

AFRICA RISK CONSULTING

Country briefing – South Africa

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1 Summary

Finance minister Nhlanhla Nene delivers his first Medium Term Budget Policy Statement which promises fiscal consolidation measures. He promises to cut expenditure by \$2.3 billion, collect an extra \$2.4 billion in tax revenues, and only fund state-owned enterprises out of sales of their non-strategic assets. This calms the markets and ratings agencies but sets the administration of president Jacob Zuma (2009 - present) on a collision course with the unions over the public sector wage bill. The National Union of Metalworkers of South Africa (Numsa) are fighting to stay in the Congress of South African Trade Unions (COSATU), showing the power of the tripartite alliance is alive and well. Major business deals taking place in October show hope for the future of the South African economy but a series of poor governance scandals underline the ongoing risks of investment. Public protector Thuli Madonsela wins an international award for her work against corruption but the Zuma administration places her under increasing pressure at home.

1.1 Austerity ahead as Nene outlines cuts to government spending

Finance minister **Nhlanhla Nene** presented his maiden Medium Term Budget Policy Statement (MTBPS) on 22 October. Nene outlined a programme of fiscal consolidation to improve the country's macroeconomic stability through investment led growth.¹ Nene made it clear that fiscal consolidation cannot wait. In September he revised the growth forecast for this year down to 1.4%, from the 2.7% in the February budget but in the October policy statement said that the long term outlook was for growth to reach 3% by 2017 if fiscal consolidation was implemented.²

¹ MTBPS transcript, 22 Oct 2014

² MTBPS transcript, 22 Oct 2014

“Nene is absolutely right to point out that South Africa needs more cash in hand. Loan redemptions are set to rise from R33 billion [\$3 billion] to R88 billion [\$8.1 billion] in the next three years and the government needs to be able to make good on what it has borrowed.”³

To bridge that gap Nene outlined three actions the government will take:

- The government will lower its expenditure ceiling by R25 billion (\$2.3 billion) over the next two years. This will keep to the planned reduction of the budget deficit from 4.1% of GDP in 2014 to 2.5% by 2017.⁴ It plans to cut public sector wage growth and non-essential services such as conferences and travel.⁵
- The government will also introduce tax proposals in the February 2015 Budget to generate additional revenue of at least R27 billion (\$2.4 billion) over the next two years.⁶ Nene said that he expects tax revenue to fall just over R10 billion (\$913m) short in the current year and, if action is not taken, this is due to rise to R51 billion (\$4.6 billion) by 2017.⁷
- The finance ministry will now require state-owned enterprises (SOEs) to submit detailed business plans in order to secure funding and will expect them to raise money through sales of non-strategic assets not through tax revenues or government borrowing, making them “*deficit neutral*”.⁸ Nene also promised that a bail-out for state-owned electricity utility **Eskom** would not affect government borrowing.⁹

The MTBPS is the mid-year update to the February budget from the finance ministry that outlines the government’s medium term fiscal plans. It sets the groundwork and tone for the February 2015 budget that will contain the meat of the proposed changes. Details on what Nene and his team are planning will not be released until then.

The markets reacted positively to the budget with the rand rallying from 11.04 to the **United States (US)** dollar on 21 October to 10.94 to the dollar on 23 October. The rand has been rising against the dollar from 11.26 on 1 October to 10.91 on 27 October.¹⁰ Financial ratings agency **Standard and Poor’s (S&P)** hinted that the move would save the South African economy from a ‘junk’ rating below its current BBB- level.¹¹

³ Source: financial journalist, Johannesburg

⁴ MTBPS transcript, 22 Oct 2014

⁵ Bloomberg, 23 Oct 2014

⁶ MTBPS transcript, 22 Oct 2014

⁷ Mail and Guardian, 22 Oct 2014

⁸ Business Day, 22 Oct 2014

⁹ Bloomberg, 23 Oct 2014

¹⁰ XE.com

¹¹ Bloomberg, 27 Oct 2014

Business leaders in South Africa have also responded positively to Nene's statement:

*"It is a step in the right direction, it should protect the sovereign rate and the credit ratings...the business environment will be better for it. Our only concern is how tax revenue might be raised."*¹²

The statement had the full backing of the South African cabinet, with local media reporting that there was not significant internal disagreement over the proposed spending cuts.¹³ However while the departments may have signed up to the cuts in principle there is scope for significant tensions when they actually have to make them. Large scale, but non-essential, projects such as the nuclear energy project and increased **South African Defence Force (SADF)** funding are likely targets for cutbacks.¹⁴ However, there will be tougher choices to make. A key area of tension will be the public sector wage bill. Nene said that cuts would have to fund any rise above 6.6% over the next two years and the unions are pushing for a 13% rise over the same time period.¹⁵ There is also a danger that the provincial governments will cut front-line (rather than non-essential) services, something the finance ministry has little control over. Nene's predecessor **Pravin Gordhan**, now the cooperative governance minister, was unable to push through minor spending cuts back in November 2013 (see *ARC South Africa November 2013 Briefing*). Nene will have the benefit of Gordhan as a key ally in convincing provincial governments to cut sensibly but has still to face a test that Gordhan, a highly experienced operator, was unable to pass.

Nene has quietened his critics in the business world with this initial budget, however he will not be popular when the cutbacks begin to affect the lives of South Africans. Nene will have to work with the incoming governor of the **South African Reserve Bank (SARB)**, **Lesetja Kganyago**. While untested in the role, Kganyago is popular with business and is an experienced former treasury official. President **Jacob Zuma** (2009-present) announced his appointment on 10 October after the current governor **Gill Marcus** revealed her intention not to seek reappointment in September.¹⁶ Nene and Kganyago have both been thrown in the deep-end and will need to tread carefully amongst high levels of debt and vested interests in SOEs to steward the economy to fulfil its considerable potential.

¹² Source: managing director, Cape Town

¹³ Business Day, 24 Oct 2014

¹⁴ ISS, 23 Oct 2014

¹⁵ Business Day, 24 Oct 2014

¹⁶ Source: managing director, Cape Town

1.2 NUMSA's rhetorical acrobatics show ANC's continued power

The **National Union of Metalworkers of South Africa (Numsa)** has lashed out at the **Congress of South African Trade Unions (COSATU)** ahead of a vote on 7 November to have its membership suspended over organising workers across sectors. Numsa secretary general **Irvin Jim** publicly asked other COSATU members to back Numsa's continued membership of the alliance and has said that Numsa will fight any expulsion in court.¹⁷ The union is a vocal critic of the tripartite alliance between COSATU, the ruling **African National Congress (ANC)** and the **South African Communist Party (SACP)** and announced in December 2013 that it would create a new **United Front** and workers party to compete in the next general elections.¹⁸ The union has sought to gain traction in COSATU in order to attack the ANC, which it portrays as having abandoned workers in favour of business.¹⁹

Numsa, like fellow rogue union **Associated Mineworkers and Construction Union (AMCU)** and radical party the **Economic Freedom Fighters (EFF)**, continues to dominate headlines. However its high media profile does not equate to influence: if Numsa leaves COSATU it will lose its access and influence to government; the AMCU is vulnerable to the problems of being an established union that has to consistently provide for its members (something that continued record breaking strikes cannot achieve); the EFF only has 5% of the vote and has yet to sway the ANC or Zuma on any significant policy. Numsa and those like it risk being radical voices with little influence. According to local sources there isn't much space in the current electoral marketplace for two leftist parties to take on the ANC so any change the new United Front could bring is limited.²⁰ Numsa's membership may also not want to take the risk of being outside of the governing alliance.

*"It is very likely the Numsa will leave COSATU in November and will have to go it alone... [however] it is not a given that they will take their membership with them, many of whom will be reluctant to disaffiliate from COSATU and the ANC."*²¹

The ANC has sought to negotiate the splits within COSATU through deputy president **Cyril Ramaphosa** but the view of the COSATU leadership, and by implication the ANC, is that Numsa needs to go.²² Numsa and Amcu strikes have cost the South African economy dearly, and with departments signed up in principle to budget cuts next year (see above), the relationship between the party and the unions may get worse before it gets better.²³ Zuma's alienation of ANC chairman and strong union

¹⁷ Business Day, 27 Oct 2014

¹⁸ Business Day, 27 Oct 2014

¹⁹ Business Day, 27 Oct 2014

²⁰ Source: think tank director, Pretoria

²¹ Source: journalist, Johannesburg

²² Business Day, 27 Oct 2014

²³ Source: journalist, Johannesburg

ally **Gwede Mantashe** may drive a further wedge between the two. Local media have reported that Zuma is actively briefing against Mantashe in ANC national executive committee (NEC) meetings because he sees him as backing a rival faction in the 2017 ANC congress.²⁴ Mantashe has objected to intervention in union affairs in the past, including Amcu's five month long platinum strike.²⁵

*"Despite splits within the ANC and the unions the tripartite alliance will remain strong; with the DA growing ground in 2014 and votes on the line the ANC can't afford to lose union support...the trick will be to keep COSATU on board while pulling the economy out of the mud."*²⁶

1.3 Major deals show businesses not afraid to invest...

South Africa has seen a number of large scale business stories over the course of October. Major businesses are clearly happy to invest in South Africa and large South African businesses are themselves doing well:

- Private equity group **Leapfrog Investments** said on 13 October that it had raised \$370m to invest in Africa and **Asia**, \$100m of which is earmarked for South Africa. Leapfrog typically invests in the financial services industry but has not released information on potential targets.²⁷
- **Ashburton Investments**, the asset management arm of South African bank **FirstRand**, announced on 8 October that it will raise \$500m from **Swiss** private banks and a range of other investors for an Africa-focused property fund.²⁸
- South African insurance and wealth management giant **Old Mutual** announced that its wealth arm had acquired investment management company **Quilter Cheviot** for \$941m bringing its total managed funds to \$147 billion.²⁹

There is further investment on the horizon. President Zuma announced plans on 15 October to drill 30 offshore oil and gas exploration wells over the next decade. The government estimates that there is potential production of 300,000 barrels per day from the fields.³⁰ Increased investment is what South Africa needs to get the economy back on track. However, the government needs to ensure that the country benefits from the money that passes through and promotes a safe business environment so that more investors follow suit.

²⁴ Mail and Guardian, 24 Oct 2014

²⁵ Mail and Guardian, 24 Oct 2014

²⁶ Source: think tank director, Pretoria

²⁷ Business Day 13 Oct 2014

²⁸ Business Day, 8 Oct 2014

²⁹ Business Day, 17 Oct 2014

³⁰ Business Day, 15 Oct 2014

1.4 but operating dangers remain

Operating in the South African market remains risky due to poor corporate governance. Both private and public enterprises are exposed to political interference and corruption, potentially damaging the value of investments in the country.

Black economic empowerment (BEE) investment company **Hosken Consolidated Investments (HCI)** has suspended CEO **Marcel Golding**. The actions followed an investigation into allegations of gross misconduct and political interference in the running of the **e.tv** station.³¹ HCI is a shareholder in e.tv through its subsidiary **Sabido Investments**. The company accused Golding of purchasing R24m (\$2.1m) shares in tv set-top box distributor **Ellies**, which broadcasts e.tv, without permission. Golding hit back saying that he was being pushed out of the company for trying to preserve e.tv's editorial independence. He has accused the **South African Clothing and Textile Workers' Union (Sactwu)**, which owns 32% of HCI, and development minister **Ebrahim Patel**, former secretary general of Sactwu, of influencing coverage of major South African infrastructure projects.³² Golding released emails between **Bronwyn Keene-Young** the CEO of e.tv and Golding's wife, HCI co-founder **Johnny Copelyn** and HCI director **Yunis Shaik** which show the station had a "*special arrangement*" with Patel to give positive coverage of infrastructure projects.³³ Media coverage has also speculated that the resignation of HCI non-executive director and former cabinet member **Barbara Hogan** is linked to these allegations.³⁴

Yunis Shaik has strong family connections to Zuma's political clique along with his brothers. **Schabir Shaik** was Jacob Zuma's former financial adviser and is currently serving a 15-year prison sentence for corruption linked to corrupt government deals with arms companies. **Moe Shaik** was the head of the **South African Secret Service** from 2009-2012 and is a key Zuma ally.³⁵ It could be that pushing Golding out of HCI is a move to preserve the influence of Zuma and his allies in the media.³⁶

Investors may become more cautious when choosing investment partners. South African services and distribution company **Bidvest Group** has pulled out of acquiring 100% of freight operator **Grindrod Financial Holdings (Grindrod Bank)**. Bidvest cited concerns over negative publicity coverage of a 2012 contract cancellation with the **South African Social Security Agency**.³⁷ The group said that

³¹ Mail and Guardian, 22 Oct 2014

³² Business Day, 28 Oct 2014

³³ Business Day, 28 Oct 2014

³⁴ Business Day, 28 Oct 2014

³⁵ Mail and Guardian, 10 Feb 2009.

³⁶ Senior political source, South Africa

³⁷ Business Day, 15 Oct 2014

their concerns were reputational as they were unwilling to take on the negative press resulting from the contract cancellation.³⁸

1.5 Public protector praised internationally but faces opposition at home

Public protector **Thuli Madonsela** is an increasingly divisive figure in South Africa but has gained international recognition for her fight against corruption. Madonsela's office has a constitutional mandate to call public officials and organisations to account over corrupt practices. It deals with tens of thousands of complaints a year and tackles high profile cases.³⁹

Berlin-based anti-corruption watchdog and think-tank **Transparency International (TI)** has awarded its **Integrity Award 2014** to Madonsela.⁴⁰ She was given the award in recognition of her ongoing fight to call the corrupt to account despite operating under intense political pressure and media scrutiny.⁴¹

In March 2014 Madonsela called for Jacob Zuma to pay back a reasonable proportion of the \$23m spent on upgrades to his **Nkandla** residence (see *ARC South Africa August 2014 Briefing*). Her repeated calls for this have led ANC members to call for her resignation – deputy defence minister **Kebby Maphatsoe** accused Madonsela of being unpatriotic and a covert agent of the **Central Intelligence Agency** – and repeated attacks by Zuma himself on the role of her office.⁴²

More recently, a report by Madonsela was responsible for a **Western Cape** high court ruling on 24 October that **South African Broadcasting Company (SABC)** chief operating officer **Hlaudi Motsoeneng** be suspended pending an investigation for raising his own salary, cutting essential personnel and falsifying his qualifications.⁴³ In February Madonsela published a report that outlined these accusations and recommended that Motsoeneng be replaced within 90 days. Despite this, communications minister **Faith Muthambi** promoted Motsoeneng from provisional to permanent COO in July.⁴⁴ The opposition **Democratic Alliance (DA)** brought the case against Motsoeneng following his permanent appointment.

³⁸ Bloomberg, 16 Oct 2014

³⁹ OPP website, 2014

⁴⁰ TI press release, 22 Oct 2014

⁴¹ TI press release, 22 Oct 2014

⁴² Daily Maverick, 15 Sep 2014

⁴³ Mail and Guardian, 28 Oct 2014

⁴⁴ Mail and Guardian, 28 Oct 2014

Part of the problem is that the role of the public protector is broadly defined in the constitution but is not clearly legally defined. The recent high court ruling against Motsoeneng backed Madonsela's report calling for Motsoeneng's suspension. Judge **Ashton Schippers** also ruled that the public protector's recommendations were both not binding on any person or institution and could not be treated simply as recommendations and ignored.⁴⁵ The complexities of this legal position will continue to be discussed as the case moves up to the court of appeal.

The office of the public protector is drastically underfunded, and has a backlog of over 40,000 complaints. The shortage of funds has led to CEO **Themba Mthwethwa** and CFO **Dumisani Dlamini** of the office leaving in September and, according to local media, staff work round the clock to try to meet demand.⁴⁶ Parliament has approved 500 positions for the office, but only 300 have ever been filled due to funding shortages.⁴⁷

*"Part of the problem is that Madonsela's predecessors were less than enthusiastic in carrying out their duties... the courts practically had to order **Lawrence Mushwana** to investigate. Madonsela is a victim of her own success."*⁴⁸

The more that Madonsela tries to take on corruption at the highest levels of state, the less likely she is to receive the funding needed to clear the immense backlog of cases. However, as the TI award makes clear, her efforts in fighting corruption have drawn international attention and she is unlikely to back down. Madonsela will therefore face increased opposition from the Zuma administration, which has consistently sought to undermine her office, and all others charged with holding public officials to account.

*"The struggle between Zuma and Madonsela is a clash between two visions of South Africa, one governed by big man syndrome and the other by the rule of law and the constitution.... currently it is not clear who will win."*⁴⁹

2 Implications

The markets and businesses should welcome Nene's provisional budget as a sign that he is following in the footsteps of his predecessor, Pravin Gordhan, and trying to get the economy back on track. The markets have picked up and optimism about the statement will bring its own reward of increased investor confidence. The language around the statement has been very carefully managed, nowhere is

⁴⁵ Business Day, 28 Oct 2014

⁴⁶ News 24, 9 Sep 2014

⁴⁷ Business Day, 28 Oct 2014

⁴⁸ Source: journalist, Johannesburg

⁴⁹ Source: journalist, Johannesburg

'austerity' mentioned, but the promises made in October will have to transform into some hardship in February. The important question now is whether Nene, who appears to have united the cabinet behind his current plan, will be able to negotiate cuts and tax rises that are effective and sensible next year.

A sensible fiscal plan lays the groundwork for increased investment, as was seen throughout October, and may encourage large players to invest in the extractive industries and South African state-owned enterprises. The continuing governance failures that plague the corporate and political worlds put this at risk. The scandals at HCI and e.tv demonstrate that if companies want to do business in South Africa they need to conduct thorough and effective due diligence to avoid damaging reputational problems further down the line. More broadly, the awareness of widespread corruption in South Africa, and the struggle of those like Thuli Madonsela who seek to combat it, is another deterrent to foreign investment.

The aftermath of the decision in November over whether or not to expel Numsa from COSATU may serve as a good example of the power that the ANC and its allies in the tripartite alliance still hold within the country. However this will be tested when it comes to the cutting of the public sector wage bill either through pay freezes, hiring freezes and natural wastage or both. The politicking in the run-up to the 2017 ANC congress will also bring more established factions in the ANC and COSATU into conflict, as evidenced by the current struggle between Zuma and Manteshe. The whole debacle should also serve as a reminder that the most vocal voices are not the most powerful opposition. It has been the DA, not the EFF or the unions, which has brought Zuma closer to a trial for corruption and forced the government appointed COO of the SABC to step down. However, if the unions ever mobilise against the ANC, they would pose a serious political challenge.