



B U S A

BUSINESS UNITY SOUTH AFRICA

**SUBMISSION TO THE STANDING AND SELECT COMMITTEES ON FINANCE
ON THE FISCAL AND REVENUE PROPOSALS AND DOCUMENTATION RELATED
TO THE 2011/2012 BUDGET**

BY BUSINESS UNITY SOUTH AFRICA (BUSAs)

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BACKGROUND

BUSA is a confederation of business organisations including chambers of commerce and industry, professional associations, corporate associations and unisectoral organisations. It represents South African business, including small and medium enterprises, on macro-economic and high-level issues that affect it at the national and international levels.

BUSA's function is to ensure that business plays a constructive role in the country's economic growth, development and transformation and to create an environment in which businesses of all sizes and in all sectors can thrive, expand and be competitive.

As the principal representative of business in South Africa, BUSA represents the views of its members in a number of national structures and bodies, both statutory and non-statutory. BUSA also represents Business' interests in the National Economic Development and Labour Council (NEDLAC).

1. INTRODUCTION

BUSA welcomes the opportunity to submit comments on the 2011/2012 fiscal and revenue proposals and related budget documentation as tabled in Parliament by the Minister of Finance, Hon Pravin Gordhan on 23 February 2011. The 2011/2012 Budget offered a realistic assessment of South Africa's economic prospects and spoke rationally to the primary challenges underpinning them.

As with previous years, emphasis on the need for a united effort between business, labour and broader civil society on the one hand, and government on the other, was again a recurring theme of the Budget. As before, business remains committed to a collective effort, whether through direct consultations with government departments, through social dialogue, or via submissions to Parliament and other regulatory and oversight institutions.

In arriving at its broad economic assessments, BUSA has drawn on a) elements of the New Growth Path, b) the State of the Nation Address, c) the BUSA discussion document, entitled Perspectives on an Inclusive Higher Job-rich Growth Path and d) recent inputs from member organisations.

Business, of course, supports the Budget's emphasis of the need to promote the rates of investment into the economy, as well as exports in order to support an environment in which higher rates of job-rich growth will be possible. Ensuring that corruption is effectively dealt with is a key component in improving our competitiveness in this regard.

BUSA already plays a leadership role in this regard, through our national anti-corruption campaign, which culminates in our annual Anti-Corruption Forum meeting. We therefore

welcome the strengthening of the Government procurement framework and are sure that the measures announced by Minister Gordhan helps to yield positive results.

2. MACROECONOMIC POLICY

Business recognises that Treasury has built a solid reputation of fiscal planning based on projections erring on the conservative side, and often being much closer to actual outcomes than many estimates from the non-government organisations and private sector. In line with its realistic characterisation of the current global economic environment as one of immense transition, profound risk and great opportunity, we believe that the overall structuring of the fiscal framework and monetary policy setting is conducive to the macroeconomic stability and the fiscal sustainability of the economy.

2.1 Monetary Policy

Business believes that the current monetary policy regime is broadly appropriately structured and that it is successfully implemented by the South African Reserve Bank. With commodity prices surging – particularly oil, on the back of the recent unrest in the Arab world – and the current downwards trajectory envisaged for the rand, it is imperative that inflation be managed carefully to ensure the overall competitiveness of the economy, as well as for living standards to be maintained lower down the socioeconomic scale.

Ensuring higher levels of sustainable job-rich growth will require investments both in the enhanced utilisation of our current manufacturing capacity and in new capacity to manufacture for export. A base factor in ensuring our competitiveness is overall stability and a clear future trajectory for our currency. In this regard, we concur with the Minister that “[t]he credibility of monetary policy in achieving our target inflation range, combined with our commitment to fiscal discipline, are important foundations”.

We further trust that the mooted discussion papers on the regulation of foreign direct investment and the prudential framework for institutional investors will build on the announcements made by the Minister in his 2010 Mid-Term Budget Policy Statement (MTBPS), as well as on remarks made by Treasury during the NEDLAC engagement following the MTBPS. These reflected that impediments to overseas Foreign Direct Investment (FDI) and portfolio investments will be reduced. BUSA is cognisant of the outcomes of the 2010 UNCTAD survey on FDI trends which indicated that FDI to South Africa had fallen by 78%.

2.2 Fiscal Framework

The counter-cyclical stance that Treasury adopted two years ahead of the global financial crisis has proved itself subsequently. It has allowed South Africa to maintain spending on public works programmes, infrastructure and support schemes for companies in distress and workers who became unemployed. BUSA therefore continues to broadly support this approach.

While there has been some initial market reaction to the slightly more expansionary positioning of the budget (at 5.3% of GDP, rather than at 4.8%), there are several factors that are likely to mitigate the persistence of any real repercussions for investor sentiment. The correction of tenuous market expectations (some as low as 4.4% of GDP), the immediate resilience of the rand and the overall downward trend of the budget deficit are three important factors in this regard.

Markets should also recognise that the higher deficit budgeted for 2011/2012, forced by lower receipts due to the lagging effects of the global crisis of 2009, was a disciplined one. It was moderated by R36bn in reallocated savings throughout all government departments. It was also achieved without negatively impacting budgeted expenditure on infrastructure development, nor has it prevented a slightly lower projection for debt servicing costs.

Given the general credibility of Treasury's projections, the necessary comfort should be provided by: the envisaged trends in the recovery of revenue; and, moderation in the growth of public spending and the support that this will lend to the likely downward trend in the deficit and the stabilisation of net debt at 40% of GDP in 2013/2014. However, it is imperative that this trajectory not be exceeded, for government's debt servicing costs are already projected as the fastest growing category of expenditure over the MTEF, at a sizeable 11.4% in real terms.

We welcome the specific attention paid by Treasury to the necessity of eliminating the primary deficit (deficit after deducting interest payments) as soon as possible. Currently, the primary deficit is projected to be turned into a surplus only after the 2013/14 financial year. This means that government borrowing is currently at levels that tend to reduce, rather than promote the supply of capital. Business would support sensible efforts to return to a primary surplus position sooner, rather than later.

Baseline additions of R94.1bn over the MTEF, and the comparatively low real growth in expenditure on transfers to households (3.2% of GDP) and compensation of government employees (1.3% of GDP) affirms the commitment to the stabilisation of growth in non-interest expenditure. In light of the doubling of the public sector wage bill over the last five years (from R156bn to R314bn), we believe that significant debate should now centre on the moderation of salary increases for civil servants.

Research has shown that the differential between public service and private sector salaries based on formal, non-agricultural employment has in 2010 reached almost 45% in favour of the former. Consensus on the moderation of this aspect will have to be reached as a matter of urgency for the good of the national economy. Should restraint not prevail in respect hereof, it is likely that expenditure that achieves the most productive results, such as the R150bn in initiatives to support job creation and R800bn in infrastructure investments, will have to be cut back. Paying civil servants so much more than their private sector counterparts does not create decent work, it undermines the ability of the economy to do so.

Overall, the clarity of the position on key macroeconomic issues as articulated in the Budget should provide as much certainty to investors and consumers as could be hoped for at present. This will be supported by the Minister's emphasis on the importance of the competitiveness of the economy in order for us to achieve higher levels of inclusive growth. In this regard, business concurs that the degree to which we will be able to realise the aspiration of decent jobs, will depend on the competitiveness of our enterprises.

3. SUPPORTING HIGHER LEVELS OF JOB-RICH GROWTH

BUSA believes that the overall focus of the Budget on supporting higher levels of sustained, inclusive growth, with the emphasis on the facilitation of job creation, promoting skills development and spending on infrastructure is appropriate. While we do not doubt the intention of government to deliver on these objectives, the capacity of the state to execute the measures announced is not only an acknowledged general concern, but an overriding cause for unease amongst business. Business stands ready to assist in this regard.

A broad-ranging package of measures was announced, on which we would like to make select comments:

3.1 Skills Development

We welcome Minister's Gordhan's terming of government's spending on skills development and education as "the most important programme of investment in future growth and redistribution". We believe that the additional R24.3bn allocation for skills development and education is a very positive development.

The improved quality and capacity of our Further Education and Training Colleges are vital in the quest for a suitably skilled labour force. We believe the R14bn allocated for the period ahead in this regard is prudent and hope that it will be met with the requisite response in terms of the provision of the suitable range of training programmes and qualifications.

We also note the R20bn and R5bn allocations to Sector Education and Training Authorities (SETA's) and the National Skills Fund (NSF) respectively. We trust that these funds will be used wisely to ensure improved and more consistent delivery from these facilities. We are particularly interested in partnering with Higher Education Minister Blade Nzimande to ensure that the private sector as the biggest driver of employment creation and the funder of the SETA's, will be occupy its rightful place in the directing of these institutions. We will also be proactive in identifying administrative blockages in accessing assistance from the NSF.

3.2 Expansion of the Public Works Programmes

In light of the cyclical downturn as a result of the Global Financial Crisis of 2009, from which the economy is still recovering, we believe the continuation of the Expanded Public Works Programme (EPWP) and, especially the community participation arm thereof, is sensible. In line with the functionality of public works-type programmes, the most significant contribution that they are able to make to the acceleration of employment creation, would be through the improvements to infrastructure and services that they result in and through the acquisition of work ethic and experience. We would encourage constant monitoring and evaluation of the EPWP in comparison to the results achieved through other programmes in terms of poverty alleviation and improved absorption into the job market on a rand-for-rand basis.

3.3 Employment Subsidy for New Workers

BUSA supports the proposal of an employment subsidy for new workers, and looks forward to engaging with government and other social partners on the Discussion Paper submitted to Nedlac by Treasury. We believe that such a subsidy programme could positively impact the inflexibility of wages for unskilled workers, and so encourage their absorption into formal employment. We will encourage the implementation of the programme subject to proper consultation, and also urge its expansion, should it perform better and more cost-effectively than other employment promotion projects, such as the Expanded Public Works Programme (EPWP)

3.4 R40bn to promote Job-rich investments

The involvement of the Development Bank of South Africa (DBSA) in the operationalisation of the R9bn jobs fund and the distinction made between the jobs fund and the R5bn youth employment subsidy are welcome clarifications. We also reiterate our positive reaction to the R20bn in tax incentives for new investments. We will also strongly motivate that these incentives should prioritise employment creation in the private sector, as this will be more productive in promoting employment throughout the economy over the medium and long term.

We also welcome the R10bn allocation over the MTEF to promote investment under the Industrial Policy Action Plan (IPAP2). These funds will be focused on the automotive production, clothing and textiles, film and television, small manufacturing and tourism. BUSA looks forward to participating in the review of this programme. On the one hand,

there is the long standing view that a broad-based lowering of the corporate tax burden is the better policy route because governments seldom have a clear quantitative and qualitative understanding of the effectiveness or the revenue impact of specific incentives. On the other hand, there is the view that we have reached the stage where some of the sector specific binding constraints can be addressed through well targeted and managed tax incentives.

In general, we would urge that access to and turnaround times in the awarding of these incentives be carefully scrutinised to ensure their improved take-up by business organisations. BUSA would be happy participate with government in such a design exercise so as to render these initiatives as effective in promoting growth and job-creation as possible.

3.5 Small Business Support and Development Finance

Support measures including funding for enterprise development initiatives (R600m), agro-processing (R250m), the national tooling initiative (R120m), the Micro-finance Apex Fund (R282m) and the pilot of a new approach to small business lending (R55m) are all necessary initiatives.

We encourage government to actively use the newly-established Development Finance Institutions (DFI) Council to ensure that these allocations, as well as the broader R115bn lending capacity of the major DFI's be actively used to ensure vigorous pursuit of broadening a successful and competent entrepreneur-base, enhancing food security and improving rural development. We would also urge that entrepreneurial support rendered through the National Youth Development Agency (NYDA), which has been allocated a sizeable R1.2bn over the next three years, be subject to direction from the DFI Council.

3.6 The Green Economy

BUSA notes that R800m has been set aside over the next three years for "green economy" initiatives and that specific allocations will be made in the Adjustments Budget. We view this tangible recognition that the move towards a more environmentally friendly economy will require government support. Many initiatives are already afoot and technologies are being developed in private industry to move towards greener ways of production. At this juncture, we caution that expectations in terms of any job creation potential that towards a green economy may realise should be benchmarked against a firm understanding of what this may entail and that allocations should be made accordingly. BUSA is ready support this process. We appeal for detailed consultation before the allocations are made, to ensure that maximum value can be obtained from any consequent expenditure.

3.7 Infrastructure

The infrastructure expenditure programme is justifiably a key component of the government's spending plan and in this regard, BUSA welcomes the R809bn allocation over the MTEF. We note, in particular, that the lion share of this allocation will be towards the development of Energy (36% or R291bn) and Transport and logistics (26.2% or R212bn). We would like to make select comments on these two categories in particular, as well as on the role of private-public partnerships (PPP's).

1. 3.7.1 Energy Infrastructure

In terms of ensuring the security of our energy supply, two major projects under way as part of Eskoms' build programme is the Medupi power station, which will generate 4700 MW at a of R125bn and Kusile power station, which will generate 4800MW, for which the projected investment cost is in excess of R140bn. While we support the roll-out of these power stations, there are concerns from business that the cost per kilowatt of electricity generated from these power stations will far exceed global norms, due to the unbudgeted escalation of costs associated with these projects. Business believes that a large part of the challenge in containing costs emanate from the phased approach utilised in building these power stations. We therefore strongly urge a review of the project management practises employed in rolling out such big electricity infrastructure projects and argue for a more integrated approach.

2. 3.7.2 Transport Logistics

Business has long held concerns over the inadequacy of South Africa's transport logistics in terms of how it hampers the overall competitiveness of the economy. In light thereof, we welcome additional allocations of R10.3 billion the MTEF for transport. Specific concerns relate to the following:

- general inefficiencies, service predictability and equipment availability of the rail network;
- upgrading Transnet's rail and port infrastructure in order to boost capacity on the rail lines that transport coal and iron ore to export terminals;
- relieving congestion and damage on our road network system by shifting other goods from road back onto rail;
- providing appropriate inter-modal facilities that would facilitate seamless movement of cargo; and,
- enhancing competition amongst and within ports.

3. 3.7.3 Public Private Partnerships

Business sees the use of PPP's a well-understood alternative to assist in leveraging private sector capacity to accelerate the roll-out of infrastructure and to ensure the effective utilisation of government's budgeted infrastructure spend. There are, however, concerns that this mechanism is not being sufficiently used to produce outcomes. While the stated intention has been for 3% of the infrastructure spending programme to be executed through PPP's, results achieved have been closer to 1.5% of the total spend.

By international standards, this figure is extremely low. We believe that extending the requirement of feasibility studies to public sector projects, such as is required for PPP's, would not only level the playing field and so encourage greater use of the PPP-option, but would also ensure greater effectiveness in the execution of projects rolled-out solely by the State.

4. TAXATION POLICY

The BUSA view is that tax policy should be used to stimulate investment in the South African economy. This approach will ensure that there is higher growth in the long run, and can so be useful in assisting government to generate higher revenues, by broadening the tax base. The excessive use of additional taxes and special levies as revenue generating instruments can be counter-productive, as it invariably reduces South Africa's competitiveness, by raising the costs of doing business. Further, we believe that they can distort economic activity leading to sub-optimal outcomes in the economy.

We would like to make specific remarks with respect to a possible review of the tax regime, the funding of the National Health Insurance and the option of a Carbon Tax.

4.1 Proposal for a review of the tax regime and regulatory impacts on business

BUSA proposes that a comprehensive review of taxes levied on the economy be executed. While it is accepted that the State needs to protect the quantum of its revenue, we believe that a rationalisation of its revenue streams can only be in favour of a more competitive South African economy, especially in terms of the costs of compliance and the associated administrative burden for its small tax base. While certain taxes such as personal income tax, tax on companies, interest on overdue income tax, value-added tax, turnover tax for small businesses, a general fuel levy and a plastic bag levy may be accepted as a *fait accompli*, others may not. Those taxes that should especially come in for review include:

- the skills development levy;
- donations tax;
- estate duty;
- securities transfer tax;
- transfer duties;
- taxes on petroleum products;
- air departure tax;
- the electricity levy;
- the incandescent bulb levy;
- CO² tax on motor vehicles;
- Customs duties; and,

- Stamp duties and fees.

In conjunction with this proposal, and in line with sentiments expressed in previous Budget speeches, we believe that the time is also ripe for effect to be given to a broader review with the aim of reducing the regulatory impact on business, especially small business.

4.2 National Health Insurance

We appreciate Minister Gordhan's frankness concerning the high likely costs of the implementation of the National Health Insurance (NHI) scheme and his commitment to a consultative and a phased approach. It is essential that the proposed NHI should rest on sound financial foundations.

4.3 Carbon Tax

BUSA shares the views of other stakeholders that climate change poses a substantial long term risk and that it is therefore essential to move towards a low carbon economy. Due to the complexities of designing the least cost trajectory towards a sustainable future and the potential negative impact on the economy, it is essential to undertake a careful and detailed analysis of the risks, costs and opportunities inherent in this new policy direction. BUSA is currently actively engaging on the Discussion Paper by Treasury on the Carbon Tax option through NEDLAC.

Our view is that the Paper does not contribute sufficiently to the much needed balanced and mature debate on the merits of different alternative policy instruments to reduce greenhouse gasses while keeping the economy on a growth path. Rather, it is a one one-dimensional focus on generating tax revenue with major negative implications for the country.

BUSA is, however, committed to working with Government to address the challenges of climate change and as reflected in its submission on the Climate Change Green Paper, considers the private sector as a key partner in achieving a lower carbon growth trajectory. As President Zuma indicated in his State of the Nation Address, the private sector is a key partner in achieving the employment targets that Government has set. It is hoped that the same recognition is accorded to the role of the private sector in this challenge.