MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

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Most commentators agree that South Africa's strength is the quality of institutions charged with development and the implementation of macroeconomic policy. South Africa's public finance management is marked by a high degree of transparency and institutional innovation. This supports social and economic development, and is also a strength which makes South Africa an investment destination of choice.

What detracts from South Africa's attractiveness is that the broader macroeconomic environment, both domestic and external, is challenging. Economic growth is too weak; unemployment is too high. Corruption and wasteful expenditure in the public sector diverts resources away from the areas where they have the most impact. Governance and efficiency challenges in tax administration adversely affect tax morality, and this has a direct impact on the sustainability of public finances and South Africa's development. Lower tax collections reduce fiscal space and government's nimbleness in confronting South Africa's economic challenges.

State-owned companies which should play a critical role for national development are paralysed by large debt burdens and a legacy of poor governance. In addition, South Africa faces new challenges in the form of rising trade protectionism and capital outflows from emerging markets, leading to higher borrowing costs throughout the economy.

In the 2018 Budget, government identified several of these fiscal risks and aimed to build the fiscal buffers to protect South Africa from a fast changing, but uncertain economic environment. Several of these risks have materialised, which is why the main objective of the 2018 Budget-shoring up confidence-remains necessary, and perhaps even more urgent given the growth outcomes of the past two quarters.

Real GDP contracted by 0.7 per cent in the second quarter of 2018 following a 2.6 per cent contraction in the first quarter, putting the economy in a technical recession. Weak domestic growth, together with a less favourable global environment implies that the economic outlook is unlikely to improve from the 2018 Budget estimates. Lower economic growth in 2018/19 has the potential of undermining the revenue targets. In this regard it is important to state, without disclosing any details, that tax collection this year is performing reasonably well despite the adverse economic environment.

In October government will have to respond to several known expenditure pressures. For instance, the new public service wage agreement is forecast to cost an additional R30.2 billion over the 2018 MTEF. The depreciation of the Rand and an increase in government bond yields means that more resources will be required to service debt. The precarious financial positions of several state-owned companies has created an over-reliance on borrowing to fund ongoing regular operational expenditures-an untenable situation over the long term.

Ten years ago government looked to Eskom, the Trans-Caledon Tunnel Authority(TCTA), Transnet and others to launch an infrastructure drive that helped mitigate the worst effects of the global financial crisis. Unfortunately, in recent years, many of these critical state-owned companies (SOCs) have had their ability to contribute to economic growth severely weakened. Government will have to explore ways to strengthen the balance sheets of these institutions in a way that does not harm fiscal sustainability. It is abundantly clear that in the long-term, no amount of fresh capital or debt will save these institutions outside a radical rethinking of their business models and a commitment to good clean governance.

In a month government will present the 2018 Medium Term Budget Policy Statement (MTBPS) and without disclosing any of the details of that presentation, Cabinet has already agreed that fiscal sustainability must remain the focus of government's efforts in public finance management. This should be a statement that makes clear government's intention to pursue a prudent fiscal policy that stabilises the debt-to-GDP ratio over the long term.

While we do not expect the new public service wage agreement to harm the expenditure ceiling, it is important that government protects the composition of spending ensuring that resources are directed towards service delivery. Government remains committed to the compensation ceilings presented for the 2018 MTEF. Several options are under consideration to address the additional cost of the new wage agreement, as announced by the Department of Public Service and Administration. These include the updated employee-initiated severance package and early retirement to encourage qualifying public servants to exit the public service.

In both the President's State of the Nation address and the Budget, government committed to addressing several inhibitors of growth. Some of the initiatives underway are:

- SOC governance reforms - This process is being overseen by the President. Already this process is beginning to yield results with the return of several SOCs to capital markets where previously they had been shut out. Eskom, Transnet and TCTA were able to secure new long-term debt to replace maturing facilities.
- A commission of inquiry into the governance of the South African Revenue Service has been established and its findings and recommendations should help us improve the efficiency of the institution.
- Government is redoubling efforts to address the main issue inhibiting growth: weak investment. This includes building a pipeline of investment opportunities and infrastructure projects. Already national government has identified 64 projects through the Budget Facility for Infrastructure and subjected 38 to a rigorous financial and technical evaluation. Institutions like the Development Bank of Southern Africa, the Industrial Development Corporation, the New Development Bank as well as commercial banks and other financiers, will be critical to ensure that we leverage concessional finance along with the project implementation capacity and governance expertise that these institutions can bring to address our infrastructure backlogs. These institutions help to address infrastructure backlogs in cities which sap the economy of its dynamism.
- The Private Sector Participation Framework is now well-established and mature. It provides for alternative financing strategies to enable infrastructure investment. It allows SOCs to partner with private sector companies to enable a faster, more efficient delivery of goods, services and economic infrastructure to support the country's higher economic growth aspirations and transformation goals.

In due course the President will announce a package of measures meant to stimulate economic growth. The President is clear that government's participation in this programme will be through existing budget resources and will be focused on unlocking efficiencies within the public sector.

At a time when global interest rates are rising, all public sector institutions need to be more prudent in their borrowing and ensure that these funds are matched to projects with high returns and high development impact. Government, business, labour and society as a whole need to work together to lay the foundation for faster growth by narrowing the budget deficit, stabilising debt, strengthening governance and making the necessary investments for faster growth in the future.