

## AFRICA RISK CONSULTING

### South Africa Monthly Briefing October 2016

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#### South Africa Summary 14 October 2016

*The National Prosecuting Authority (NPA) charges finance minister Pravin Gordhan with fraud over his awarding a pension bonus to former South African Revenue Service (SARS) director Ivan Pillay. Gordhan and his allies accuse president Jacob Zuma (2009-present) of orchestrating the charges as a pretext to remove the finance minister from office. The news leads to an immediate 5% drop in the value of the rand and wipes \$3.4 billion from the value of the Johannesburg Stock Exchange (JSE). Former political leaders, including former finance minister Trevor Manuel, believe that if Gordhan goes, a debt downgrade is inevitable. Students protest at campuses across the country over a government decision to increase fees by 7% in 2017. The protests, ongoing for three weeks, are orchestrated by a small and increasingly violent group demanding universal free higher education. Zuma convenes a task force to address the protests, which includes the justice, police, state security and defence ministers but excludes the finance ministry.*

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#### NPA charges Gordhan with fraud....

The **National Prosecuting Authority (NPA)** formally charged finance minister **Pravin Gordhan** on 11 October with fraud over his awarding a pension bonus to former **South African Revenue Service (SARS)** director **Ivan Pillay**.<sup>1</sup> Observers in **South Africa** regard the move as a calculated political attack by president **Jacob Zuma** (2009-present) and a pretext to remove Gordhan from office. Political allies of Gordhan within the ruling **African National Congress (ANC)**, including chief whip **Jackson Mthembu** and **Gauteng Province** premier **David Makhura**, spoke out against the charges.<sup>2</sup> Ruling revolutionary alliance partner, the **South African Communist Party (SACP)**, also condemned the charges as political interference.<sup>3</sup> Sources within the ANC say that those not in Zuma's immediate camp are concerned at the aggressive political move:

*"Zuma and his clique are throwing caution to the wind, desperate that they are going to lose control of the country...they could not care less about any of the wider consequences."*<sup>4</sup>

**National Director of Public Prosecutions (NDPP) Shaun Abrahams**, whom Zuma appointed from relative obscurity in 2015, announced that he would be prosecuting Gordhan, Pillay and former SARS commissioner **Oupa Magashula**.<sup>5</sup> They will appear in a **Pretoria** magistrates court on 2 November. The charges relate to Magashula paying Pillay a R1.1m (\$79,300) pension after his dismissal from SARS in 2010, when Gordhan was finance minister, *"without following correct procedures"*.<sup>6</sup> Court papers leaked to the media show the NPA accuses Gordhan of giving Pillay an early retirement package and new contract *"unlawfully, falsely and with intent to defraud"*<sup>7</sup> as SARS was under no obligation to do so.<sup>8</sup> Abrahams admitted in June that the charges against Gordhan are weak – the

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<sup>1</sup> Business Day, 11 Oct 2016.

<sup>2</sup> Business Day, 11 Oct 2016.

<sup>3</sup> Business Day, 11 Oct 2016.

<sup>4</sup> Source, ANC insider, Johannesburg

<sup>5</sup> Daily Maverick, 11 Oct 2016.

<sup>6</sup> Daily Maverick, 11 Oct 2016.

<sup>7</sup> Reuters, 14 Oct 2016.

<sup>8</sup> Reuters, 14 Oct 2016.

pension was not Gordhan's direct responsibility, the decision did not breach any regulations or laws, and Gordhan did not gain financially from the decision.<sup>9</sup> According to a senior legal expert:

*"I am relieved that I will not be the prosecutor tasked with securing a conviction – [the chances of this are] highly unlikely. [It] raises questions about whether the NPA truly believes that it will be able to secure a conviction in the case."<sup>10</sup>*

Abrahams and the NPA have been trying to charge Gordhan over the so-called 'rogue unit' that Gordhan set up within SARS when he was commissioner in 2008 (see *ARC Briefing South Africa May 2016*). However, they appear unable to find any evidence that Gordhan's actions were illegal as the charges do not relate to the special investigative unit.<sup>11</sup> Gordhan responded to the charges on 12 October. He described them as "entirely without merit" and accused Abrahams and the NPA of being:

*"contaminated for abuse for political ends...where do they get their instructions from and for what purpose?"<sup>12</sup>*

Gordhan has also said that he has no intention of resigning his position, alluding to the presence of others in office with pending charges. Zuma, notably, has 783 charges for fraud and corruption pending a further appeal before the **Supreme Court of Appeal (SCA)** in **Bloemfontein** in January 2017.<sup>13</sup> However, commentators in South Africa believe it is highly likely that Gordhan will be dismissed after the first hearing on 2 November:

*"All Zuma has to do is ride out the media storm, he has already upset everyone he could, the rand is already tanking and he appears to have little regard for our economic future – in his mind he has nothing to lose by firing Pravin [Gordhan]."<sup>14</sup>*

### ... and the rand, JSE, and business suffer

The announcement of the charges against Gordhan had an immediate and sustained impact on the economy. The charges come a few weeks before Gordhan delivers his mid-term budget statement crucial for South Africa to avoid a ratings downgrade on 26 October.<sup>15</sup> Following the announcement the rand fell 5% against the dollar from R13.78/\$ on the morning of 11 October to a low of R14.48/\$ the next day.<sup>16</sup> The currency remained at around R14.30/\$ from 11-14 October and is R14.28/\$ at time of writing.<sup>17</sup> Currency analysts fear that if Gordhan goes, the rand could drop as low as the R15.89/\$ it hit in December 2015, when Zuma fired former finance minister **Nhlanhla Nene**.<sup>18</sup> The decision also hit the **Johannesburg Stock Exchange (JSE)** where the banking index fell by 5.2% on 11 October, removing \$3.5 billion of value from the exchange.<sup>19</sup> Bond yields also rose from 8.685% to 8.935% across the day.<sup>20</sup>

A wide range of business leaders condemned the move as politically motivated and extremely damaging to the economy.<sup>21</sup> The leaders of **Business Unity South Africa (BUSA)**, **South African Chamber of Commerce and Industry (Sacci)**, the **Banking Association of SA (BASA)**, **SA Chamber of Mines (SACM)**, **Black Business Council (BBC)**, and **Business Leadership SA (BLSA)** all released

<sup>9</sup> Daily Maverick, 11 Oct 2016.

<sup>10</sup> Legal expert in Business Day, 14 Oct 2016.

<sup>11</sup> Daily Maverick, 11 Oct 2016.

<sup>12</sup> Gordhan statement, 12 Oct 2016.

<sup>13</sup> Eyewitness News, 12 Oct 2016.

<sup>14</sup> Source, ANC insider, Johannesburg

<sup>15</sup> Treasury press release, 10 Oct 2016.

<sup>16</sup> XE.com

<sup>17</sup> XE.com

<sup>18</sup> Source, economic journalist, Johannesburg

<sup>19</sup> Business Day, 11 Oct 2016.

<sup>20</sup> Business Day, 11 Oct 2016.

<sup>21</sup> Business Day, 11 Oct 2016.

statements condemning the charges and calling on Zuma to keep Gordhan as finance minister.<sup>22</sup> According to a leader of one of the business councils:

*"We are begging the presidency not to undo all of the work of businesses to try and grow the economy of the last year...firing Gordhan will lead to currency deflation, increased cost of debt and the consequent failure of business and rise in unemployment. We know that the ANC will turn around and blame us (businesses) for this but really it is all on Zuma. He is responsible for thousands of potential job losses."*<sup>23</sup>

Many senior economic figures are worried that the charges against Gordhan alone are enough to trigger a downgrade of sovereign debt ratings by the end of the year.<sup>24</sup> Ratings' agency **Standard & Poor's (S&P)** warned South Africa in September that it viewed the political situation as the largest factor in any future downgrade (see *ARC Briefing South Africa September 2016*). Former finance minister **Trevor Manuel** warned that Zuma's sustained attack on constitutional democracy meant that ratings agencies will have already made up their minds to downgrade:

*"We can hope and try to persuade them [the ratings agencies] when they come, but in many respects, my sense [is that] the die is cast."*<sup>25</sup>

Business confidence is already at its lowest since 1985, according to Sacci's annual business confidence index (BCI) of 5 October.<sup>26</sup> The BCI lost 2.6 index points to fall to 90.3 in September, the worst index reading for 2016 and the lowest for 31 years; it is 4.1 points below that recorded in September 2015, the previous 20-year low.<sup>27</sup> The index is not a direct reflection of the political situation. SACCI compiles it based on 13 economic indicators.<sup>28</sup> These include energy supply, manufacturing, construction of buildings, share prices, real private-sector borrowing, precious metal prices, and the rand exchange rate.<sup>29</sup> The current low is driven by large decreases in the value of building plans passed, the price of platinum and gold in **United States (US)** dollars, low manufacturing output and falling share prices on the JSE.<sup>30</sup>

### Student protests close university campuses

Students have held violent protests at campuses after higher education minister **Blade Nzimande** announced fee increases. Protests started in late September and have continued across October, devolving into increasingly acrimonious confrontations with police and security staff. Student **#feesmustfall** protests led to a major government policy reversal in 2015. Nzimande suggested that universities needed to be able to set their own fee increases due to constrained budgets. He capped these at 8% per year, and said that students from poorer backgrounds would have no fee increases at all.<sup>31</sup> However, students protested at campuses across the country, starting at the **University of the Witwatersrand (Wits)** in **Johannesburg** and the **University of Cape Town (UCT)**.<sup>32</sup> Police attempted to violently disperse the protests on 22 September, however they have spread to over 30 campuses across the country.<sup>33</sup> Protesters demand free education for all in order to correct the historical inequalities perpetuated by the apartheid regime.<sup>34</sup> However, the three weeks of protests

<sup>22</sup> Business Day, 12 Oct 2016.

<sup>23</sup> Source, senior business leader, Johannesburg

<sup>24</sup> Business Day, 14 Oct 2016.

<sup>25</sup> Manuel in Business Day, 14 Oct 2016.

<sup>26</sup> Business Day, 5 Oct 2016.

<sup>27</sup> Business Day, 5 Oct 2016.

<sup>28</sup> SACCI statement, 5 Oct 2016.

<sup>29</sup> SACCI statement, 5 Oct 2016.

<sup>30</sup> SACCI statement, 5 Oct 2016.

<sup>31</sup> Daily Maverick, 22 Sep 2016.

<sup>32</sup> Daily Maverick, 22 Sep 2016.

<sup>33</sup> Daily Maverick, 28 Sep 2016.

<sup>34</sup> Daily Maverick, 28 Sep 2016.

risk tens of thousands of students having to repeat an academic year, at their own cost, as they are unable to attend classes.<sup>35</sup>

Protests have attracted hundreds of students and have led to clashes with police involving petrol bombs and rubber bullets, as well as the burning down of buildings on a number of campuses. Many universities have shut down for the safety of staff and the greater student body. In the period of 10-14 October:

- Police arrested 36 students during violent clashes at the **University of Fort Hare** in the **Eastern Cape**;
- A security guard died at the **Cape Peninsula University of Technology** after protesters allegedly locked him in in a burning building at its **Bellville** campus;
- Security guards found three petrol bombs on the Wits campus and members of the clergy formed a barrier between police and protesters in an effort to stop the ongoing violence;
- Protesters set two buildings on fire at the **Pietermaritzburg** campus of the **University of KwaZulu-Natal (UKZN)**;
- Protesting students shut down the main campus of the **Tshwane University of Technology** in capital Pretoria; and
- Police arrested nine students for violent behaviour at **Sefako Makgatho Health Sciences University** in Pretoria.<sup>36</sup>

The **South African Students Congress (Sasco)** in Gauteng on 11 October called for a complete shutdown of all campuses in the province.<sup>37</sup> The province is at the centre of the violence that has also seen the **South African Police Service (SAPS)** use increasingly heavy-handed tactics against protesters.<sup>38</sup> This includes the use of rubber bullets, tear gas, and the beating of protesters with batons.<sup>39</sup> The protests are largely peaceful at the time of writing, and involve a minority of the student body – far less than the protests over fee rises in October 2015. University vice-chancellors have been in talks with the leaders of various #feesmustfall movements in campuses for the last three weeks.<sup>40</sup> However, negotiations repeatedly fall through due to the protesters' insistence that the government make university education free for all.<sup>41</sup> Many sources in South Africa fear that negotiations are unable to end the protests:

*"[In] at least two universities hours of negotiations, in which huge concessions were made by the universities, ended in protesters demanding a total shutdown. Given this, the future of higher education depends now on universities opening and staying open while the law and the constitution are used to protect the university community from violence."<sup>42</sup>*

The government appears to be moving in this direction. Zuma established a higher education task force on 12 October involving the ministers of the presidency, higher education, home affairs and science and technology.<sup>43</sup> The majority of the task force is the so-called 'security cluster' for justice, police, state security and defence.<sup>44</sup> The finance minister, who has the ability to alter the higher education budget, is not part of the task force.<sup>45</sup>

*"The students believe that if they push hard and long enough, the government will be able to magically create free university education for all...however, this task force shows that Zuma is*

<sup>35</sup> Rand Daily Mail, 14 Oct 2016.

<sup>36</sup> Business Day, 12 Oct 2016.

<sup>37</sup> Business Day, 12 Oct 2016.

<sup>38</sup> Business Day, 12 Oct 2016.

<sup>39</sup> Business Day, 12 Oct 2016.

<sup>40</sup> Rand Daily Mail, 14 Oct 2016.

<sup>41</sup> Rand Daily Mail, 14 Oct 2016.

<sup>42</sup> Mail and Guardian, 13 Oct 2016.

<sup>43</sup> EYN, 12 Oct 2016.

<sup>44</sup> EYN, 12 Oct 2016.

<sup>45</sup> EYN, 12 Oct 2016.

*gearing up for war. What business does the defence minister have in a task force about student fees?"<sup>46</sup>*

## Implications

Zuma is behind the NPA's move against Gordhan. There may be some questions as to how directly he influenced the charges, but it is a move by the president to keep his faction of the ANC in power. Gordhan has a series of ANC elder figures lined up to defend him but Zuma and his allies still control the country – it is likely that Gordhan will go, to be replaced by someone more loyal to Zuma. Gordhan's best shot at staying will be a quick rebuttal of the charges through the courts.

The timing of the announcement is political. It draws attention away from the ongoing student protests and the news that Zuma's own major criminal charges are back in court. Unlike in October 2015, when the ANC and business leaders were able to persuade the president to back down in the face of market fury, it will take more to reverse this decision. Zuma has worked out that he can basically do what he wants and there will be no immediate consequences. He can use the time while cases move from court to court to ensure that his position becomes stronger. It will take a major and overt political move against him to change course. However, with Gordhan facing criminal charges even Zuma's enemies in the ANC will be unwilling to go all out to back him. They appear to be waiting for the 2017 *legkotla* to make their move.

While the economy appears to be of little concern to the president, the potential fallout from Gordhan's removal is significant. The currency markets, which increasingly play the role of opposition activists in South African politics, are already pushing the rand down against the dollar. This leads to the increase in import costs at a time when major export commodities – notably platinum, coal and steel – have low value. It may also drive up inflation. A ratings downgrade seems likely if Gordhan goes – he had returned from a trip to visit S&P in the US to intercede for more time when the NPA made the announcement. S&P made clear in its statement in September that it considered stability in the finance ministry is crucial to not downgrading debt to junk status. Increasing the cost of debt and decreasing foreign investment even further will hit both private enterprise and the public purse. This is before any of the impact of the kind of policy a pro-Zuma finance minister might enact, which is likely to involve putting greater strain on the private sector to prop up ailing state and state-owned enterprise finances. South Africa has proved over the past seven years that it has a highly resilient economy – with many businesses riding out low growth and a wildly fluctuating currency. This will be put to the test once more.

The struggle on campuses for free education is symptomatic of Zuma-era South Africa. Poor economic performance has driven down higher education budgets, leading to universities needing to increase fees to remain solvent. The ANC has repeatedly promised a brighter future for South Africans including higher education – but is currently unable to deliver that leading to widespread dissatisfaction. The unwillingness of the protesters to compromise also echoes the disregard of Zuma and his allies for compromise and due process – when the president can defy an order from the Constitutional Court, anything is possible, so long as you don't obey the rules. Zuma's gathering of his security cluster in a task force presents a worrying end scenario for the protests. The government consulting the army on how to handle students at its top educational institutions echoes the state violence of the apartheid era and, another Zuma-era tragedy, the **Marikana** massacre.

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<sup>46</sup> Source, economic journalist, South Africa

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