MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

REMARKS BY DEPUTY FINANCE MINISTER, DR. DAVID MASONDO AT

JP MORGAN SOUTH AFRICA OPPORTUNITIES CONFERENCE

Vineyard Hotel, Cape Town

2 December 2019

Honored guests,

Ladies and Gentlemen,

Good morning

Thank you for the opportunity to speak at the third edition of the J.P.Morgan South African Opportunities Conference. I am pleased that the focus of this year's conference is on implementation and determination to create sustainable and inclusive growth in South Africa. There are a number of policy and strategy solutions South Africans have put in place. Amongst other plans, includes the *Economic Strategy for South Africa* recently publicly launched by Minister of Finance, Tito Mboweni. This is the time for implemtation! The extent to which I will talk about plans and strategies today, would simply to contextualise and remind ourselves on what we should implement in order to create sustainable and inclusive growth in South Africa.

Let me from the onset, state that low economic growth and growing public debt mainly driven by expenditure on wage bill, state owned enterprises and debt-service costs; are amongst the major obstacles to sustainable and inclusive growth in South Africa. In my remarks, I will try to lay out some of the government measures to be implemented in order to stabilize public debt and stimulate growth.

Allow me to be open with the fact that, it will take a close working partnership between government, investors, corporates and labour unions to find solutions to these challenges; and to implement these solutions.

Low economic growth

Our economic growth continues to be too low to tackle the high levels of unemployment and poverty. The first quarter 3.2 GDP declined, followed by a 3.1 percent increase, this means that we have had zero growth in the first two quarters this year.

There are two main reasons for our low economic growth. The first being low savings, which reduces our capacity to finance investment necessary for inclusive economic growth. This means that we have to rely on foreign savings to meet the NDP target of 30% investment to GDP. The second reason for our low economic growth is the small size of our domestic market which makes it irrational for investors to increase their investment since sales of what they produce will be small.

Therefore, to generate economic growth we need to engage with rest of world as a source of export demand and investment. However, it does not mean that we should not mobilize domestic investment; and increase domestic demand through increasing the rate of employment.

To attract both domestic and foreign investment; and boast our export performance, we need to be globally competitive. It should be cheaper and easier for investors to do business in South Africa. The cost of doing business in South Africa is relatively high, especially our network industries (ports, rail, telecoms). It is for this reason, that the recently released government *Economic Strategy for South Africa* does not only focuses on reducing the costs of living; but also improving the competitiveness of our network industries to reduce the costs of doing business in South Africa. For instance, commuters spend plus or minus 50% of their income on transport – a very inconvenient and expensive transport system. The taxi industry-led public transport system in South Africa is not sustainable. There must be a serious mass transit system very soon. The goods transport system led by the trucking industry is also not sustainable. To correct these structural bottlenecks in our network industries such as the transport industry, will require us to work together through private-public partnerships.

Exports remain low as a share of GDP; and are still dominated by minerals. We need to increase our export performance. Again, it is for this reason, that the *Economic Strategy* also pays attention to boasting the global competitiveness of our manufacturing sector. This must includes value-addition to our minerals. This is notwithstanding the rise of economic nationalism in the global north associated with trade wars and Brexit.

The *Economic Strategy* has also crystalized many aspects of the NDP. The plan lays the basis upon which we hold each other accountable in our quest to achieve higher and more inclusive economic growth.

There are a number of economic growth interventions that the Strategy suggests. These interventions include:

1. Prudent fiscal and monetary policy;
2. A flexible yet competitive exchange rate;
3. A new or *reimagined* industrial strategy;
4. Prioritising labour-intensive sectors such as agriculture and tourism; and
5. Lowering barriers to entry;

Under the leadership of President Ramaphosa, some of these growth-enhancing interventions are being implemented, with the following notable examples:

a) The new Integrated Resource Plan has been gazetted;
b) The Infrastructure Fund, which will mobilize both public and private-sector funding for infrastructure, is being rolled out;
c) The visa regime of the country is being greatly simplified;
d) The unabridged birth certificate requirement for minors visiting the country has been abolished;
e) A number of industrial parks have been upgraded, and we have approved the demarcation of more SEZs; and
f) Cabinet has instructed ICASA to implement the licensing of broadband spectrum.

These and other interventions will ease bottlenecks, create new opportunities for small and medium-sized businesses, and allow for greater investment in public infrastructure for the provision of services.

We therefore encourage corporates to invest in South Africa now! We are greatly encouraged by the increasing investment pledges to President Ramaphosa's investment drive which is an important sign of confidence in the economy. These investments are expected to add over 400,000 jobs over the next five years.

Growing the economy will require the increase of both foreign and domestic financial capital. At this point, let me be clear about our views. Firstly, from a Finance Ministry's perspective, the savings of workers must be protected. In this regard, they should never be exposed to risks emanating from poor financial management in either the public or the private sector.

Secondly, the onus must be on economic actors to ensure that the value proposition of the investment is sound. Government should not compel asset managers to invest their clients' money in unsound or poor-return projects. Economic actors should also behave as South African ambassadors and send the correct message to our international counterparts that we are ready to do business with them.

In channeling savings appropriately, let us not forget that the size of long-term fund managers such as pension funds alone is a source of enormous power and influence in driving economic growth and reform. They have the ability to secure longer-term returns by insisting on high standards of delivery, governance, and social responsibility. We need to ask ourselves this: *what prevents the full potential of these instruments from being unleashed on the economic potential before us?*

Expansion of South African companies

We are proud that a number of South African companies have outgrown our domestic market and have become global champions in their respective sectors. We need to continue this trend of growing South African companies to the point that they are able to compete in international markets. These companies should continue investment in the local economy and create jobs in our country. As you might expect, we will insist that these companies remain South African tax residents to protect our country's interests.

We must work together with our African governments and regulators to ensure policy certainty.

Expenditure and declining revenue

Ladies and gentlemen, as I have said before, our public debt is not suistainable. In the current financial year public debt is projected at just under 60 percent of GDP, or around R3 trillion.

A fiscal deficit of around 6 percent of GDP over the medium term implies that this number will rise to R4.5 trillion in 2022/23.

We have revised our revenue estimates in line with trends in the economy and to ensure greater fiscal prudence. In the recent years, we have introduced a number of measures mostly in the form of tax revenue raising initiatives. However, tax collection is below the South African Revenue Service targets. Institutional capacity at SARS is being restored which bodes well for revenue collection going forward. Raising taxes in the context of low economic growth is no longer an option.

Our main short-term intervention to stabilize our debt is on the expenditure side. We have set ourselves the goal of achieving a primary balance - that is, to close the gap between annual non-interest spending and annual revenues by 2022/23. We have already identified around R50 billion of spending reductions in the next two years, and the outer year of the MTEF will contain spending that grows no more than in-line with CPI.

But this is not enough. A primary balance will also require an additional R150 billion in reductions. As a matter of policy we have also decided that this should not come from service delivery and investment components of spending. The opportunity is ripe for us to not only cut spending but also improve the composition of that spend; and ensure that the majority of our budget is allocated to growth enhancing spending.

As government, we need to revive the infrastructure expenditure program focusing on areas including health, education, energy and transportation. I understand that the Minister of Health Dr Mkhize will be addressing this audience on the proposed National Health Insurance initiative. Government needs to continue to invest in human capital enhancing activities and redress inequalities in our society.

Wage bill constitutes 35% of the total government expenditure, and 46% of the gross tax revenue. We are working as we speak with our social and political partners to achieve savings in the wage bill, and in this regard we also have to look at a wage-freezes starting with us public office bearers, top managers, executives at all levels of the state if we are to seriously tackle our looming fiscal crisis.

SOEs and Expenditure

Part of repriotization of our expenditure would mean moving away from the recent trend of the fiscal budget increasingly becoming a bailout fund for state-owned companies. We also have to bring in private-sector participation; and ensure that SOEs that remain in public hands become commercially viable; and rationalize some of them.

Currently a significant part of our expenditure does not only go to the wage bill, but bailouts of underperforming SOEs. These bailouts have become unaffordable. I am sure that investors in the room today would agree with me that if management kept asking for equity injections every financial year you would reassess your investment decision in that particular company. There is no reason for government to behave differently unless there is a clear market failure that needs to be address by a SOE.

I am sure that at this point we as government are beginning to sound like a broken record but we cannot emphasise enough the importance of Eskom to our economy. The liquidity challenge at Eskom needs to be resolved urgently so that the Executive management team will on operational matters to improve the performance of the national utility.

To fix Eskom's capital structure, we need to reduce the debt component and this will require all of us to come up with innovative solutions. National Treasury, the Department of Public Enterprises and Eskom are working together on this important matter and we are hoping to provide much anticipated details on our coordinated plan in the near future. This coordinated plan will also take into account the broader energy sector plan and we will engage all stakeholders including labour unions accordingly.

Let us be clear: debt in Eskom is a symptom of a deeper problem related to Eskom's cost structure, its business model, as well as revenue generation and collection. Eskom is owed R25 billion by municipalities. Municipalities cannot continue to provide free electricity and other services to non-indigent of our population, including government departments and SOEs.

The appointment of a new Eskom CEO is encouraging and we all now need to rally behind him and his Executive management team as they work towards turning the national utility around.

Furthermore, restoring good governance and creating sustainable business models is critical. We should also consider that SOEs cannot receive blank cheques; there must be strict conditions in place. Performance of the SOEs against these strict conditions needs to be based on clear KPIs communicated upfront. SOEs must also share in the pain of any fiscal adjustment.

Moodys' credit rating

About a month ago, Moody's changed our sovereign credit rating outlook from stable to negative. S&P also came out later in the month cutting the outlook of our nation's debt to negative citing slow growth, a growing debt burden and upward revision to the fiscal deficit. Downside risks to our "investment grade" credit rating are significant.

A ratings downgrade will make things substantially worse by raising the cost of borrowing for government, SOEs and this will spill-over to private enterprises and eventually all borrowings across the economy. This will force borrowing costs, including for households to rise, causing a further decline in investment.

Banks and corporations, faced with increased borrowing costs, will:

1. pass on this to consumers by way of higher interest /bank charges,
2. cut back on lending, and
3. cut back on investments.

All this will slow down the real economy. The slowdown in the economy will generate a negative feedback loop/ vicious business cycles and put more pressure on the government's future credit rating.

National Treasury is alive to the great anticipation for the 2020 Budget Speech where we are expected to outline details around fiscal consolidation measures particularly relating to Eskom and the Wage Bill. Relevant government departments will be working very hard in the coming weeks to meet these expectations where possible. Again, government would welcome all support available to move us forward.

Conclusion

In closing, I would like to make a call to all of you to say *"Masibambaneni Mzansi"*. Our challenged economic situation calls for us to work together towards a common goal – inclusive and suistaible economic growth as the Theme of this conference requires us to do.

Realising inclusive and suistainable economic growth will require us to build strong growth coalitions and alliances with labour, business, government and civil society. As our rugby national team recently reminded us, we are indeed stronger together and can achieve a lot more if we work together.

As our first democratic President, Nelson Mandela, once said: "*It always seems impossible, until it is done*".

To Kevin and other J.P.Morgan colleagues, let us continue to work together as good citizens to save our economy.

Thank you.