



## **RESPONSE**

*October 24<sup>th</sup>, 2014*

### **Medium Term Budget Policy Statement 2014**

Finance Minister Nhlanhla Nene has just released the 2014 Medium Term Budget Policy Statement. This document is a mid-term adjustment to the government's budget that lays out their spending plans.

This budget comes against a backdrop of significant economic threats. Economic growth has slowed dramatically in 2014, severely undermined by prolonged strikes, particularly in the minerals and manufacturing sector, a growing budget deficit, and Eskom's continued crisis. This is particularly problematic due to the need for a sustained high growth rate in order to create sustainable employment, increase tax revenue and allow for sustainable national development.

The Minister is clearly cognizant of these problems and has attempted to address them in this statement. In particular, he has stated that while spending on social programmes and education will continue, the government must do more with less. Spending on advertising, consultancies and government salaries will generally be adjusted downward or frozen at current levels. At provincial levels, where he pointed out that 61% of spending is on salaries, closer attention will be paid to keeping spending on this line item in check.

Minister Nene has not avoided the thorny problem of Eskom requiring a bail out. In response to this issue he has announced that Eskom will borrow a further R250 billion over the next 5 years, and that Government will supplement this with R20 billion that will be raised from the sale of "non-strategic assets". Recent speculation has been that these assets up for sale will include government shares of Telkom and Vodacom. This decision can be questioned on the basis that Telkom and Vodacom are both valuable, dividend paying assets. As a result, some analysts have likened this decision to "selling the roof to pay the rent". However, in the short term Eskom simply cannot be allowed to fail, and the money must come from somewhere.

Helpfully, the Minister has stated that "we will not balance the budget on the backs of the poor." This is an excellent and just decision. The poor did not create South Africa's present financial problems, and they should not be made to pay for them. Minister Nene then stated that "intensive effort has to be focused on achieving the intended savings and maximising efficiency," largely through fighting waste and corruption, containing procurement costs and cutting back on expenditure that does not affect service delivery.

In addition to all of these cost-cutting measures, it appears likely that some form of tax increase is on the cards for 2015, with the Minister announcing that "about R15 billion a year in additional revenue will need to be raised. Details will be announced in the 2015 budget." Quite where this tax revenue will be found is unclear. The current tax base cannot plausibly be extended, and most tax payers are

already under serious pressure, with the increased costs of transport, food and other products stressing their finances.

Overall, Minister Nene's scheme is excellent, and must be applauded for its clear sighted acceptance of realities, while not attempting to foist the costs of fiscal reform onto the poor. Indeed, as he pointed out himself, adjusting to fiscal realities in time will buy the country space to adjust, in order to grow faster in the future. It is better to reform in advance, than to suddenly be subjected to aggressive, unavoidable financial cutbacks after the Treasury has been exhausted and the economy devastated. The experiences of Italy and Greece should act as a clear warning of the need for financial prudence in the face of economic difficulties.

However, while Minister Nene's plans are excellent, there is a very real question about the government's ability to implement them. Of late the government has committed itself to an incredibly murky, uncosted and potentially problematic nuclear power build scheme. Massive capital expenditures of this type are not South Africa's strength. The staggering cost overruns and chaotic scheduling of the Medupi and Kusile coal fired power stations are excellent examples of this and there is no reason to think that a massive nuclear power scheme will go any better.

Similarly, the expenditure of R250 million on Nkandla has been a major, continuing saga of waste and corruption. No decisive action has been taken to recover the money, and instead a protracted process of buck passing has taken place. While Nkandla is not the only case of wasteful government spending, it is an excellent example of how the government has failed to take decisive action on corruption and mismanagement.

On lowering the wage bill, Minister Nene is correct, but the public service unions are simply not going to be interested in the concept of wage freezes. The National Education, Health and Workers Union – a major public sector union - is currently demanding a 15% wage increase, and is hardly likely to endorse the Minister's call for spending less on government salaries.

Ultimately, Minister Nene is doing as well as can be expected. He has not avoided the hard realities of South Africa's current situation, and he is cognizant of the needs of the poor and the importance of social delivery. However, the will and ability of the government to implement his budgetary plans is in serious doubt. It is worth recalling that in the last Budget, then-Minister Pravin Gordhan also insisted on cuts to government luxuries such as expensive automobiles, credit card expenditures and gala events – only for North West Premier Thandi Modise to purchase a luxury German automobile immediately afterwards. Whether Minister Nene can enforce fiscal discipline any better remains to be seen.

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<sup>i</sup> This is hyperbole, since shares in Vodacom cannot really be considered a central asset of the government, or a crucial national institution. However, the argument about selling performing assets to pay for non-performing assets remains salient. For more on this argument see: <http://www.bdlive.co.za/opinion/columnists/2014/10/21/no-protests-over-selling-the-roof-to-pay-the-rent-plan>