A REFORM-MINDED BUDGET TO PUT SOUTH AFRICA BACK ON TRACK

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It is not surprising that the International Budget Partnership ranked South Africa first, along with New Zealand, on the 2017 Open Budget Index. The National Treasury has, once again, demonstrated its worth and strength through the 2018 National Budget Review. Although there are notable revenue shortfalls and taxes had to be increased, the budget framework has put South Africa back on the path of fiscal prudence, which will be positively viewed by ratings agencies. Importantly, there is a renewed focus on introducing economic reforms, which, if implemented, could lift gross domestic product (GDP) growth going forward.

Tax hikes

Value-added tax (VAT) has increased by one percentage point to 15% from 14%, to plug revenue shortfalls. Along with below-inflation adjustments for personal income tax brackets, the VAT increase will raise R36 billion in this fiscal year. The average VAT rate in Africa is around 15%. South Africa is now in line with similar countries, including Mauritius, Ghana and Ethiopia, but would seem uncompetitive on tax relative to Nigeria, which has a VAT rate of 5%, although there are plans to increase it to 10%. The VAT increase will negatively impact the financial well-being of South Africans. Other taxes are also on the rise:

- Excise duty on luxuries increased to 9% from 7%;
- Higher estate duty of 25% for estates more than R30 million;
- A fuel levy of 52c per litre;
- Excise duty on alcohol and tobacco increased by between 6%-10%.

Free tertiary education

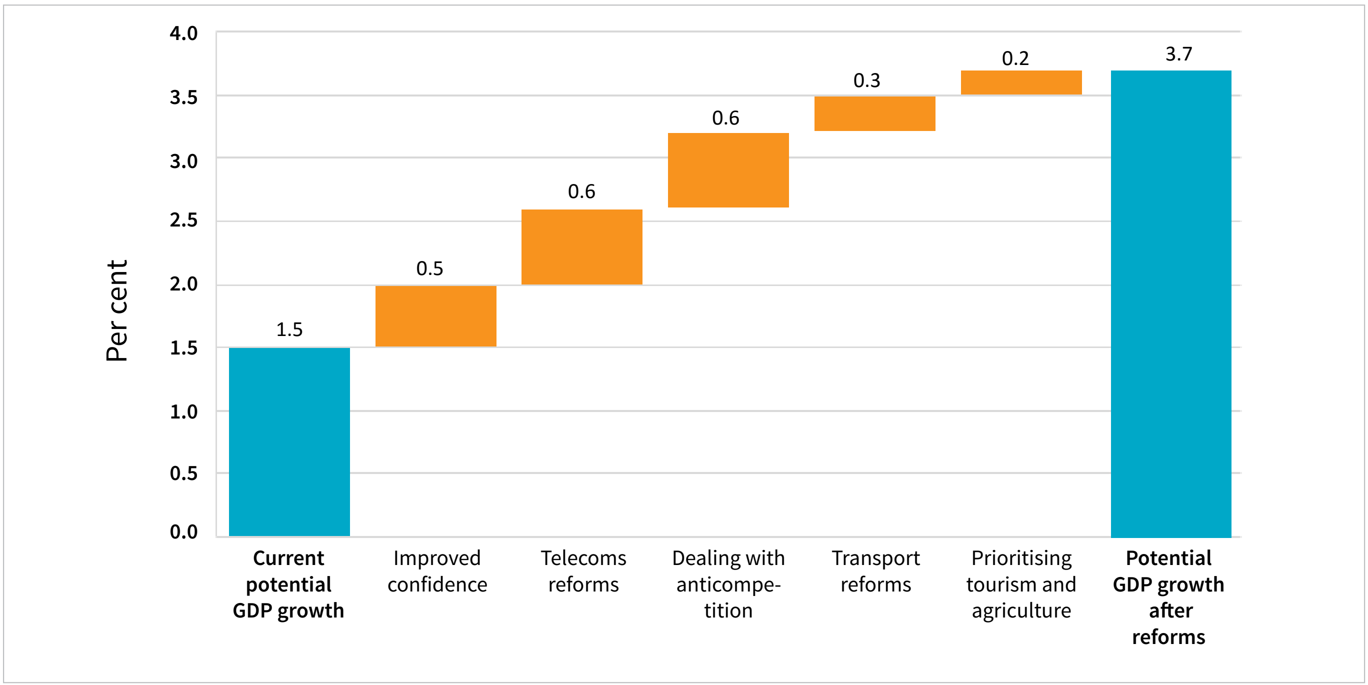
The National Treasury has defined the scope of free education to include all expenses incurred by a student during their year of study — tuition fees, prescribed books, meals, accommodation and travel allowances. The benefit will be for students from families with annual household incomes of below R350 000, beginning with the first-year cohort of 2018. There are more than 340 000 university and more than 420 000 technical vocational education and training (TVET) students. Within the next three years, the cost of free education will be R67 billion, which is 4% of revenue over the same period. Post-school education and training have now become the fastest growing component of expenditure, at 14% over the forecast period. Given that **#FeesMustFall** was a legitimate concern by students, and the pressure placed on the fiscus to honour this commitment, there is a need to find different sources of revenue through economic reforms.

Economic reforms

For some time, credit ratings agencies, along with economic counsel provided by leading contributors, have urged South Africa to undertake a journey to lift its potential GDP through economic reforms. Since the 2008 global financial crisis, South Africa has seen its potential growth — a state in which the economy can grow, without generating significant levels of inflation — decline from 3% to the current level of 1.5%. For the first time since 1994, the National Treasury has identified five economic reforms, and quantified the commensurate likely contribution, to lift GDP growth. This is a positive step. Reforms include: improving confidence, the rollout of the broadband spectrum in the telecommunications sector, dealing with anticompetitive behaviour, improving logistics in the transport sector, and prioritising the tourism and agriculture sectors (see Figure 1 on page 2).

This work has provided a good framework to judge the resolve of the new administration's commitment to economic reforms going forward. Indeed, more reforms bring higher GDP growth.

Figure 1: Identified economic reforms to boost potential growth



Source: National Treasury, February 2018 National Budget Review

Confidence boosting measures

A study by the South African Reserve Bank indicates GDP growth of between 0.4% to 1.0% can be achieved when consumers and businesses feel confident and have a high degree of certainty about economic prospects. The actions taken by authorities on implementing economic policy underpins this confidence and certainty. Lately, the administration led by President Cyril Ramaphosa has provided the green shoots of confidence-building measures, which could prove instructive in rebuilding trust between the government, labour and business.

State-owned enterprises (SOEs)

Eskom has drawn down its R350 billion credit line with the National Treasury to the tune of R220.8 billion, with more than R46 billion used in the past three years. The electricity utility makes up the lion's share of the total guarantees, worth R466 billion, committed towards SOEs. These guarantees remain a major source of risk for South Africa's budget. While it is admirable the Ramaphosa-led administration moved swiftly to install a new board and acting chief executive officer at Eskom, much work is required to wean the utility off its dependence on state finances. The real test for the new Eskom leadership is in how they reduce the guarantees and have the institution continue as a going concern — without government funding. Most state-owned companies worldwide received some form of government injection during the 2008 global financial crisis, but have since competed with themselves to 'pay back the money' and stand on their own feet.

Government debt

There is a notable downward revision of the expected path for the debt-to-GDP ratio from what was proposed in the October 2017 Medium-Term Budget Policy Statement. As opposed to debt levels rising to more than 60% of GDP, it is forecast they will peak at around 56% of GDP and taper off. The debt-to-GDP ratio is expected to remain at these lofty levels for the next decade, which is a very long time. Continued efforts to drastically grow the economy are needed. At these debt levels, the economy needs to sustainably grow at more than 4% to stop further credit ratings downgrades.

Opening South Africa for investment

In what will prove to be the largest step change since 2008, South Africa will increase its prudential offshore limits for funds under management by institutional investors, expressed in Regulation 28, by five percentage points to 30% from 25%, with allocations to Africa increased to 10% from 5%. This is a progressive step which will increase diversification benefits for South African investors and attract foreign investment back into South Africa.

Bottom line

This budget is progressive and represents a new dawn for South Africa. After several years of evident decay, the tide seems to have turned. One always needs to look for the proof in what gets promised, but in the 2018 National Budget Review, President Cyril Ramaphosa and his team have demonstrated the resolve and agility South Africa can have in effecting positive change.