



2018

MEDIUM TERM BUDGET POLICY STATEMENT

Speech

The economy at a crossroads

Minister of Finance TT Mboweni

24 October 2018

2018 Medium Term Budget Policy Statement Speech
Check against delivery

Madam Speaker

President of the Republic

Deputy President

Cabinet Colleagues and Deputy Ministers

Deputy Speaker

Governor of the South African Reserve Bank

Leaders of all political parties

MECs for Finance

Representatives of organised business and labour

Civil society and faith community leaders

Honourable Members

Directors-General of the National Treasury and other departments

Acting Commissioner of SARS

Fellow South Africans

It is my singular honour and privilege to table the twenty second Medium Term Budget Policy Statement for consideration of the House and of all South Africans.

Today I also table:

1. The Division of Revenue Amendment Bill,
2. The Adjustments Appropriation Bill,
3. The Special Appropriation Bill,
4. The Rates and Monetary Amounts and Amendment of Revenue Laws Bill,
5. The Taxation Laws Amendment Bill,
6. The Tax Administration Laws Amendment Bill, and finally,
7. The 2018 Adjusted Estimates of National Expenditure.

Madam Speaker

In *A Tale of Two Cities*, Charles Dickens opens with:

“It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity... we were all going direct to Heaven, we were all going direct the other way...”

So too is the present time. As a country, we stand at a crossroads. We can choose a path of hope; or a path of despair. We can go directly to Heaven, or as Dickens so politely puts it, we can go the other way.

For ordinary South Africans, it has become a difficult time. Administered prices, such as electricity and fuel, have risen. Unemployment is unacceptably high. Poor services and corruption have hit the poor the hardest.

Under the leadership of our President, and much like the central character in *A Tale of Two Cities*, we have, as a country, chosen the difficult path of redemption.

The Medium-Term Budget Policy Statement is a central part of our planning as a country. It is designed to outline how we spend scarce resources for the benefit of all South Africans.

This Policy Statement provides us with an opportunity to take stock of the strides we have taken in the year. We do this in a data driven way, providing credible evidence to judge our collective performance as a society.

However, it is more than a set of numbers, reams of data, charts, graphs or words. Our performance should be measured by whether people are gainfully employed, whether our children are learning in decent schools, and whether we have health care facilities that are up to standard.

The Medium-Term Budget Policy Statement is an opportunity to restore trust between government and society. South Africans correctly expect more from their government. They are right to expect that their money is spent wisely and productively, and goes to meeting their basic needs.

The 2018 Policy Statement is built on a strong conviction that South Africa can be renewed. It reinforces our commitment to the National Development Plan. It articulates the President's vision of *Thuma Mina*.

Together, as a country, we can rebuild and recast our future.

We are at a crossroads. This Policy Statement highlights the difficult economic and fiscal choices confronting us over the medium term.

We must choose a path that takes us to faster and more inclusive economic growth and strengthens private and public sector investment.

We must choose a path that stabilises and reduces the national debt. We cannot continue to borrow at this rate.

We must choose to reduce the structural deficit, especially the consistently high growth in the real public sector wage bill. New fiscal anchors may be required to ensure sustainability, in addition to the expenditure ceiling.

We must choose public sector investment over consumption.

Reconfiguring our state-owned companies requires us to take a hard look at how they operate. Our current challenges with state-owned companies present an opportunity to demolish the walls that exist between the private and public sectors.

Along with other key economic institutions, we will urgently fix the South African Revenue Service. It is a matter of public record that the capacity of SARS has been weakened. It is in this context that the SARS leadership team must be strengthened. The organisation has many talented and committed employees who want the organisation to succeed and who are working tirelessly to re-build trust.

The global and domestic economic outlook

Madam Speaker, I present this policy statement against the backdrop of a technical recession in South Africa. The economic expectations at the time of the Budget in February 2018 have not materialised. Since then, the risks to the global growth outlook have become more pronounced.

Rising interest rates in the United States of America and a stronger dollar reflect a strong US economy. In the medium term, strong US growth will support export growth.

But monetary policy normalisation has created turmoil in financial markets. Countries with large twin deficits and high levels of external debt – notably Turkey and Argentina – have experienced sharp currency depreciation, rising credit spreads and large capital outflows. In some cases, inappropriate policy responses have exacerbated market volatility.

Developing countries are now expected to grow by 4.7 per cent in 2018 and 2019. For 2018, South Africa's growth forecast has been revised down from 1.5 per cent to 0.7 per cent. Growth is expected to recover gradually to over 2 per cent in 2021 as confidence returns and investment gathers pace.

That said, any forecast is based on a set of current assumptions. In the documentation tabled today, we outline different scenarios including macroeconomic and fiscal risks.

Implementing measures to stimulate the economy

The National Development Plan outlines our long-term vision. A core element of this vision is a commitment to strong, sustained and inclusive economic growth to sharply reduce unemployment, poverty and inequality.

During the first decade of our democracy, economic growth was closely linked with that of the rest of the world. Over the past decade, however, our growth has been significantly slower than our peers. With the right initiatives, we can once again recouple our growth performance with that of the global economy. Our growth agenda must raise potential output by boosting productivity, increasing competition and reducing the cost of doing business.

As a start, the President has announced five measures to stimulate the economy:

1. Implementation of growth-enhancing economic reforms
2. Reprioritisation of public spending to support growth and job creation
3. Enhancing infrastructure investment and establishing an Infrastructure Fund
4. Addressing urgent and pressing matters in education and health
5. Investing in municipal social infrastructure improvement

Allow me to take some time to expand on the various elements of the President's plan.

Growth-enhancing economic reforms

The first element of the President's plan is to implement growth-enhancing economic reforms. Rebuilding confidence will unlock private sector investment. Investors are in it for the long run. They want to know that our policies are clear and consistent.

We must stop talking in contradictory terms.

The President has already taken the lead in rebuilding confidence by appointing a team of investment envoys. We look forward to the upcoming Investment Conference.

Already, in the mining sector, we have finalised the Mining Charter and we are withdrawing the Mineral and Petroleum Resources Development Amendment Bill.

Visa requirements will be eased to boost tourism. We will make it easier for people with skills to work in South Africa. Ten-year multiple-entry visas will be extended to several countries.

In telecommunications, the proposed policy for the licensing of high-demand spectrum has been gazetted. Frequencies to enable high speed internet will be auctioned early next year. Steps will be taken to reduce data costs and improve data quality.

Recently concluded power-purchase agreements will create an estimated 61 000 jobs and enable investment of R56 billion. Through the renewable energy IPPs, we have secured equity for local communities, who will receive about R29.3 billion in net dividend income over the life of the projects. For recently signed projects, 53 per cent is owned by South African shareholders while black shareholders own 34 per cent of the equity.

Restructuring of the electricity sector is underway. This must include a long-term plan to restructure Eskom and deal with its debt obligations. A review of the current Electricity Pricing Policy will form a part of this process.

We are building partnerships to find solutions to the development challenges faced by South Africa and the region. Partnerships are essential.

1. The recent Jobs Summit brought together business, labour, community and government to leverage our collective strength towards the urgent need to protect and create jobs.
2. South Africa offers a strong investment value proposition. We have a highly diversified, open economy with an abundance of natural resources, an extensive and modern infrastructure network and sophisticated and deep financial markets. The upcoming investor conference will showcase these strengths to local and international investors.
3. We are upgrading the economic planning and coordinating capacity of the state. *Southern Africa – Towards Inclusive Economic Development* or SA-TIED is a programme with other government departments and international agencies to produce high-quality evidence-based policy research. We have already published 24 research papers in 2018. The programme will train young scholars and give government officials the opportunity to obtain their PhDs in Economics and related fields. Our ultimate aim is to improve the interface between cutting-edge research and policy formulation.

Reprioritisation of public spending to support growth and job creation

The second element of the President's plan is about reprioritisation and more effective spending. Spending is projected to be R5.9 trillion over the medium term. Spending will still grow faster than inflation. This is a lot of money. We can do more with it.

We are proposing a combination of reprioritisation, changes to grant structures and in-year allocations amounting to more than R50 billion. Of this amount, reprioritisation of R15.9 billion goes towards infrastructure programmes, supporting industrialisation, and the Expanded Public Works Programme. An additional R16.5 billion of reprioritisation will be allocated to various programmes, including funding to restore capacity at the South African Revenue Service.

Agriculture will be an important driver of our economic recovery. The Land Bank will continue to support emerging farmers. Our reprioritisation efforts will support the Bank to conclude transactions worth R16.2 billion over the next 3 to 5 years that will create jobs in agriculture. A significant portion of the funding will go towards export-oriented crops that are highly labour intensive.

Housing subsidies amounting to R1 billion will be centralised to help low- to middle-income households access affordable home loans, which will result in more South Africans acquiring their own homes.

We are determined to support greater economic development within our townships and countryside communities. Our spending on infrastructure aims to promote industrialisation across the country. We are spending R668 million over the medium-term to revitalise government-owned industrial parks in township areas. So far, government has upgraded infrastructure at Vulindlela and Komani, both in the Eastern Cape, Botshabelo in the Free State, Seshego in Limpopo and Isithebe in KwaZulu-Natal.

Since 2011, municipalities have completed over 270 projects to the value of R3.7 billion funded through the Neighbourhood Development Partnership Grant. This has attracted over R8.7 billion of private investment in the township. In Tembisa in Ekurhuleni, public investment to the value of R125 million in roads and transport infrastructure has enabled access to social and economic facilities. The investment will attract an estimated R3.5 billion of additional public and private investment in commercial, retail and residential developments. In Msunduzi Municipality over R77 million in public investment in the Edendale Urban Hub has already attracted private and public sector investment in excess of R1 billion. We will continue to roll these out in other parts of the country.

The Giyani Water Project is plagued by malfeasance. It is a cesspool of corruption. The challenges range from a complete disregard for supply chain rules to poor contract management, resulting in irregular expenditure. It is clear that a new delivery and financing model is required to provide water services to communities. A key element of the new approach will be a stronger focus on project management and contract governance to ensure that projects, such as the Giyani Water Project, are fit for purpose and maximise value for money in the water sector. I have asked the Director-General of the National Treasury to work with the Department of Water and Sanitation to ensure that appropriate action is taken against all guilty officials implicated in the Auditor-General's report. The President has informed me that he will go to Giyani to see exactly what has happened and what needs to be done.

We are dealing decisively and urgently with the water crisis in the Vaal River System. Our immediate focus is to mobilise short-term financing by reprioritising funds and increasing capacity. I have asked the President and the Minister of Defence for the military to assist with engineering and other expertise to resolve the crisis in the Vaal River System. I am happy to report that approval has been granted. The generals in charge have already started working on solutions.

Water is critical. Current water delivery models are not working in many cases and we need to consider new ideas and models.

Given the land transport intensity of our economy, it is vital that our road network supports growth and development. Over the medium term, funds are reprioritised to enable the strengthening and rehabilitation of the national non-toll road network, of which about 75 per cent is beyond its design life. But if we want a road transport infrastructure that works, we need to pay our tolls. Government remains committed to the user pay principle because it is the most efficient and effective way to ensure that the direct benefits of services are paid for by those who use them. We need to restore a culture of payment in this country to ensure the sustainability of our services and to give confidence to those institutions who invest in our bonds.

Establishing an infrastructure fund

The third element of the President's plan is to improve government's approach to infrastructure investment and to establish an Infrastructure Fund.

Over the next three years, public infrastructure expenditure is estimated to be R855.2 billion, of which state-owned companies alone account for R370.2 billion. General government accounts for the remaining R485 billion, mainly in the form of conditional infrastructure grants.

Too many projects are poorly prepared. Too often, government spends money on infrastructure when it could be better and more effectively done by the private sector. The Development Bank of Southern Africa, the Government Technical Advisory Centre and the Presidential Infrastructure Coordinating Commission will receive R625 million to strengthen project preparation.

Development finance institutions, multilateral development banks and private banks have committed technical resources to help finance, plan and implement projects. We

will develop innovative finance solutions that combine capital from the public and private sectors.

Government will establish an execution unit made up of engineers, quantity surveyors, architects and other professionals to ensure that challenges in the Vaal River System and with the Giyani Water project are resolved. The execution unit will also advise government on new delivery and financing models to provide basic services to communities.

Government will develop a framework to help investors assess potential long-term returns on public infrastructure projects. We want to enable investment in public infrastructure by commercial banks, development finance institutions and pension funds. This will require both innovative financing mechanisms and accompanying regulatory reforms.

We have successfully partnered with the private sector in the past. The N3 highway between Johannesburg and Durban and the N1/N4 platinum highway were built and are operated and maintained by the private sector. For these projects to operate efficiently, we have service level agreements in place with our private sector partners. These kinds of partnerships will be accelerated.

Addressing urgent and pressing matters in education and health

The fourth element of the President's plan is to address urgent and pressing matters in education and health.

The largest allocations in the medium-term are for education, health, social development and community development. Together, these four areas will receive more than 60 per cent of non-interest expenditure.

Nobody should learn in a school that is unsafe. Our children must have access to adequate sanitation. We have committed to eradicating pit latrines at schools. The President has directed that there is a plan to ensure that all schools have safe and appropriate sanitation.

We will ensure that female learners in schools have access to sanitary pads. Several provinces have already taken the lead in rolling out the provision of free sanitary pads in schools. Funds will be added to the provincial equitable share to enable provinces to progressively further this objective.

Access to health care services is enshrined in our Constitution and in our Bill of Rights. We will continue to work closely with the National Department of Health and other role players to ensure that the gradual phased implementation of National Health Insurance is adequately financed. We are immediately reprioritising R350 million to recruit in excess of 2 000 health professionals into public health facilities. We are further reprioritising R150 million to purchase beds and linen for hospitals where the need is most dire. These two interventions build on the Presidential Health Summit convened last weekend which has brought new focus to improving the quality of health care.

Investing in municipal social infrastructure improvement

The final element of the President's plan to stimulate the economy focuses on investing in municipal social infrastructure.

All South Africans share the pain of poorly performing municipalities: potholes, broken street lights, roads that flood when it rains, and challenges with electricity.

We are acutely aware that some municipalities are facing serious capacity constraints in executing their plans and programmes. The Auditor-General has consistently shared audit messages that emphasise the importance of accountability in the management of municipal affairs. This year, 113 municipalities adopted unfunded budgets, up from 83 in the previous year. Municipalities owe more than R23 billion to service providers – mainly to Eskom and water service agencies.

In many cases, like in the Modimolle-Mookgophong municipality, the financial challenges faced by municipalities are a reflection of weaknesses in governance, or even fraud and outright corruption. The funds lost by municipalities in the collapse of VBS Mutual Bank offer a dramatic illustration of how greed and corruption impacts the achievement of developmental objectives.

This matter was ventilated in the house yesterday. But this is not the only case in which public funds have been diverted to benefit a few greedy individuals. There are such many cases where projects are manufactured, contracts are awarded corruptly and construction costs are inflated, or where corrupt practices have taken hold in the provision of land use rights.

For those with some knowledge of the Bible, you will recall the words of Isaiah in chapter 58 verse 12:

“Your people will rebuild the ancient ruins and will raise up the age-old foundations; you will be called Repairer of Broken Walls, Restorer of Streets with Dwellings”

We must repair our towns, and our streets, and fix the pipes under our roads.

The National Treasury will work closely with the Department of Cooperative Governance and Traditional Affairs to deal with financial misconduct in all spheres of government. We are developing measures to improve transparency and governance processes. Key is the employment of qualified, competent and incorruptible officials. We need to restore a culture of compliance with the PFMA and MFMA in all organs of state.

Civil society can help. In some cases, such as in Emalahleni, citizen associations have successfully challenged local government to implement the measures prescribed by law to address financial problems.

Fiscal stance

The President’s plan is achievable. But any growth plan must be built on two macroeconomic preconditions: a sustainable fiscal position and low and stable inflation. I am confident that Governor Kganyago and his team will continue to work tirelessly to keep inflation down. And please, let us not distract him with these regular attacks on the mandate and independence of the South African Reserve Bank. Today we reiterate what is contained in section 224 (2) of the Constitution:

“The South African Reserve Bank, in pursuit of its primary object, must perform its functions independently and without fear, favour or prejudice, but there must be regular consultation between the Bank and the Cabinet member responsible for national financial matters.”

My job is to make the fiscus stronger.

Government remains committed to its goal of stabilising and bringing down the debt-to-GDP ratio. In recent months, deteriorating economic performance, revenue

shortfalls and a weaker rand have all contributed to higher debt projections. The consolidated budget deficit is estimated at 4 per cent in 2018/19, compared with the 2018 Budget projection of 3.6 per cent of GDP. After rising to 4.2 per cent, the deficit stabilises at 4 per cent in the outer years. Gross debt is on pace to stabilise at 59.6 per cent of GDP in 2023/24.

Other risks identified in the February 2018 Budget have materialised, including a public-service wage agreement significantly above inflation, and the continued decline in the financial condition of some state-owned companies, leading to requests for budget support.

In recent budgets, we took important steps by reducing the expenditure ceiling and increasing taxes. Given the weakness of the economy, government is aiming to manage these pressures, while avoiding additional fiscal measures that could limit growth.

The 2018 public-service wage agreement exceeds budgeted baselines by about R30.2 billion over the medium term. We have not allocated additional money for this. National and provincial departments will be expected to absorb these costs within their compensation baselines. The Department of Public Service and Administration will work with national and provincial departments to help them manage the implementation of the agreement, while protecting our key developmental priorities.

The wage bill remains the biggest cost pressure on the budget. Over time, wages have crowded out other goods and services and capital investment, particularly in health, education and defence. In some cases, this has contributed to a build-up of unpaid invoices in provincial departments.

Around 85 per cent of the increase in the wage bill is due to higher wages, rather than headcount increases. The national wage ceilings remain unchanged, despite the new wage agreement.

Revenue collections up to the end of September 2018 have grown by 10.7 per cent compared to the same period last year. Latest estimates, however, suggest that the full year tax collections will be R27.4 billion less than expected, of which R20 billion reflects increased VAT refunds, and R7.4 billion reflects lower corporate tax and personal income tax. Although some of the VAT refunds reflect ‘once-off’ payments,

we expect revenue shortfalls of R24.7 billion in 2019/20 and R33 billion in 2020/21, relative to the 2018 Budget.

Madam Speaker, concerns have been expressed about the slow pace of VAT refunds. We recognise that this has hurt the cash flow of a number of companies, including small businesses. The Acting SARS Commissioner has committed to processing the outstanding VAT refunds as quickly as possible. We estimate total additional VAT refunds of R20 billion, made up of R11 billion to clear the backlog, and an upward revision of R9 billion for the current fiscal year.

We are of the view that this will provide a much-needed boost to the real economy.

An Independent Panel of Experts investigated options to mitigate the impact of the VAT increase on lower income households. My thanks to the panel for their excellent work. I would also like to thank the 30,000 individuals and NGOs who provided comments on the Panel's recommendations.

Madame speaker, I received 3 299 tweets in total. One of them is from Tintsi Ngwenya in Johannesburg, who said:

"Sanitary pads should be tax free"

After considerable debate and consultation, as of the 1 April 2019, government will zero-rate the following items:

1. Sanitary pads
2. Bread flour
3. Cake flour

The revenue loss associated with zero-rating these items is estimated at R1.2 billion. However, zero-rating these products targets low-income households and restores the dignity of our people.

On carbon tax, we have heard the concerns of business and labour during the parliamentary hearings. The carbon budgeting system and the carbon tax will be aligned. This is done by imposing a higher tax rate as a penalty for emissions exceeding the carbon budget. The original date of implementation was 1 January 2019, but this will be postponed to 1 June 2019.

Restoring good governance and fighting corruption

We can spend our money better. Too much money goes missing. We must restore good governance and fight corruption in all of its forms. Money that leaks out of the system is no longer available to support our efforts to reduce poverty and lighten the burden of the poor.

Madame speaker, among the many tweets we received from the South African public was a plea to strengthen the internal auditing capacity at our municipalities.

It is necessary for us as a country to face up to the events of the recent past, and learn from them. We are taking the following steps to strengthen financial management:

1. Treasury will work with the Office of the Auditor-General to reduce fruitless and wasteful, irregular and unauthorised expenditure. Law enforcement agencies will act against those implicated in wrongdoing.
2. At local government level, we are deploying skilled professionals to boost revenue collection and attain our developmental objectives. Many of these are retirees that have heard the President's *Thuma Mina* call.
3. There will be financial recovery plans for non-performing departments.

Reforming state-owned companies

Madam Speaker, our state-owned companies can spend our money better. Many of these state-owned companies need to be reconfigured.

In the past year, almost all of the regional and domestic routes operated by South African Airways have become profitable. SAA will reduce and ultimately stop operating loss-making international routes. SAA procurement has unlocked annual cost savings of R400 million.

Despite these efforts, SAA is still loss-making and even more radical measures need to be undertaken. There should be no holy cows!

To support a sustainable reconfiguration of our airline portfolio, in 2018/19 government will provide additional funding for SAA and South African Express Airways. Minister Gordhan and I are working closely to limit the fiscal cost of these measures. By the

end of the year, the boards of these two companies will present plans to strengthen and align their operations.

Government has been working with the Johannesburg Stock Exchange to strengthen debt listing requirements for all issuers, including state-owned companies. These proposals aim to bring about increased transparency and improved governance for SOCs, and complement other government measures.

Thank you and conclusion

Madam Speaker, as I conclude, allow me to thank the President for his guidance and leadership. My appreciation also goes to the Deputy President. I would like to thank the Minister of Defence and my Cabinet colleagues, including members of the Ministers' Committee on the Budget, for their cooperation and support.

I also wish to thank Provincial Premiers, Finance MECs, and Municipal Mayors, who share our fiscal and financial responsibilities.

Deputy Minister Gungubele, the acting commissioner of the South African Revenue Service, the 10th Governor of the South African Reserve Bank and the Director-General of the National Treasury have been resolute pillars of support.

I know that Members of the House will join me in expressing appreciation to:

1. Staff of the National Treasury,
2. The South African Revenue Service, and
3. The finance family institutions.

I am also grateful to the finance and appropriation committees, who have responsibility for steering consideration of the Division of Revenue Amendment Bill, the Adjustments Appropriation Bill, the Finance Bill and the Taxation bills.

Madam Speaker, let me summarise my main points.

1. South Africa finds itself at a crossroads. This Medium-Term Budget Policy Statement highlights the difficult choices that we need to make over the next few years.
2. Our economic outlook has been revised down due to a technical recession and turmoil in international markets. Our economic growth will be just 0.7 per cent this year, rising to over 2 per cent over the medium-term. Relative to the 2018

Budget, revenue has been revised down. Once-off factors have contributed to the debt projections being revised upwards.

3. Against this background, together, we have much to do. We must repair damaged government institutions, as their failure impacts poorer households the most. There have been failures at municipal, provincial and national departments. There have been governance challenges at key state institutions.
4. State institutions are being repaired and renewed, but serious governance problems exist across the public sector. Our state-owned companies need to be reconfigured in a number of ways.
5. The President has initiated a plan that will support our economic recovery. We will implement growth enhancing economic reforms. We will reprioritise public spending to support growth. We will take steps to establish an Infrastructure Fund that will create opportunities for private-sector financing. We will urgently deal with education and health, and invest in municipal social infrastructure.
6. Our growth reforms will be underpinned by fiscal and monetary stability. I will ensure our debt stabilises and is reduced as soon as possible.

In conclusion, Speaker, let us not forget that this year marks the centenary of Madiba's birth. As we were preparing this Medium-Term Budget Policy Statement, his wise words came to mind:

"Difficulties break some, but make others. No axe is sharp enough to cut the soul of a sinner who keeps on trying, one armed with the hope that he will rise even in the end."

We can choose whether or not these difficulties break us as a country, or make us.

We can choose whether we will allow the axe to cut our soul, or if we will try again.

We must make sacrifices and choose a path of redemption. As Dickens notes:

"It is a far, far better thing that I do, than I have ever done; it is a far, far better rest that I go to than I have ever known."

All South Africans want us to choose the path of prosperity and opportunity.

We are at the crossroads, we can either choose to go left or to go right or to go straight on the path to nowhere. We are choosing the road of prosperity and opportunity, where

the true spirit of South Africa lies. I urge South Africans to journey with us on this path.
A path destined to take us out of poverty and deprivation.

It is a call to all of us: public servants, business, civil society, communities and labour.

This is what our people deserve.

I thank you.