OUTA

ORGANISATION UNDOING TAX ABUSE

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ANALYSIS OF SPECIAL SUPPLEMENTARY BUDGET 2020

SUBMISSION BY ORGANISATION UNDOING TAX ABUSE (OUTA), WITH SUPPORT FROM THE PUBLIC AFFAIRS RESEARCH INSTITUTE (PARI), TO THE SELECT AND STANDING COMMITTEES ON FINANCE

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Table of Contents

Executive summary

OUTA's submission on the supplementary budget presents an analysis of the economic outlook, a perspective on Zero-based Budgeting, the revised fiscal framework, public sector compensation and the state of local government finances with support from the Public Affairs Research Institute (PARI).

Economic outlook

The Covid-19 pandemic has affected the economy drastically, resulting in a sharp economic downturn, necessitating an economic and fiscal response commensurate with the unprecedented nature of the situation. The underlying structure of the economy needs to be addressed. OUTA would like to see the unbundling of monopolistic state-owned enterprises coupled with intensive capital investment in SMME and township economies to promote self-reliant local economies. A critical mass of political will is pivotal to cut unnecessary, fruitless, wasteful, irregular, and corrupt spending.

Zero-based Budgeting

We welcome the zero-based budgeting approach but are concerned that it will be mainly targeted at large programmes which have not been clearly defined. The whole of government should be taking this approach to act more efficiently and effectively with taxpayers' money. Zero-based budgeting will support to achieve more fiscal room-to-manoeuvre to secure core service delivery and to preserve the provision of basic human rights. We recommend a series of publicly inclusive debates in Parliament on the implementation of zero-based budgeting. A clear and rational process with clarity about roles and responsibilities needs to be spelt out.

Revised Fiscal Framework

The upward revision of spending plans is seriously concerning as the R2 trillion mark for 2020/21 consolidated expenditure has been breached. Public finances are dangerously overstretched. OUTA agrees with National Treasury's sentiment that business as usual, or a passive plan for spending over the next three years, is no longer an option. Those impasses of South Africa's political machinery that are repeatedly blocking radical rationalisation and restructuring of state expenses must be replaced with new fora for public engagement on spending priorities.

Taxation

We recommend a proactive and radical reprioritisation of scarce tax revenue toward capital investment such as infrastructure, and essential service delivery as in goods and services. OUTA has been advocating for government to refrain from increasing existing taxes and tariffs on South Africans due to known patterns of waste and abuse in the public sector. We reiterate this call. We support consideration of a Wealth Tax, due to the long-term implications of negative or near zero growth and the country's high-level of inequality. We also support 'digital tax' of medium and large ICT firms like Facebook, Twitter etc who influence public discourse in South Africa for large profits without materially benefiting the public. Illicit financial flows should be dealt with urgently to maximise revenue over the medium term.

Debt

OUTA is not convinced that the Finance Minister and National Treasury's plan to stabilise debt is going to work. OUTA recommends a qualitative analysis of debt, which should feature in the debates as well. We are concerned that South Africa will fall into a debt spiral if the application of debt is not strictly controlled. This implies the need for a more forceful reaction to AGSA findings, especially at the municipal level.

State Owned Entities

State Owned Entities (SOEs) have posed a significant fiscal risk for several years. The National Planning Commission recently published a position paper with comprehensive recommendations for reform in the largest state-owned entities and companies which need to be accelerated.

Compensation

Over the medium term, compensation and debt-service costs will be the largest expenditure items, outstripping the investments government makes in human capital, social and economic infrastructure, and service delivery. This is not acceptable. OUTA strongly support's National Treasury's decision to initiate a process of rationalising the cumulative cost of remuneration in the public service.

Local Government

Local government in aggregate is no longer financially viable in its current form. The financial crisis in municipalities is not new and has not been caused by Covid-19, merely exacerbated by it. The real reasons for the current financial crisis are structural. The assumptions about how the local government fiscal model would work are no longer valid. The result is that many municipalities will never be financially viable under the current macro-economic circumstances. We urgently require a review of the entire local government fiscal and operating framework.

Introduction

The drastic impact of the Covid-19 pandemic and the sharp economic downturn that followed necessitates a radical economic and fiscal response. In its own account, the special supplementary budget represents a macroeconomic consolidation of government's initial economic and fiscal response to the Covid-19 pandemic. In this submission, the Organisation Undoing Tax Abuse (OUTA) presents our analysis of the supplementary budget with support from PARI.

According to the National Treasury's full Supplementary Budget Review: "*In the current environment, government cannot not raise sufficient tax revenues to sustain current spending levels and service its debt obligations. In time, this will lead to an unravelling of the social gains of the past 26 years. If this spiral is not halted and reversed, it is likely that some state-owned companies and public entities will collapse, triggering a call on guaranteed debt obligations. Failure to substantially reduce costs, address longstanding governance failures, prosecute state-capture participants and undertake profound operational reforms has contributed to already unsustainable financial positions in many public-sector institutions.*"

OUTA strongly agrees with this and we contend that the only way for the economy to survive is by drastically pruning state expenditure. We are pleased that Minister Mboweni has emphasised a zero-based budgeting approach for the medium term but are concerned that it will be mainly targeted at large programmes which have not been clearly defined. All levels of state institutions, including the municipal level, should be taking this approach to act more efficiently and effectively with taxpayers' money. Pruning away the dead wood in programmes need not undermine people's rights, but rather it is necessary to sustain expenses toward the long-term provision of basic human rights.

It is imperative for government to make South Africa more attractive for private investment to stimulate the economy by providing policy certainty. There is a need to implement policy decisions that in many instances have been paralysed or postponed indefinitely due to intra and inter-party politics. Some sectors that South Africa has been heavily invested in are not future growth sectors. To address unemployment, there is a need to set South Africa on a path of broadening participation in the real economy and grow the country's tax base by increasing economic activity - rather than adjusting rates and taxes upward. To move onto this path, we need to be re-industrialising and embracing a future in which business is increasingly conducted through digital channels, which, with the correct tax instruments in place, can realise much needed tax revenue.

Economic outlook

The picture painted by the Minister of Finance is decidedly grim. The South African economy is expected to contract by 7.2% this year, with some worst-case scenario estimates that it will contract by up to 16%. The Minister of Finance pointed out that this will be the largest contraction in 90 years.

South Africa's unemployment rate increased to 30,1% in quarter one of 2020, with the number of unemployed persons now at 7,1 million. The Quarterly Labour Force survey for quarter one of 2020 is merely a foreshadowing of what is to come as the results do not yet reflect the full impact of the raft of retrenchments since a lockdown was implemented in response to Covid-19.

For South Africa to achieve a V-shaped recovery rather than an L-shaped recovery, will not only require coherent policy measures but also effective implementation of economic, fiscal, and sectoral policy measures to bring about certainty. We note the three-phase response that has been adopted of (1) preserve, (2) recover and (3) pivot. Government's demonstrated capacity to respond with the requisite level of urgency with its measures to preserve the economy has fallen short. Without confronting real political impasses and capacity constraints, the country will battle to achieve recovery and will remain trapped in economic stagnation rather than pivoting.

National Treasury, the Department of Trade and Industry, and the Department of Employment and Labour should be working together a lot more closely. While Treasury limps along reliant on former officials to provide intellectual capacity, the Minister of Trade and Industry has been focused on the minutiae of disaster regulations and the Department of Employment and Labour has been slow to administer UIF TERS pay-outs. Due to overly bureaucratic and slow administration, businesses have not been supported in a manner sufficient to stave off further retrenchments. These businesses and jobs are lost and will be difficult to recover.

Improving the cost and ease of doing business are among the measures that Treasury proposes. To do so will require a mind shift in departments whose officials regard business with mistrust but are mandated to create an enabling business environment. Where a country is ranked on the index is based on the average of 10 sub-indices: (1) starting a business, (2) dealing with construction permits, (3) getting electricity, (4) registering property, (5) getting credit, (6) protecting investors, (7) paying taxes, (8) trading across borders, (9) enforcing contracts and (10) resolving insolvency. South Africa is currently ranked 84 in the world for ease of doing business, down from its previous position of 82.

Responsibility for each of these is spread across different organs of state and the private sector. Electricity supply has been one of the key factors constraining the economy and remains a priority to address. Resolving insolvency is an area that should be bolstered now to support economic recovery.

The supplementary budget does not go beyond providing the detail related to the initial response measures announced by the President and Minister of Finance. The initial stimulus response presented has not been a true stimulus. Rather than a genuine stimulus, OUTA contends that the proposed Special Supplementary Budget is a highly constricted reaction to its self-pronounced fear of a sovereign debt crisis. The actual macroeconomic interventions that are proposed do not ameliorate the risk associated with spiralling sovereign debt and the rising cost of borrowing from multilateral institutions for capital investment in the domestic economy.

In various countries, there has been a second wave of infection, with attendant impacts on economic activities. Many of the initial measures announced in South Africa will have been exhausted by October and it is imperative therefore that the Medium-Term Budget Policy Statement and Adjusted Budget in October must go beyond this initial response by not only appropriately responding to the realities that the second half of the year will hold but also providing leadership and charting a way forward out of too many crises with which the country is beset.

We hope that the Minister of Finance and National Treasury will make use of the October adjusted budget to announce further interventions that fundamentally change the current composition of expenditure at the national level. The desirability of entire departments and their entities must be seriously reconsidered in a zero-based budgeting paradigm. OUTA supports this paradigm and recommends that the responsibility of job creation and economic growth is decoupled from central government alone. Government must open itself to long-term partnerships with domestic and international private sector groups for access to alternative financial resources, with civil society groups for access to social capital and with academia for access to intellectual resources. We also hope that in October, the Minister of Finance and National Treasury will provide more information about realistic plans to restore and pivot the economy.

According to National Treasury: "*Cabinet has endorsed a 2021 budget process that moves towards debt stabilisation. The 2020 MTBPS will set out plans to narrow the deficit so that debt peaks at 87.4 percent of GDP by 2023/24. An expanded partnership between government, business, labour and civil society is needed to agree on and implement far-reaching economic reforms.*" The full Special

Supplementary Budget document concedes that its plans are largely based on an optimistic future scenario where government agrees to prioritise debt stabilisation.

If the average rate of return on capital is greater than the rate of economic growth, inequality will continue to increase regardless of monetary policy.

Cabinet has reportedly agreed to implement the capped growth of our public Wage Bill despite political disagreement on this issue. OUTA strongly supports this determination. The Covid-19 pandemic has affected the movement of goods internationally, offering local businesses a small window in which to gain a foothold to increase their production and local market. In addressing the underlying structure of the economy over the MTEF, OUTA proposes that the unbundling of monopolistic SOEs is coupled with intensive capital investment in SMME and township economies to promote self-reliant local economies.

Zero-based budgeting

We are pleased that Minister Mboweni has introduced a zero-based budgeting approach for the medium-term but are concerned that it will be mainly targeted at large programmes which have not been clearly defined. The whole of government should be taking this approach in order to act more efficiently and effectively with taxpayers' money. There is not enough tax revenue to cover the expenses from stale programmes that fail to deliver year after year.

High levels of indebtedness mean that interest repayments are burgeoning while tax revenue is under pressure. Therefore, OUTA supports zero-based budgeting, but calls on government to implement this principle across the spectrum in organs of state to eliminate all tax leaching programmes that can no longer be justified. We recommend a series of publicly inclusive debates in Parliament on the implementation of zero-based budgeting.

A zero-based approach entails that the previous year's budget is not taken as the starting point for the next year's budget. Rather, every programme must justify its spending as a worthy allocation from scratch. This will be a massive, but worthwhile exercise.

A critical mass of political will is pivotal to cut unnecessary, fruitless, wasteful, irregular, and corrupt spending. Corruption must be dealt with openly and severely, and services must be delivered more efficiently and effectively. Each programme must be justified by demonstrating how it is advancing people's constitutional rights.

Lawfare has become a feature of our South African landscape with civil society organisations frequently resorting to the courts to seek relief where Constitutional rights are not being realised due to poor service delivery or under-allocations. In order that the state can deliver on core services and ensure rights realisation rather than seeing it erode further, we regard zero-based budgeting to be a crucial intervention. We would like to highlight that how it is implemented will be important and caution against the inclination to identify programmes according to largest spend first and merely use historical underspending as a yardstick for cuts. Underspending does not imply necessarily that the programme is not a key programme. It may indicate rather that there is underperformance which in turn can point to deeper issues, such as poor capacity in a department to deliver or scale up services. It is important that realistic plans to address these underlying issues are simultaneously implemented by departments or the zero-based budgeting exercise may deliver short-term quick wins but in the long-term have consequences that will become the making of future crises, because the actual issue continued to be ignored.

Another crucial consideration when applying zero-based budgeting is the effect on aggregate demand. The application of the state's procurement budget sees money circulating in the economy. OUTA would like to see better regulation by the Competition Commission to reduce collusion, price rigging and abuse of dominant positions. Many sectors are dominated by firms that occupy the position of being virtual monopolies. This makes it particularly difficult for new entrants to the market. We recommend that in its engagements with business, government appeals to companies to offer supplier development programmes in key sectors, which will support smaller firms to be better placed to grow and integrate into private sector value chains as well as to offer government improved services when winning government tenders.

OUTA recognises that there is weak capacity within departments to review spending outcomes, but that the Auditor General and National Treasury officials are trained in methods to assess the performance and expenditure. The Auditor General's office has a particularly strong grasp of which programmes across government are underperforming and their reports must be the point of reference. While we acknowledge that the Treasury has some capacity, we are however concerned that in recent years, it lost many skilled officials and cannot be a universal solution.

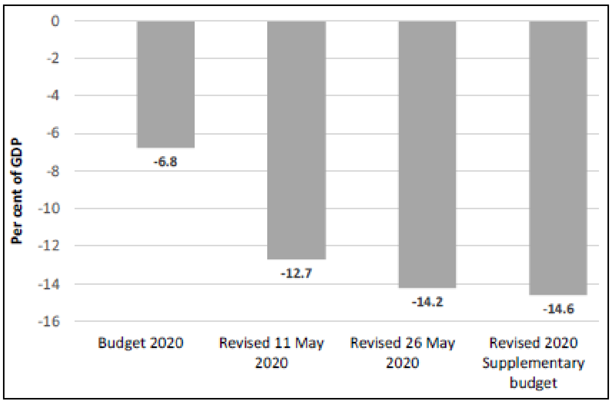
Due to the extent of additional work that zero-based budgeting requires to re-evaluate programmes rigorously and critically, we recommend that Treasury addresses these capacity gaps immediately. Therefore, OUTA recommends that the Committee request that the National Treasury table a Human Resources report and strategic plan to fill posts with talent demonstrating the highest levels of integrity and financial skills. Provincial Treasuries, which have failed on countless occasions to fulfil their oversight function in rural municipalities, should be instructed to do the same. These should also report to Parliament on their oversight shortcomings and needs for systemic improvement. Structural, governance and financial reforms are in order.

There is a need for clarity about the interface between the departments/entities, Department of Performance Monitoring and Evaluation in the Presidency, Provincial Treasuries and National Treasury in respect of how zero-based budgeting will be implemented. Decisions to reduce spending of programmes will require political buy-in and are likely to be highly contested. A clear and rational process with clarity about roles and responsibilities needs to be spelt out. South Africa is at a crossroads and now is the time to separate political discourse from public administration.

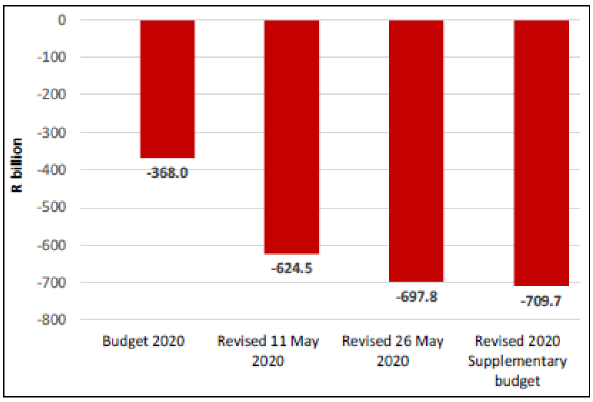
Revised fiscal framework

The upward revision of spending plans is seriously concerning and OUTA strongly recommends that government reviews the decision to simply add Covid-19 spending of R145 billion to original spending forecasts with only marginal downward adjustments to business as usual spending intentions – thus breaching the R2 trillion mark for 2020/21 consolidated expenditure. The deficit widened rapidly between the tabling of budget 2020 and the revised supplementary budget being tabled. In the space of five months, the budget deficit went from R368 billion (6.8% of GDP) to R709.7 billion (14.6% of GDP).

Main budget deficit (percent of GDP), 2020/21



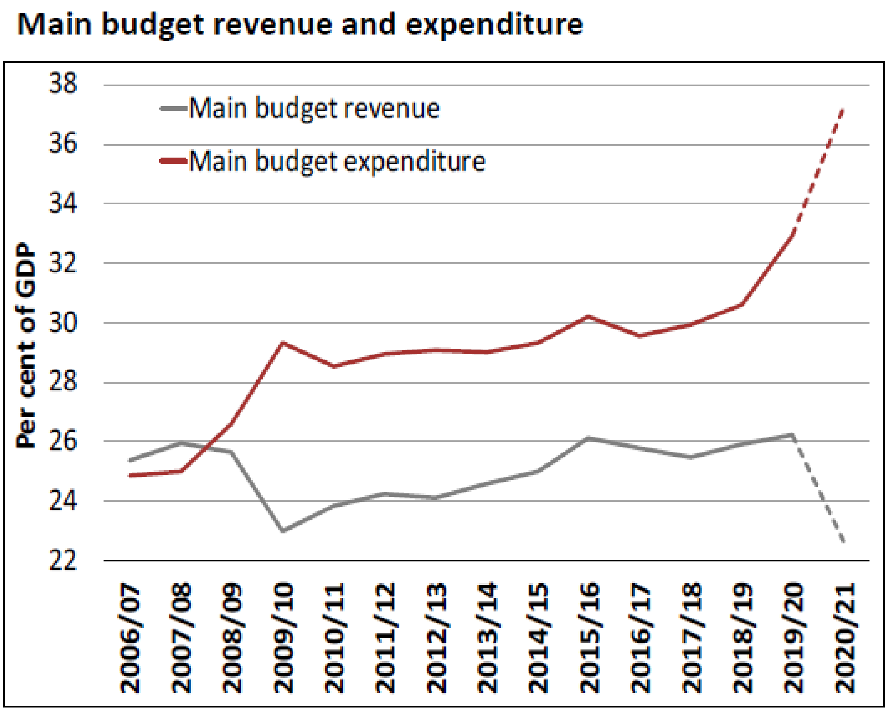
Main budget deficit (R billion), 2020/21



Source: National Treasury

Public finances are dangerously overstretched. OUTA agrees with National Treasury's sentiment that business as usual, or a passive plan for spending over the next three years, is no longer an option. Those impasses of South Africa's political machinery that are repeatedly blocking radical rationalisation and restructuring of state expenses must be replaced with new fora for public engagement on spending priorities.

Spiralling debt-servicing costs can cause a sovereign debt crisis that will undermine the livelihood of every single South African. The key fiscal policy issue as being expressed by the Minister of Finance resides in the hippopotamus with its mouth wide open, which the figure below depicts – the rapidly widening budget deficit due to the difference between revenue and government expenditure.



Source: National Treasury

State Owned Entities have posed a significant fiscal risk for many years, widening the hippo's mouth so to speak. Now, additional expenses demanded by Covid-19 related needs compound the problem by reducing revenue and driving up spending. A key question is which monetary and fiscal policies should be implemented to improve the situation. Expansionary monetary policy has been found to reduce potential and real surpluses in national current accounts. We thus note with concern signs of quantitative easing.

On the condition that certain governance standards are upheld in practice, expansionary fiscal policy is worth considering. Proposed adjustments in the Supplementary Budget contain significant increases in focused expenditure, but spending purposes are almost entirely intended to address Covid-19 related issues over the term. We recommend a proactive and radical reprioritisation of scarce tax revenue toward capital investment such as infrastructure, and essential service delivery as in goods and services. This will be important in October, because presumably Treasury is currently applying expansionary fiscal policy rapidly in the form of tax measures that are putting money in the hands of consumers and increased spending to stimulate aggregate demand during the economic contraction, but by October we are likely to see signalling of fiscal consolidation. In that time of trimming programme budgets, it is important to keep aggregate demand in mind to ensure that recovery is enabled.

Taxation

The Special Supplementary Budget reflects that billions will be lost in tax revenue due to the lockdown. We note that the tax measures tabled are those which were already announced, and which largely have to do with cushioning businesses and citizens whose income is impacted by the pandemic. Treasury highlighted that VAT and Pay-As-You-Earn (PAYE) are the tax types that have seen the largest decreases due to the impacts of the pandemic. Going forward, the impact of retrenchments is likely to affect PAYE and business closures will affect Company Income Tax. VAT revenue will also be affected by consumers having less income.

OUTA has been advocating for government to refrain from increasing existing taxes and tariffs on South Africans due to known patterns of waste and abuse in the public sector. We reiterate this call. We do, however, support consideration of a Wealth Tax, due to the long-term implications of negative or near zero growth and the country's high-level of inequality.

We also support 'digital tax' of medium and large ICT firms like Facebook, Twitter etc who influence public discourse in South Africa for large profits without materially benefiting the public. Illicit financial flows should be dealt with urgently to maximise revenue over the medium term.

In the main, performance and conduct in government has a significant impact on domestic and international investment as well as tax compliance. A demonstrated and open implementation of severe disciplinary measures for public officials who fail to comply with fundamental public finance management legislation is imperative. The AGSA produces an annexure to the PFMA and MFMA reports they produce. The annexure deals with auditees' key controls and looks at whether the auditee has implemented the recommendations that the auditor has made in the previous financial year. OUTA filtered the AGSA report to show auditees that on each of the key controls of leadership, financial performance and governance, there was not only failure to implement the AGSA's recommendations but also regression. The table below shows which departments movement has regressed on every single of the key controls. We call on Parliament to reprimand these departments and to ensure that they address the issues that the Auditor General has highlighted for them to address.

Assessment of auditees' key controls at the time of the audit (per audit outcome)

Number	Auditee	Auditee type	Portfolio	2018-19 audit outcomes			Overall assessment			Movement		
				Audit opinion	Predetermined objectives	Compliance with legislation	Leadership	Financial and performance	Governance	F	P	C
309	National Skills Fund	PE	Ntnl		N	R				↓	↓	↓
339	Free State Development Corporation	PE	FS			R				↓	↓	↓
345	Public Works	DP	KZN		R	R				↓	↓	↓
358	Economic Development and Tourism	DP	NC			N				↓	↓	↓
375	Marine Living Resources Fund	PE	Ntnl		R	R				↓	↓	↓
378	Human Settlements	DP	GP		R	R				↓	↓	↓

Good | In progress | Intervention required | F Financial | P Performance | C Compliance | O Overall

↑ Improved | ↔ Unchanged | ↓ Regressed | A Addressed | N New | R Repeat

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | With findings

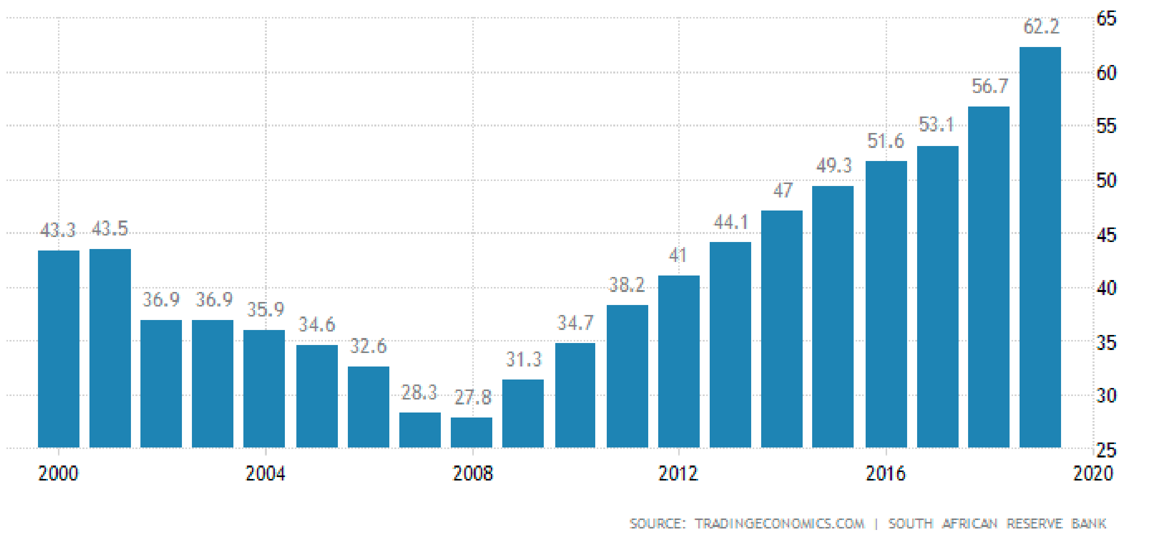
DP = department
PE = public entity

Source: Auditor General of South Africa

Debt

The V shape figure below is unfortunately not an economic recovery, rather it shows the trajectory of government's debt to GDP ratio over the last twenty years. Projected gross national debt for 2020/21 is now R3.97 trillion and debt servicing costs, a massive R236.4 billion for 2020/21. The country's gross national debt to GDP rose from 57% in 2018 to 62% in 2019. In 2020, the debt figure is projected to increase sharply. The supplementary budget forecast is that gross national debt will increase to 81.8% of GDP this year, whereas in February, the projection had been 65.6% of GDP. The difference can be ascribed largely to lower tax revenue collections and UIF payouts.

Government Debt to GDP ratio



We are cognisant of government's intention to borrow US$7 billion from multilateral finance institutions for the pandemic response and that this is comprised of US$1 billion loan approved by the New Development Bank, US$4.2 billion through the IMF's rapid financing instrument and that the World Bank and African Development Bank have also been approached.

When the 2008 global economic crisis hit, debt to GDP had been on a downwards trajectory, so the country was in a comparatively better fiscal position to respond to the 2008 economic crisis than we are now. Then we were in a better position to apply expansionary fiscal policy, because the 2008 debt to GDP level was 28%. This time, expansionary fiscal policy being financed through debt pushes the debt ratio to uncomfortable levels. If the rand weakens over time, our foreign denominated debt will cost us more.

OUTA is not convinced that the Finance Minister and National Treasury's plan to stabilise debt is going to work. OUTA recommends a qualitative analysis of debt, which should feature in the debates as well. We are concerned that South Africa will fall into a debt spiral if the application of debt is not strictly controlled. This implies the need for a more forceful reaction to AGSA findings, especially at the municipal level where money just disappears. On the same day that the Finance Minister presented the supplementary budget, deputy Auditor General Tsakani Maluleke presented the AGSA's report about municipal audit outcomes for the 2018/19 financial year to Parliament's National Council of Provinces. The report, entitled "Not much to go around, yet not the right hands at the till" shows that R1.26 billion was spent on consultants to help draft municipal financial statements, but audit outcomes continued to regress. Irregular expenditure in municipalities increased to R32 billion in 2018/19 – up from R25.2 billion in 2017/18. Wasteful expenditure was at R2 billion. We note that the figure for irregular expenditure is more than the R20 billion fiscal relief package to municipalities. It is disturbing that only 20 municipalities of the country's 257 municipalities attained a clean audit. The trend of poor financial management is worsening and must be reversed.

We note that the process to find a new Auditor General is underway, given that Kimi Makwetu's term is ending. We urge Members of Parliament that this process must be handled transparently and an Auditor General with excellent credentials and of the highest level of integrity must be appointed.

Reprioritisation of expenditure

Consolidated spending for 2020/21 has been revised from R1.95 trillion in the 2020 Budget to R2.04 trillion, mainly due to additional funding of R145 billion allocated for government's COVID-19 response. This amount is made up of R122 billion for the fiscal relief package, R3 billion to recapitalise the Land Bank and the remaining R19.5 billion for provisional allocations for Covid-19 fiscal relief.

While the pandemic brought about additional spending of R145 billion, the total rise in expenditure is R36 billion due to reprioritisations of R109 billion.

We note with serious concern Schedules 3 and 4 in the 2020 Division of Revenue Amendment Bill, which details how the equitable share allocated to municipalities will increase whilst allocations to provinces originally earmarked for Basic Education (Education Infrastructure Grant), Health (National Tertiary Health Services), Transport (Provincial Road Maintenance Grant), and Human Settlements (Urban Settlements Development Grant) will decrease.

In the 2020 Adjustment Appropriations Bill, an increased allocation to the Departments of Defence and Police are also unacceptable, and OUTA recommends that this is reviewed immediately. Additional responsibilities of the police and military should be funded by ordinary allocations and internal reprioritisation alone. These departments are well known for systemic waste, non-reaction to poor audit outcomes, abuse of power and corruption at all scales. These absorb a massive portion of the fiscus, almost entirely going to salaries of staff, without adequate and efficient benefit felt by a public that is plagued by violent crime and human rights violations.

We are concerned that additional allocations for 'peace and security' being allocated to the Police and Defence departments take ordinary appropriations that do not achieve their stated objectives for granted. The costs of procuring personal and protective equipment, and operating roadblocks and air support, should be drawn from original allocations. Further, we recommend that, as an introductory example, the cost of employees in the Department of Defence should be reduced significantly by whatever means necessary and reallocated to infrastructure expenditure in departments that are essential for recovered economic growth post-Covid19. National Treasury states clearly that over the medium term, compensation and debt-service costs will be the largest expenditure items, and outstrip the investments government makes in human capital, social and economic infrastructure, and service delivery. This is not acceptable. Rising public debt means that an ever-increasing share of tax revenue is transferred to government bondholders.

We note in terms of the downwards revisions that the Integrated National Electrification programme that provides bulk infrastructure and household connections has been revised downwards by R1.5 billion. This programme has been underspending in recent years; however, we are concerned about this downwards revision and a downwards revision of R21.8 million to planned energy savings projects. It is difficult at a household level to do lockdown without electricity. News reports that are highlighting that in Gauteng there has been a surge in illegal connections. If energy efficiency projects and installing of solar water geysers and panels were being done, it would contribute to addressing some of the peak demand issues that lead to load shedding and would also give households that do not have an ability to pay some relief.

The National Planning Commission recently published a position paper with comprehensive recommendations for reform in the largest state-owned entities and companies which need to be accelerated.

State Owned Entities

This section aligns itself with the National Planning Commission's position paper titled 'The Contribution of SOEs to Vision 2030: Case Studies of Eskom, Transnet and PRASA'.

The National Planning Commission (NPC) recently conducted research on the alignment of key infrastructure SOEs with the National Development Plan and concluded that these are misaligned due to:

- Years of uncertain policy expectations
- Precarious funding strategies
- Poor institutional accountability and poor governance
- Political interference

In the NPC's own words, *all [these factors] have led to the chronic underperformance of some SOEs, and in some cases, near-collapse.* OUTA strongly agrees with this statement. Significant shortfalls in delivery have an impact on economic growth and have led to extremely worrying increases in government debt. The NPC continues to state that this has spilled over into increased national credit risk. Most problematic is the adverse impact non-performing SOEs have on the lives of the poorest and vulnerable members of society and in constraining economic development. The only noteworthy area of success among major SOEs is black economic empowerment.

We contend that even this gain of empowering historically disenfranchised groups will no longer be viable in the future if serious and urgent reforms are not implemented. Further, the discretion associated with black economic empowerment procurement policies have been manipulated by politically connected individuals and families - and we trust that the Public Procurement Bill will go a long way in addressing this issue.

OUTA suggests that there are four types of reforms that are urgently needed in SOEs:

1. Governance
2. Financial
3. Structural
4. Policy and Process

Governance Reforms

Appointment and management processes in major SOEs must not only adhere to private corporate governance norms such as those contained in the King Codes. It must also include a clear and simple mechanism that holds senior managers, executives, and board members accountable to the public. For example, the selection and oversight of these key public officials must be transparent and systematically participative. The Report of the High-Level Panel on the Assessment of Key Legislation and Acceleration of Fundamental Change recommends the same.

OUTA concurs with the panel's recommendations that Parliament can and should provide effective oversight and evaluation of current assets, and public inspection of custodian and user immovable asset management plans as a mechanism to facilitate and promote transparency and accountability. However, the Government Immovable Asset Management Act (Act 19 of 2007) does not govern land owned by SOEs, and much well-situated, vacant urban land is owned by SOEs rather than by government departments.

Such enterprises are regulated by specific laws, which often stipulate how assets may be disposed of. OUTA agrees with the proposal that each such law should be reviewed and amended to ensure that where well-situated vacant urban land is owned by SOEs, the land should be released to address the legacy of spatial inequality, in particular for the provision of low-cost housing. The amendment should provide that well-situated SOE land cannot be left unused. Further, OUTA recommends that non-core assets of SOEs must be sold urgently to reduce exposure and risk to the taxpayer.

An overarching law-making intervention that applies to the governance and management of all SOEs will be recommended under the Policy and Process Reforms subsection below.

OUTA echoes the NPC recommendation that *Internal accountability must be improved. This can be achieved by narrowing performance management indicators, stronger linking of executive remuneration to outcomes achieved rather than measurement of activities, inputs or outputs, and finally by requiring more systematic public disclosure of the main objectives from SOE Shareholder Compacts as well as of an assessment of the achievement of these annual objectives in public reporting and to Parliament, to facilitate public scrutiny.*

Financial Reforms

OUTA recommends strong reinforcement of commercial transparency in major SOEs. While developmental objectives are essential in the South African developmental state, the financial share and implications of preferential procurement should be explicit and systematic.

On allocations from the National Revenue Fund and general state coffers, allocations to SOEs must be strictly conditional – not only in emergency or special circumstances. Whilst the operational restructuring of Eskom, PRASA, SAA and other financially crippled entities is welcome – taxpayers urgently need clarity on the debt restructuring plans being contemplated by National Treasury and the Department of Public Enterprises.

Structural Reforms

The National Planning Commission's position paper on the contribution of SOEs to vision 2030 are worth noting here:

Where there are repeated failures in operational performance, or where fiscal and credit risk starts to outweigh benefits, government has a duty to implement organisational reforms. These include corporate governance, funding, and policy and process reforms.

Where chronic operational, governance and financial underperformance continues, and organisational reforms are inadequate, structural reforms should be introduced. This means opening the provision of the service or infrastructure to other economic actors besides the state and/or changing the structure of state ownership. The debate about structural reforms must move away from the unhelpful binary and ideological privatise/nationalise discourse.

It is the underlying nature of the market conditions that must guide the decision to create or retain an SOE or components thereof. It is hard to see on either constitutional or efficiency grounds why the state should use public resources to intervene with an SOE in private commercial activities where the market is competitive and produces outcomes that are acceptable to both sellers and buyers, or where light failings can be regulated. Scarce resources would be better directed to where markets do not operate efficiently.

Trust is an essential element of democratic legitimacy, and the declining levels of trust in leaders and institutions impact negatively on nation-building. One reason for this is that in some instances the wrong people are appointed to senior positions, which eventually results in a loss of public trust in them and the institutions they lead. The Constitution empowers the President and Premiers to appoint members of the National and Provincial Executives. Without abrogating from these constitutional powers, measures should be introduced that allow for more transparent and participatory appointment processes.

Such processes will empower the public with more information and knowledge about the new members of the executive and their relative skills, experience and merits, and would provide a forum where appointees can publicly commit themselves to applicable standards and to certain objectives, against which their subsequent conduct and performance can be measured. An empowered public will, in turn, be able to assist the legislatures to ensure that executives are more accountable to electorates.

Policy and Process Reforms

OUTA welcomes publication of the long-awaited Public Procurement Bill by National Treasury. This legislative reform, as a start, can have a major positive effect on the quality and real impact of state expenditure.

We strongly recommend that the Committees call for urgent publication of the still longer-awaited Government Shareholder Management Bill from the Department of Public Enterprises, which has the potential to transform the way SOEs and other public entities are governed. This type of reform must be demanded by Parliament before pending debt restructuring plans for major SOEs such as Eskom, Transnet, PRASA and Denel are approved.

Shareholder compacts and other ad hoc, case specific policies that govern state ownership and custodianship of public assets have proven to be ineffective and difficult to account for. Overarching legislation is therefore imperative. Such legislation can and should provide for compulsory, public consultation with financially and politically disinterested stakeholders on all mega-transactions that directly or indirectly draw resources from the National Revenue Fund.

Compensation

The Minister of Finance's speech highlighted that nearly half of all consolidated revenue will go towards the compensation of public servants and that Minister Senzo Mchunu is negotiating with the labour movement to find a balanced solution which sets compensation at an appropriate, affordable and fair level. As the Committees will be aware, in the post supplementary budget Parliamentary joint meeting of the Finance and Appropriations Committees the Minister revealed that wage negotiations had deadlocked at the bargaining council and the matter will now proceed to the labour court.

OUTA strongly supports National Treasury's decision to initiate a process of rationalising the cumulative cost of remuneration in the public service. According to the full Special Supplementary Budget Review document, compensation of employees will see the most significant change in share of expenditure by economic classification for 2020/21, with virtually all savings being allocated to transfer payments that aim to provide for public health interventions related to Covid-19, as well as scaling up and maintaining social assistance interventions for distressed and vulnerable households.

However, much of these transfers will be channelled through organs of state that have proven to be incapable of, or unwilling to, efficiently and transparently manage public finances. The increased allocation to local government in the proposed Division of Revenue Amendment Bill is case in point. OUTA urges the Committees to facilitate engagements with AGSA, DPME, civil society organisations and strategic oversight entities such as the Financial Intelligence Centre to promote experimental monitoring and evaluation of Covid-19 related spending. Virements and other forms of budget manipulation are commonplace in municipalities across the country.

Local Government

This section was compiled by PARI and is fully supported by OUTA. Local government in aggregate is no longer financially viable in its current form. It has been relatively less impacted by the declining fiscal resource envelope relative to the other spheres of government: their allocation of the equitable share has been increased (by R11 billion), and the suspension of conditional grants is lowest in local government (R12.6 billion).

However, the Minister emphasised that municipalities "face significant financial stresses. Metropolitan municipalities reported that their revenue collected in April fell by about 30% on average. This decline is due to a combination of lower demand for services such as electricity and water, and significantly higher non-payment rates for municipal bills." Even before the impact of the coronavirus pandemic, many local municipalities were struggling to stay afloat. The AGSA's 2018/2019 local government report indicates that just over one third of municipalities ended the financial year in deficit – they had spent more than they had received in revenue. In-year (S71) reporting by local government indicated that at the end of March 2020 (or just before the lockdown started to impact the economy) monies owed to municipalities totalled just over R180 billion. More than three quarters of this debt had been outstanding for more than 90 days, and most of this debt (around 70%) is owed by households.

As the economic impact of coronavirus increases, we should anticipate that this debt will rise rapidly, particularly if we bear in mind that the prices of all municipal services will increase from 01 July 2020. It would be prudent to assume that a significant part of this debt will never be recovered. We should thus anticipate that considerably more municipalities will move into an operating deficit in the 2020/2021 financial year. There are insufficient national fiscal resources to fill this deficit. The most likely (almost inevitable) outcome is a further deterioration in municipal service provision and critical infrastructure maintenance, and effective deprivation of access to basic services for low-income households who will no longer be able to afford them. There are also insufficient funds in the current fiscal framework to extend the volume and reach of the free basic services provision to provide relief to these households.

The important point to make is that this financial crisis in municipalities is neither new, nor easily addressed. It has not been caused by Covid-19, merely exacerbated by it. Nor is it a reflection only of operational inefficiencies and poor financial management, although these factors certainly contribute to making things worse than they might have been. The real reasons for the current financial crisis are structural (and thus require a structural solution) and can be traced back to the original local government design contained in the 1998 White Paper. That White Paper – reflecting the conditions at that time (including the very low cost of electricity) – had to make enormous assumptions about how the local government fiscal model would work in their design of the local government framework. Twenty-two years later it has become clear that many of those assumptions are no longer valid. The result is that many municipalities will never be financially viable under the current macro-economic circumstances. The longer that we maintain the fiction that they will be, the greater the long-term damage to poor households and basic infrastructure.

We urgently require a review of the entire local government fiscal and operating framework: a critical assessment of the actual (not assumed) revenue generating potential of local government, and the real (not assumed) cost of providing comprehensive services. We need to answer the following critical questions:

- Does our current municipal demarcation system reflect the reality of local government financial viability? If not, what demarcation structure will result in a better alignment with fiscal reality?
- Does the allocation of powers and responsibilities to local government reflect their ability to fund those mandates?

This exercise should be undertaken as a matter of urgency. Constitutional remedies for dysfunctional municipalities are not being used. Section 139 of the Constitution offers a wide range of remedies for dysfunctional and financially distressed municipalities. However, these remedies are not being implemented as envisaged. Both provincial and national government (including National Treasury) carry the responsibilities for this regulatory failure.

The implementation of zero-based budgeting offers significant opportunities. Although it presents numerous operational challenges, we believe that the principle of zero-based budgeting in local government offers significant potential benefits, not least the following:

1. An opportunity to accurately determine the actual cost of providing municipal goods and services
2. An opportunity to increase citizen participation in budgeting since each expenditure item and the associated prioritisation criteria must be clearly explained. This will, we believe, facilitate robust public discussion on the most appropriate use of scarce public resources, and deepen democracy.
3. An opportunity to root out wasteful and non-priority expenditure at the start of the budgetary process since these programmes can no longer be “hidden” in incremental budgetary processes.

In terms of addressing the operational challenges, there are numerous opportunities to increase technical capacity in this regard through partnerships with the private sector and civil society.

Conclusion

In conclusion, the massive contraction in the economy that is expected this year due to the impact of the Covid-19 pandemic has had a drastic impact on tax revenue, increasing the budget deficit. OUTA is therefore in support of measures to bring spiralling debt under control and avert a debt crisis. A sovereign debt crisis that will undermine the livelihood of each South African. Public finances are dangerously overstretched, and a passive plan will not succeed. We therefore welcome the introduction of zero-based budgeting to achieve more fiscal room-to-manoeuvre to secure core service delivery and to preserve the provision of basic human rights.

OUTA strongly supports National Treasury's decision to initiate a process of rationalising the cumulative cost of remuneration in the public service. While we welcome these pronouncements, we observe that government's track record of implementing previously announced measures has fallen short and therefore we are concerned about its ability to ameliorate the risk associated with spiralling sovereign debt and the rising cost of borrowing from multilateral institutions for capital investment in the domestic economy. By October, many of the immediate measures announced will have been exhausted. In October, we hope that the Minister of Finance and National Treasury will present the first of the interventions that fundamentally change the current composition of expenditure at the national level and provide direction on economic recovery plans. Structural, governance, financial and policy reforms are in order.

The Special Supplementary Budget should not provide for short term needs only. It should be a point of departure for fundamental economic and policy reforms that will recreate a productive South Africa post-Covid19. Tax revenue is falling far short of superfluous, wasteful, and irrational expenditure plans. The people want need government to act swiftly by enabling independent and resilient livelihoods for all.

OUTA is optimistic about the opportunities for systemic change posed by the challenging economic climate we find ourselves in. Government can and must make it easy and desirable for business and civil society to drive economic growth. We believe that this can be achieved is through strategic partnerships between the State, business, and civil society.