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Escaping the hippo's jaws: Mboweni's broad strokes emergency budget

Amid analogies about his trademark aloe ferox and a hippo's gaping jaws, Finance Minister Tito Mboweni delivered a bleak supplementary budget that was a little light on detail on how the government about how it expects to actively raise revenue and reduce expenditure to address the significant debt and revenue shortfall challenges the fiscus faces.

Finance Minister Tito Mboweni

“There was mention of raising about $7bn that Treasury would borrow from international funders, but the minister did not provide details about what we would be doing differently to repay that debt. In fact, there were no real announcements about tax increases, notable expenditure decreases, or commentary about the handling of state-owned entities (SOEs), which was surprising,” says Mike Teuchert, national head of taxation at Mazars.

“There was never any intention to revisit taxation measures in this budget. Its purpose was to reallocate spending to fight the pandemic. The issue of tax changes will have to be revisited in the 2021 budget. However, the reality that there is little scope to increase revenues remains. The only way to increase revenues is to grow the economy,” says Sandy McGregor, portfolio manager at Allan Gray.

The economic landscape

The economy is expected to contract by 7.2% this year, and while this represents the worst performance in 90 years, it is roughly in line with the market’s expectation. Economic growth is likely to return next year, with 2.6% in 2021 and 1.5% in 2022, which are realistic forecasts but still too weak to address many of the structural issues.

The budget deficit, at close to 16% of gross domestic product (GDP), is slightly more than the 14% that the market was projecting. However, this compares to the 7% contained in the February 2020 budget, which provides an idea of the extent of the deterioration in revenue while expenses remain heightened.

The debt-to-GDP ratio for this year will be close to 82%, ahead of market expectations of around 76% and the 60% in the February budget.

The virus response has added some R145bn government spending. However, through reprioritisation, Treasury has managed to shift about R100bn in spending from other departments.

“Even with the counter-cyclical fiscal and monetary measures implemented, including the R500bn Covid-19 support package, rate cuts and easing of financial conditions, our position remains tenuous,” says Reza Hendrickse, portfolio manager at PPS Investments

“This supplementary budget made it clear that public finances are currently overstretched and that over the coming months, government will need to detail far-reaching reforms. Reprioritising expenditure is however not sufficient to tackle the current situation, and greater action is needed in order to curtail spending. Unfortunately, we continue to face the conundrum of needing to stimulate growth in the face of austerity. And unfortunately, we can expect to see some tax increases in the forthcoming medium-term expenditure framework,” he says.

Revenue collection collapse

The glaring issue currently is that revenue collection has collapsed. Tax collections are likely to miss this years’ target by R300bn, leading to the consolidated budget deficit reaching 15.7% of GDP for the 2020/21 year. This is more than double the forecast from February.

Personal income tax receipts are down. With many small businesses shutting down, large organisations retrenching people and many employers unable to pay salaries in the wake of Covid-19, personal income tax revenues will be under pressure for a while yet. Despite the speculation about a wealth tax or higher taxes for high income earners, these options would have been complex to implement in the middle of a tax year. It’s not surprising that we did not hear anything about this from the minister for that reason. However, tax increases are necessary to stabilise debt, and we are likely to see an increase in personal income taxes announced in the February 2021 budget speech, says Yolandi Esterhuizen, registered tax practitioner & compliance manager, Sage Africa & Middle East.

“In the February budget speech, the minister said government was planning to broaden the corporate income tax base and use the additional revenue to reduce the corporate tax rate. Today’s speech confirmed that these measures (restricting net interest expense deductions, and limiting the use of assessed losses carried forward) will be postponed to at least 1 January 2022. This means businesses will need to wait for relief from a lower corporate income tax. During this time, where businesses need relief more than ever, this is a pity,” she says.

Over the medium term, there will have to be an increase in tax revenue. Government is looking for some R40bn over the next four years. In part, this will come from stimulating the economy, which will obviously lead to increased revenue. But there are also likely to be some tax changes that will take place, which will be on the cards for October’s Medium-Term Budget Policy Statement and the February 2021 budget, says Maarten Ackerman, chief economist and advisory partner, Citadel.

Borrowing and indebtedness

“Unfortunately, we are likely to undershoot our revenue target this year by about R304bn, which will need to be funded.

Borrowing requirements are increasing rapidly to cover the shortfall, which now stands at R780bn, compared to about R340bn in the February budget," Ackerman says.

National Treasury now expects government borrowing to be close to 81.8% of gross domestic product this year, eclipsing the previous 65.6% forecast. Borrowing will be supplemented by $7bn, which the government intends to borrow from multilateral finance institutions, including $1bn from the New Development Bank and $4.2bn from the International Monetary Fund.

Mboweni made the point that for every one rand spent, 21 cents is used servicing debt, which is not sustainable. Contextualising our level of indebtedness, he commented on the reality of countries facing sovereign debt crises, once borrowing reaches unsustainable levels. He also made reference to examples such as Argentina, Zimbabwe, Greece and Germany in the 1920s, which faced these challenges, but stated the intention to avoid this path.

"Although our debt levels are not extreme by developed market standards, the unfortunate reality is that South Africa's funding rate is around a 4% real rate, compared to some developed markets which are able to borrow at a real rate of zero or less. This amplifies the drain on resources significantly compared to developed markets. Putting a positive spin on the current situation, the government boldly expects debt to stabilise going forward, at 87.4% of GDP in 2023/24, and intends to narrow the deficit, and target a primary surplus," says Hendrikse.

State-owned enterprises

Not much detail was offered on tackling the troubled state-owned enterprises (SOEs) or how the public sector wage bill will be addressed, but the governor stated R3bn would be channelled into Land Bank in order to help recapitalise the institution, given its importance.

Public Service and Administration Minister Senzo Mchunu is also in talks with labour movements about public sector wages to find a balanced way forward.

Reforms will focus on rationalisation, reducing the number of and merging some of the SOEs together, equity partnerships (which is very positive), and stronger policy certainty. And any transfer from the fiscus will be strictly conditional on improving their balance sheets.

"The minister made the point that in zero-base budgeting and in trying to reach a surplus position, it will require enormous discipline and cutting all expenditure that we can't afford. He said we're not as rich as we were 10 years ago, so hopefully the reality is sinking in for government in general that we simply cannot continue to spend the way we have done. Unfortunately, he provided no further details on this, referring to the medium-term policy statement for more, Ackerman says.

Unemployment

Unemployment remains one of South Africa's biggest challenges. The emergency budget speech mentioned that the Presidential Youth Employment Intervention and the repurposed public employment programme will be rolled out over the medium term and that an additional R19.6bn has been set aside for this purpose. "I did hope to hear about a possible extension for the TERS (temporary employer/employee relief scheme) since many small companies are struggling, even if the lockdown has been eased somewhat," Esterhuizen says.