debt to GDP ratios are central to the achievement of a sustainable fiscal future over the medium term.
- The medium-term expenditure reduction of R85 billion identified by the Cabinet sub-committee is a necessary step in South Africa's journey towards fiscal consolidation, whilst ensuring that this reduction has not negatively impacted on real growth in social spending.
- The increase in the debt-to-GDP ratio to 56.2% in 2022/23, which is a significant increase on the 2017 Budget's forecast of 48.2% over the medium term is of concern. The relatively low level of foreign debt appropriately removes risks associated with potential rand volatility.
- The budget deficit forecast for 2017/18 of 4.3% which is a significant increase on the 3.1% forecast in the 2017 Budget, is of concern.
- The commitment by government to finalise a framework on guarantees to State Owned Enterprises (SOEs) aimed at reducing the exposure to and improving the quality of its guarantee portfolio is important, as is the commitment to disposing of non-core assets. We stand ready to work alongside government to ensure that these commitments are expeditiously met.

3. Tax proposals

- We believe that raising of gross tax revenue by R36 billion in 2018/19 through a variety of taxes in a manner least disruptive to sustainable, inclusive economic growth and employment has been carefully considered.
- Business is on record last year as having said that future tax increases over the medium term would need to maintain an optimal balance between direct taxes such as Corporate Income Tax (CIT) and Personal Income Tax (PIT) and indirect taxes such as Value Added Tax (VAT). It was clear that any further CIT and PIT tax hikes would have been counter productive. Tax increases need to maintain an efficient, diversified and sustainable tax system that should be aligned with Government's economic growth objectives and job creation in line with the NDP.

- In view of this, we are broadly supportive of the taxes identified for increase in the Budget, including the increase in VAT by 1% to 15%. This is forecast to yield R22.9 billion in the 2018/19 financial year. While business recognises that consumers will come under greater pressure with a VAT hike, we believe that this is the least damaging of available options. We applaud Treasury's decision to ensure that a suitable proportion of the revenue generated from the VAT increase will be directed towards real increases in social grants. It is to be hoped that this will offset any negative impact on the poor arising from the VAT increase. Business, however, would have liked to have seen the VAT increase also accompanied by a further zero-rating a basic goods as an additional compensatory mechanism to the most vulnerable. In that regard we note yesterday's discussions at the Standing Committee on Finance and would support expanding the list of zero rated goods.
- We look forward to the publication of the discussion brief on the proposed acid mine drainage levy and the proposed environmental fiscal reform policy brief. We particularly look forward to the recognition in these documents of the significant voluntary expenditure by business in support of environmental initiatives.
- Business is concerned about the announcement of the implementation of the Carbon Tax by 1 January 2019 when there are significant implementation challenges, and the country is on track with nationally determined contributions to reduce greenhouse gases in terms of the 2015 Paris Agreement. Implementation of the Bill not only requires significant work, but also relies on regulations which have not yet been published for comment. We would like to be afforded an opportunity to engage on the date of implementation of the Carbon Tax. The media statement accompanying the release of the Bill for comment indicated that a decision on the implementation date would be made taking the economy into account. This is a far more considered approach that we believe is necessary if we are to avoid unintended consequences and ensure the conditions for growth.
- We welcome, however, the indication that further environmental taxes would not be introduced in the absence of a policy briefs which BUSA trusts will be fully consulted upon in Nedlac.

4. Consolidated spending

- Business notes that real growth in non-interest spending will average 1.8% over the next three years. We note with approval that post-school education and training, health,

social development and community and economic development are the fastest growing categories. We view this growth in expenditure favourably as it serves as a catalyst for building the foundation for sustainable, inclusive economic growth.

- The reduction in the expenditure ceiling by R85.7 billion over the next three years without reducing employee compensation budgets is appropriate.
- We note the announcement that the Public Procurement Bill is in the process of being developed. In this regard, we support the intentions of the Bill to combat corruption, advance transformation, improve efficiencies and improve governance. Business looks forward to engaging further on the Bill and is hopeful that this will be tabled at Nedlac for engagement, in line with agreements reached among social partners in this regard in both the Nedlac Trade & Industry Chamber and Public Finance & Monetary Policy Chamber.
- Government's commitment to drought relief and short-term assistance in disaster relief grants is acknowledged, as is the R2.1 billion allocation over the medium term to support SMMEs during the critical start-up phase, and the support provided to small and emerging enterprises in the agricultural sector. However, business is disappointed at the lack of detail with regard to the review of incentives. While it is understood that this review will be finalised during the course of 2018, it is essential that an appropriate balance is struck between optimising value for money in terms of incentive programmes on the one hand, and support for economic growth on the other.

5. Emergent Risks

- While we are confident that the Budget has helped to stabilise the negative trajectory in economy, we must be mindful of the continuing risks to the outlook.
- One of the largest risks to the budget forecast remains the threat of a sovereign ratings downgrade remains, with potential effects on borrowing costs, currency weakness, disinvestment, consumption and employment. While it remains to be seen whether the 2018 Budget displays adequate intent on the part of government to avoid further downgrades, it must be borne in mind that the risk of further downgrades is likely to remain for the foreseeable future. Business remains committed to working alongside Government and social partners to minimise the possibility of such downgrades.
- Significant risks to the overall fiscal outlook continue to be posed by the overall public-sector debt requirement (inclusive of government borrowing and that of state entities such as SOEs). Business is supportive of government's plans to address shortcomings

in the operations, procurement practices, and corporate governance of SOEs. In some cases, most notably Eskom, the task is urgent, and some form of restructuring appears both inevitable and overdue. The ramifications of Eskom's restructuring on the fiscus and business is unclear, and we look forward to the work of the Sovereign Ratings Task Team in Nedlac that has approved research to consider a sustainable model for Eskom. Of the utmost importance in stabilising the energy sector is the finalisation of a least-cost Integrated Resource Plan (IRP) which is a direct input to transitioning South Africa into a low carbon economy. We are concerned that despite repeated requests, consultation on the IRP and Integrated Energy Plan has not taken place at Nedlac despite commitments thereto.

- A further risk is that of the performance of the economy itself. Business has consistently warned of overly optimistic GDP forecasts and the negative impact this has on subsequent budgets and the credibility of government's fiscal consolidation plans. For this reason, every effort should be made to support the economy and encourage the private sector to invest, create jobs and grow government's revenue collection.
- We note the damaging impact of corruption in the public and the private sector on the fiscus, both in relation to the leakage of public funding required for social and economic investment, as well as its negative impact on revenue collection. It is incumbent on National Treasury to play a leading and decisive role in addressing corruption and malfeasance in SARS, and broader government. We as business are on record that we will adopt a zero tolerance approach to corruption in our own ranks.

6. Conclusion

- The success of government's programme depends not only on giving effect to cost containment measures but also on a meaningful increase in the rate of GDP growth. Without this, the fiscus will continue to be constrained. Business therefore appeals to government to implement the necessary policy and regulatory reforms with the urgency required to boost business confidence and consumption.
- Business is ready and willing to engage government and social partners extensively on such changes and is encouraged by the commitment to social dialogue by both the President in the State of the Nation Address as well as the Minister in the Budget Speech. Business would like to emphasise the central importance of Nedlac in efforts to



grow the economy and address the continued challenges of poverty, inequality and unemployment.