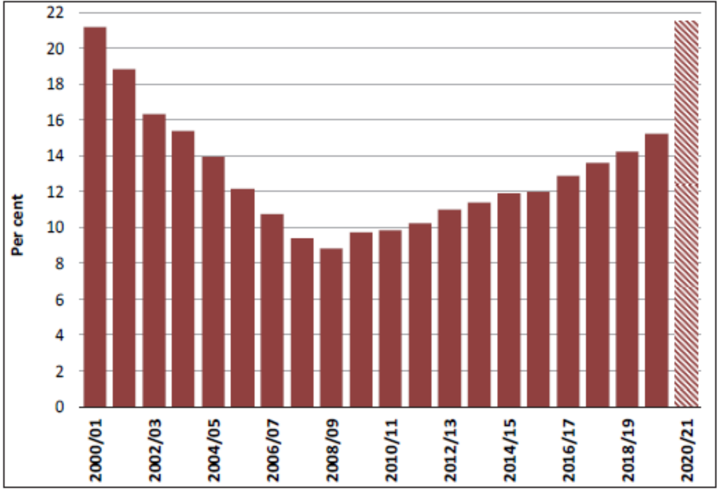
COVID-19: An update since our last note

Living in and adapting to a fluid environment seems to be the new normal. This week's note focuses on the Supplementary Budget only.

The Supplementary Budget: Low on detail, high on intent
"[Our] debt is our weakness…Our Herculean task is to close the mouth of the Hippopotamus! It is eating our children's inheritance. We need to stop it now!" - *Minister Tito Mboweni*.

The debt spiral

Figure 1.1 Debt-service costs as a proportion of main budget revenue



Source: National Treasury

Out of every rand of tax we pay, 21 cents go towards paying the interest on our past debts. At the beginning of this year (before the additional COVID-19 debt), debt repayment equalled our spend on healthcare. National Treasury is expecting the South African economy to contract by 7.2%, putting us back to 2012 GDP levels. The difference, however, is that there are now 6.5 million more people in South Africa than in 2012.

This means that in 2020, 11% more people will share the wealth of 2012. Early projections are that gross national debt will be close to R4 trillion or 81.8% of GDP.

COVID-19 budget implications

The R500 billion economic support package announced by President Ramaphosa earlier this year, includes R142 billion allocated to COVID-19 specific expenses, and R3 billion that is earmarked to refinance the Land Bank. R109 billion of the R145 billion will, however, be financed by restructuring current expenses. The net effect is an increase of R36 billion in government expenses excluding an increase of R7.1 billion in debt service costs.

However, the biggest problem is the collapse in the economy and the impact this will have on revenue collection. Tax revenue is expected to drop by more than R300 billion from original estimates, resulting in a budget deficit of R761.7 billion (15.7% of GDP). This equates to a person earning R100 000 spending R115 700 for the year. While this is achievable for a year or two, the amount that needs to be borrowed increases as the cost of repayments increases, until no-one is prepared to lend you money. As at 15 June, the estimated risk premium (based on bond yields) for the country stood at 5.2%, compared to 3.2% at the end of December 2019. This is indicative of the uncertainty investors feel about South Africa's future economic growth path, and it has an impact on the interest rate we pay for borrowing money.

The path forward

USD$7 billion will be borrowed from the World Bank, the IMF and the New and African Development Banks at low interest rates (the New Development Bank is also informally referred to as the BRICS Bank). That means R260 billion will have to be borrowed on the open market at an interest rate of around 11%. Treasury did a scenario plan between a passive road where we just continue down this debt spiral and an active road where we start making difficult decisions. Continuing on the debt spiral path is not an option, and therefore we will have to make drastic changes. Cabinet is planning to have a zero deficit in its Budget by 2024.This will require government expenditure to be slashed by R230 billion over the next two years and additional taxes of R40 billion to be raised. It will also require that the role of state-owned enterprises (SOEs) like Eskom is reduced in the economy.

Future taxes

SARS Commissioner Edward Kieswetter has indicated that he believes we have reached an inflection point on tax rates and that it isn't possible to increase them any further. Instead, SARS will focus on four specific areas to improve tax compliance. These are international taxes, organised crime, the use of third-party data to verify tax returns and the collection of taxes owed.

The public wage bill and the Rule of Law

South Africa is not yet in sovereign debt crisis territory, but if our debt burden is not urgently brought under control, this may become unavoidable. The Supplementary Budget has indicated that as a country we are serious about bringing our debt burden under control, but it did not provide a lot of detail on how this will be achieved. Public wages more than tripled over the past 12 years and now account for 35.4% of consolidated national expenditure, 40% more than the world average. Interest on debt and public wages as a percentage of government revenue highlights the problem. Currently Government spends 79.8 cents of every rand earned on wages and interest, with little left for infrastructure or other projects. Any potential solution must address both these issues. In addition, it must become clear that there are consequences for those who played a part in state capture and corruption.

Summary provided by Ronald King, Head of Public Policy and Regulatory Affairs at PSG.

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