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CAN THE NEW SOUTH AFRICAN FINANCE MINISTER'S MID TERM AND ACTUAL BUDGET SAVE SOUTH AFRICA FROM ITS ECONOMIC WOES

Anis Mahomed Karodia (PhD)

akarodia@regent.ac.za
Professor, Senior Academic and Researcher, Regent Business School, Durban, Republic of South Africa

Paresh Soni

Paresh.Soni@mancosa.co.za
Institutional Researcher, Management College of Southern Africa (Mancosa), Durban, Republic of South Africa

Stanton Thomas

researchadmin@regent.ac.za
Research Administrator and MBA Student,
Regent Business School, Durban, Republic of South Africa

ABSTRACT

The paper attempts to analyze the mid – term budget of the new Finance Minister of the Republic of South Africa. The new Finance Minister has to walk a very tight rope in balancing the economic crisis that confronts the Republic, on the basis that government debt has escalated and is reaching proportions that might not be manageable in both the short, medium, and long term. This is further exacerbated by endemic corruption and a government that is out of tune with the economic realities of the country. Can the public sector splurge be halted? On the other hand there is a misplaced trust in the faith of foreign investors. South Africa exemplifies the issue of increased taxes upon the citizens of the country, while all else in the public sector fails. In reality the financial crisis in South Africa is a tight squeeze in terms of balancing the budget and the treasury faces tough choices on tax increases. It was a band aid budget and therefore the markets will wait to see if the Finance Minister can really pull it off in terms of dealing with the vexing financial issues that confront the country, including the necessity of the privatization of parastatals that show no appetite for the developmental agenda of the state. South Africa's economic status has been again downgraded by the rating agencies and South Africans wait with bated breath to see if Standard and Poor and Fitch will do the same. South Africa's economic status is now dangerously near junk status and this does not bode well for the South African economy and the development agenda of the state. The medium – term budget policy statement of the new Minister of Finance has not really brought about confidence within the country. The country will have to wait to see its outcomes in the months that lie ahead. However, against all odds the Finance Minister must be commended for his efforts in wanting to turn the economy around. He cannot do it alone and therefore requires the support of the Cabinet, all politicians and the bureaucracy. The paper examines a host of issues that were tabled by the Minister in his Medium – Term Expenditure Policy statement.

Key Words: Mid – Term; Budget; Economic; Woes; Debt; Corruption; Taxes; Privatization; Parastatals; Policy Statement; Development

RESEARCH METHOD

The authors rely on their own critical analysis of the South African economic situation and therefore, the classical research methodology is not used to unpack the issues raised in this paper. It is in many ways a critical commentary of the financial state of play in the country, which faces a very deepening financial and economic crisis coupled with rampant corruption, poor policy formulation, an inept public service, widening inequality, excessive poverty, massive unemployment that the government has allowed to go out of control, exacerbated by a host of other important economic variables that stymies development and that the country is saddled with the increasing burden of debt on the part of the government. The research method utilized will encompass the critical analysis undertaken by the authors in terms of their observations and the analysis will be strengthened by the use of primary sources of data extracted from newspaper articles published in the popular press.

FINDINGS

The idea of a paper of this nature is to capture the salient issues raised by the Finance Minister in his Medium – Term Budget Policy Statement and to critique his statements from financial, economic and development parameters. Naturally, therefore, the findings will be dispersed throughout the discussion in the paper. It is thus obvious that the paper and the authors will not make any finite findings or conclusions with regards a host of important variables that require an understanding by the reader, in terms of the economic crisis that confronts South Africa. The cardinal issue that the paper raises is that, can the Mid – Term Budget Policy Statement of the Finance Minister deal decisively with the myriad of economic and financial challenges that confront South Africa, after 20 years of democracy. A further issue that the paper exemplifies is the question of whether the country under the present government is sliding into economic morass and financial decay. The paper will therefore, in many ways and, in terms of its finite findings that are made throughout the discussion in the paper, address these issues as best as it can. It is hoped that the paper will in some ways stimulate discussion on many of these important issues.

INTRODUCTION

It is easy to get a round of applause in the South African Parliament, overtly dominated by ruling party Members of Parliament, who dare not criticize the government. If they do so they will do so at their own peril and will bear the ire of the ruling party, which conducts itself as a “dictatorship” and does not tolerate any opposition. The idea in South African parliamentary democracy is simple, just stand up and say what people and the ruling party want to hear no matter that the promises made will eventually be broken. Broken promises by the government of South Africa have become the order of the day since the dawn of democracy in 1994. The public and South African’s at large have been regularly struck by the yawning disconnect between rhetoric and action. The Sunday Times editorial (2014: 6) reports that “on the same day that Nene, the Finance Minister was talking about spreading the “pain” pledging to freeze posts and departmental budgets, slash the squadron of consultants servicing the government and ensure any bailouts for state companies are “deficit neutral,” top officials in the Presidents administration were behaving as if nothing had changed. The very Members of Parliament that clapped politely at the Finance Minister’s musings were quietly hitching another carriage to the ‘gravy’ train. More whip positions are being created in parliament and the President’s own office is swelling at an ever increasing rate according to many African National Congress (ANC) Members of Parliament, and moves are afoot to ‘expand’ parliament by adding new banquet halls and meeting venues.” Minister Nene’s point was that as part of this “pain,” tax rates are likely to go up.

There are two reasons South Africans ought to reject this notion. The first that the private sector is being squeezed to slash jobs and salaries in an economy set to grow only 1.4 percent this year. The Sunday Times editorial (2014:6) states that "the government is acting as if it has an open cheque book to hire anyone it wants, and pay above the bar and norm for them too. Government spending as a percentage of GDP has now rocketed to 45.9 percent, largely because of a bloated and increasingly voracious public service." While the Finance Minister is talking austerity, the labour unions are demanding 15 percent wage increases and he has budgeted for a 6.6 percent increase, and the wide gap between the two does not bode well because South Africa could see further strike action, which will compromise investors and further destroy the economy. The all embracing reality and fact that confronts South Africa is that government officials do not pay attention to Finance Ministers, like they did with the former Finance Ministers Pravin Gordhan and Trevor Manuel in respect to 'tightening belts.' The same fate will meet the current Minister of Finance. Austerity in South Africa concentrates on small issues while the big problems continue unabated. Various newspapers according to the Sunday Times Editorial (2014: 6) indicates that "for the 2012 /2013 financial year, fruitless and wasteful expenditure in government departments came in at a rather stupendous R22 billion."To put this in context, the amount frittered away in one year is the equivalent of what more than half a million South Africans pay in income tax, using the average tax bill of R44 000. It is therefore, little wonder people are resistant to new taxes. The country is sliding to the whim and fancies of politicians and do not understand the concept of austerity and fiscal prudence. There is thus no doubt according to the Sunday Times editorial (2014:6) that "into his second term President Jacob Zuma's presidency is a failure, if only for the fact that he has not done anything of substance. He needs to do one thing and that is to cap the runaway public service salaries," amidst the introduction of other austerity measures that are urgently required to save the country.

A PRESIDENT IN SERIOUS DECLINE AND HAMPERS SOUTH AFRICA'S IMAGE

South African democracy is being shamed by the President of the country. President Jacob Zuma, for most of his presidency, has evaded censure but not ridicule, His inexplicable failure to answer to the country is reflective of a man in the throes of serious decline. The zest with which the ANC is pursuing his exculpation from the Nkandla scandal, which saw about R256 million abused by him and his cronies, is indicative of the protection that many, besides Zuma, require within the organization for their own interests. "Parliament represents the voice of the people, a voice that is being stifled at every turn. All of this is frightening and of concern. A leader of any worth would unabashedly disclaim any possible impropriety with vigour, if he or she was in the right. But, it is obvious that the president cannot reasonably explain what is now a heresy and a tragic assault on South Africa's hard fought freedom" (Ganesh, 2014:6). Every possible loophole to stall or deflect responsibility is relentlessly being pursued to protect the president, much to the detriment of the country, and this has to stop. The president was involved in the Guptagate Scandal, the Arms deal Scandal; the Nkandlagate Scandal, the Spy Tapes Scandal, the Rape Scandal, and a host of other scandals and still remains the leader of the ANC and president of the country. It is indeed a travesty that the diminishing of our democracy is being led by the very people whom the nation once believed would champion it. Cry the beloved country for corrupt revolutionaries who believe that it is their right to lead and not to be questioned. The economy of the country cannot be left in their hands because 'under them the country is not only sliding but decaying.

SOUTH AFRICA'S MISPLACED FAITH IN FOREIGN INVESTORS

The South African government, given its mismanagement of the economy over time, believes that all South Africa needs is foreign investment and South Africans are told that if it gets enough foreign investment, the economy will flourish and there will be jobs for everyone. In fact there is growing evidence to the contrary. It has to be realized by the government that South Africa is not a lucrative option for investment currently because foreigners will in the coming months given the mismanagement of the economy, labour unrest and corruption will wash out South African equity and bond markets in search for more attractive yields elsewhere" (Crotty, 2014: 11). What the government does not realize is the fact that to date most foreign investment here has chased yields in the bond and equity markets, which generally involves little or no commitment to the country and is usually dependent on something South Africa has no control over, such as quantitative easing in the United States. However, even the foreign direct investors, those that invest in hard assets, want something back and increasingly they want it sooner rather than later. In South Africa, for example, Crotty (2014) reports that "foreign direct investment (FDI) isn't always what it's cracked up to be because Moody's has placed Edcon on "review for a downgrade." This is evidence that a once powerful South African retail institution has been brought to its knees. The question is by whom? The answer to this categoric, the very foreign investors who are regarded as being just what the country needs. It must be recalled that in 2007, "private equity specialists Bain pumped R25 billion into a deal that saw predominantly South African shareholders sell out and be replaced by mainly foreign bondholders. The deal was underpinned by aggressive forecasts that put Bain and the Edcon executives under considerable pressure to deliver. Several years later it is evident that bond investors, paid out of pre – tax profits, have done very well and the senior Edcon executives have also done well. They were recruited from overseas and particularly their advancement was due to the company's poor performance. It points to poor government control and the fact that the government is unable to control issues of this nature that have a direct negative impact on the South African economy" (Karodia, 2013).

The above scenario in terms of foreign direct investment clearly shows that it is hard to see where South Africa has scored. Thousands of jobs have been lost and, because of the heavy debt funding, billions of rands in taxes have not been paid. And this from a deal that was described by financial pundits, as a demonstration of huge confidence in South Africa by foreign investors. It must be appreciated by the so – called financial pundits, economists and the government of South Africa that Edcons troubles have been exacerbated by Bains arrogance. It has insisted on appointing foreigners, who have no experience of South African retail, to top positions and paying them significantly better than local executives. This is the problem in South Africa when it comes to foreign direct investment because government is impotent in controlling foreigners that wreak havoc in terms of South African business and thus compromise the economy overtly. Local executives would have warned about the possible outcomes of this catastrophic outcome, but it seems that both the government and Bains are not listening to local knowledge. Perhaps it's time to take better care of our own investors, rather than being hoodwinked by foreigners and governments obsession with them and therefore the enticement of foreign investors must be controlled and this obsession in terms of faith in them be broken, in the interests of South Africa's economy and, its development agenda.

PROFITS MUST COME BACK HOME TO AFRICAN COUNTRIES

Global tax reforms must now curb the practice of shifting billions abroad and foreign companies undertaking business in Africa should be made to pay a fair amount of tax where they do business on the African continent. In this regard Lisa Steyn (2014) on the mid – term budget states that "shady business must be dealt a blow and there has to be a crackdown on tax havens because, for example, South Africa loses more than $10 billion a year because of foreign companies which avoid paying the correct amount of tax or which make profits disappear for tax purposes." As the South African fiscal deficit grows wider, it will remain a mystery for the Finance Minister to find the cash to plug the multi – billion – rand gap that the country is confronted with. The idea is not to increase individual tax, but closing the long – standing loopholes to stop tax avoidance by multinationals. Tax reforms in a worldwide move is now aimed to tighten tax regulation as proposed by the G20 nations by addressing the profit shifting by large multinationals and tax base erosion that is believed to be costing significant amounts in lost revenues especially in developing economies. Lisa Steyn (2014: 8) indicates that "tax base erosion and profit shifting, according to the South African Revenue Service (SARS), are tax planning strategies that exploit gaps and mismatches in tax rules to make profits "disappear" for tax purposes or to shift profits to locations where the taxes are low and results in little or no corporate tax being paid. It is not illegal but not ethical.

A December 2013 research report by non – profit organization Global Financial Integrity (In Lisa Steyn, 2014: 8) indicates that "the cumulative illicit financial outflows from the top 15 developing economies between 2002 and 2011, the report states that South Africa, lost about $100.7 billion over that period – an average of more than $10 billion a year." It can thus be extrapolated that this unacceptable base erosion and profit – shifting practices results in significant and ongoing erosion of the South African tax base, across numerous sectors of industry. If these matters were left unattended, the sovereignty of the South African fiscus will be under immense threat and obviously sovereign fiscal independence will be very seriously compromised. This is exemplified by the reality that South Africa's fiscal deficit is expected to reach 4.1 percent according to the Finance Minister, as indicated in his mid – term policy statement. This is not unique to South Africa in terms of tax avoidance and is a worldwide phenomenon used by multinational corporations. It is therefore obvious that an overhaul of the global tax regime is long overdue and there has to therefore be a single set of tax rules to address tax erosion and profit shifting.

According to Lisa Steyn (2014: 8) "Africa is believed to be one of the biggest losers when it comes to base erosion and profit shifting and that wasteful incentives are the most prevalent and costly drivers of tax erosion with an estimated net drain on resources to the value of between $1.2 trillion and $1.3 trillion." Given this scenario, the Finance Minister, The Treasury, the South African Revenue Services, the Reserve Bank and other financial institutions must now pay attention to these issues, in order to save the South African economy. Capital inflows and outflows must be studied by the country, including customs duties for imports and exports and included in this must be an evaluation of cross – border transactions. Phenomenal amounts of money can be saved and brought in to deal with the economic crisis confronting South Africa and could ease the intervention strategies of the Finance Minister.

PLACING THE MID – TERM POLICY STATEMENT AND BUDGET IN PERSPECTIVE

The mini – budget or in reality the mid – term policy statements by the Minister of Finance of South Africa is perhaps what the economy needs but the cardinal issue that arises, which is the question of compliance. It can therefore be confidently asserted that Finance Minister Nhlanhla Nene's first budget, although not quite in the realm of austerity, is one of the most severe the country has seen since the dawn of South African democracy in April of 1994. The policy statement is indeed brave, but according to analysts as reflected by Donnelley (2014: 1) "it is feared that the Finance Minister would not be up to delivering the harsh medicine that many believe the country needs to avoid credit ratings downgrades, in order to address the country's toxic mix of rising government debt and a steadily widening budget deficit in the face of falling tax revenue and an acute and chronic anemic economic growth." What the Minister announced in terms of the adjustment budget, will impose larger spending cuts on the government, reducing its expenditure ceiling by R25 billion in the next two years. It might be impossible to freeze government wage increases given the toxic labour union demands and the history of strikes. The issue of 6.6 percent increases of public salary wages over the next three years will be well nigh impossible and, a freeze on government personnel headcounts and a review of all budgeted vacancies, is a utopian ideal set by the Finance Minister. This is further exacerbated by the countrywide local elections that will take place in 2015 and government is therefore in a quagmire in terms of appeasing both local and provincial public servants by not upsetting the apple cart because it could compromise its chances of winning the local elections. It has learnt from the decline it experienced from this years national elections and would not want to bear the brunt of rejection by an electorate that has historically placed its confidence in the ruling ANC government.

Wage compensation still makes up the largest share of current spending. In 2014 / 2015, it is expected to make up 40.3 percent of total current spending, marginally lower than the 40.5 percent in 2013 /2014. There is a distinct possibility that the proposals will pitch him against the public sector unions, which have floated demands for increases far above the inflation rate and hovers between 15 to 20 percent, even before the start of formal wage negotiations next year. Nene has also introduced a policy shift for the funding of state – owned entities, a number of which are in perennial financial crisis and, it is constantly draining the fiscus. Donnelley (2014: 1) states that "the R20 billion announced to prop up Eskom (The Electricity Supply Commission) is going to be sourced from the sale of noncore state assets, although the treasury provided no details about what the state will sell. He was loath to use the word privatization for fear of confrontation with the labour unions. A clear indication that he does not have the support of the government and, as things stand his announcement is more pie in the sky because of the power that unions wield in the body politic of South Africa. The Minister did not also articulate and distinguish commercial activities from development mandates and tougher financial reporting requirements will not come to fruition, given the history and poor track record of government in this regard. The problem that arises that, in order to fund deficits and support government mandates the taxpayer will be burdened to raise additional revenue to the tune of R44 billion over the next three years. Details of the tax policy changes will only be announced in the main budget next year. These efforts are aimed at reigning in the budget deficit and in this regard Donnelley (2014: 1) indicates that "it is expected to be 4.1 percent of Gross Domestic Product (GDP) this year, a small slip from the 4 percent projected in February, reaching 2.5 percent of GDP for 2014 /2015, from 46.9 percent rising to 49.7 percent in 2016 /2017."

The government in its various statements has acknowledged that some of these measures could have a dampening effect on economic growth in the short term. But according to Donnelley (2014) "the treasury said in the budget policy statement they were essential to sustain investment and revive growth over the longer term. The Minister of Finance has demonstrated a commitment to fiscal consolidation on both the revenue and expenditure side. However, given South African politicians propensities to overspend and their appetites to ignore government imperatives to curb expenditure, the biggest issue that confronts the state, is the issue of compliance by politicians and the bureaucracy. The question therefore arises whether Nene can deliver on his plans and whether there is a broad commitment from within the Cabinet and the President to deliver on a budget that is unpopular. Curbing both the state wage bill and its headcount will require the support of all nine provinces and their willingness to curb expenditure on goods and services and, a failure to achieve this, would have dire consequences on the economy of South Africa. In reality, a purposeful analysis of the financial woes confronting the country indicates that the country faces a fiscal cliff, given the ever increasing percentage of government revenue used to compensate civil servants. Any intervention would be dependent upon governments will to curb the size of the South African civil service.

The disastrous consequences of President Jacob Zuma's poor and costly leadership and the ANCs calamitous policy flops are starting to show. In reality the President has failed to put the interests of the country ahead of his own personal interests. He often chooses cronies ahead of those who can get the job done. He has not shown the leadership required or the management that is so vital, not to mention his ongoing capacity to attract scandal. For the first time since the advent of democracy, a finance minister has had to rope in spending and increase taxes. The new Finance Minister is saddled with a President that has a very poor legacy of leadership, which has been characterized in the incomprehensible changing of ministerial responsibilities and line functions, so much so that in the case of the "Communication's Department, the treasury has been unable to work out a budget for it and, the Small Business Department is also budget – less and the Economic Development Department increasingly appears to manage itself and do little else besides reports the Mail and Guardian Editorial (2014: 36). Nene has done a commendable job in exceedingly tough times, but the lack of political will from the ruling party and the President will frustrate the Finance Minister's efforts.

THE STATE WEIGHS UP ITS FINANCIAL STRATEGIES

There is speculation that the government may be looking to off – load its 39 percent stake in Telkom, with about R10 billion, and other stakes in companies such as Sasol. Foskor and Scaw Metals, held by the Industrial Corporation according to Gedye (2014), who further states that "the state according to its medium – term budget statement, the government is going to liquidate its investment in the South African Special Risk Insurance Association, valued at R75 million, although it is unclear if this move is related to funding for state – owned entities" (Gedye, 2014: 3). It might also sell its stake in Vodacom. The non – strategic assets according to the medium – term policy statement, could include property, direct and indirect shareholdings in listed firms, and non - strategic government shareholdings in state – owned companies and surplus cash balances in public entities. According to Gedye (2014: 3) the Finance Minister said that "bailouts for state – owned entities were over and that other state – owned companies were under scrutiny. In this regard a new framework is envisaged that will distinguish commercial activities from development mandates. Therefore, financial risks need to be addressed to improve governance in terms of the South African Express, the South African Post Office and the Land Bank." According to the budget statement as reported by Gedye (2014: 3) "support will depend on state – owned firms making a sound and sustainable case and strengthening internal governance. By the same token the government will closely monitor Eskom's financial position and, if necessary, could consider providing additional support to the utility by converting its existing subordinated R60 billion loan to equity."

TELECOMS FARCE MOCKS THE FINANCE MINISTERS PLANS

The issue arises as to why the ministry of communication was split into two when President Zuma announced his new Cabinet in May this year? There are ramifications about this decision. It was a frustrating move according to Gedye (2014: 4) "that ignored the trend of convergence in the telecoms and broadcasting industries, and took government policy backwards." There is much confusion because the decision was political, rather than bureaucratic or administrative. Treasury officials have indicated that the budget from the old ministry and department of communication would become the budget for the new ministry and department of telecommunications and postal services. Reacting to the medium – term budget statement, opposition Democratic Alliance (DA) Member of Parliament (MP) Marian Shinn said (In Gedye, 2014) that "R620 million that had been allocated to the Universal Services and Access Fund and Sentech, two organizations that answer to the Department of Telecommunications and Postal services, should resolve this dispute." She further added that "the medium – term budget policy statement reports a figure of R65.7 million for the 2014 national macro organization of the state and therefore, considering the focus of efficiencies in the medium – term budget statement, the confusion surrounding the two ministries and departments is all the more perplexing. The budget review states that the government aims to restructure the way departments and agencies work together to eliminate inefficient resource allocation and overlapping mandates." In reality what is going on is any – ones guess.

IT IS HOPED THAT INFRASTRUCTURE WILL BE THE GOLDEN GOOSE

The finance Minister lays out plans to restore confidence and attract private investment. The figures tabled below show how the medium – term budget hopes to achieve this by trimming South Africa's fat.

Figure 1: State Spending has grown more than revenues

Planned reduction in spending and increase in revenue growth

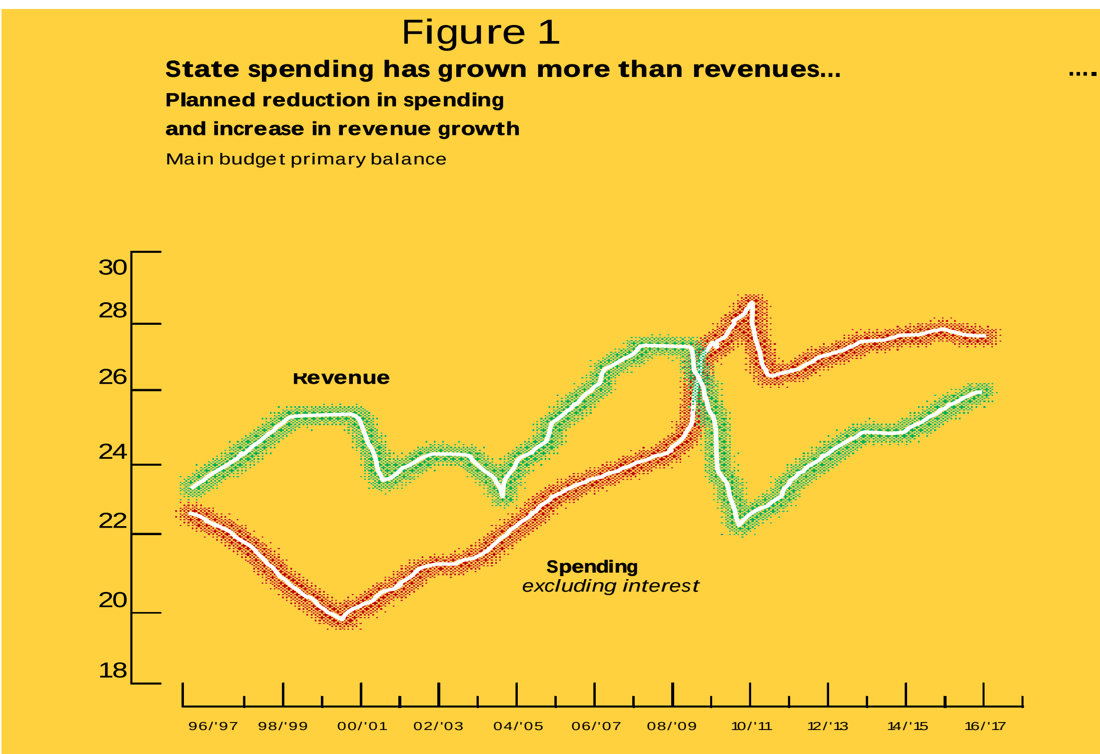

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Figure 2: Expenditure will continue to be restrained Slowdown in main budget spending growth Percent (%) real growth excluding interest – 2003 to 2017

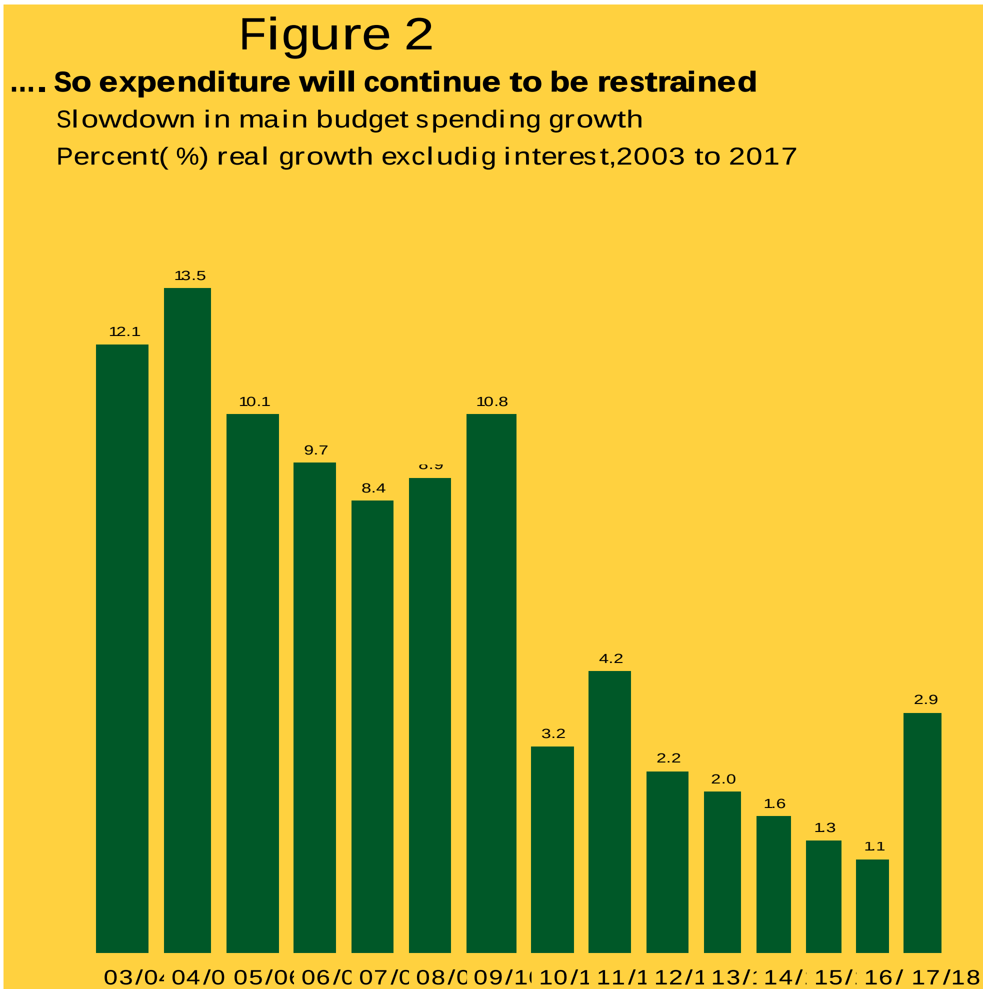
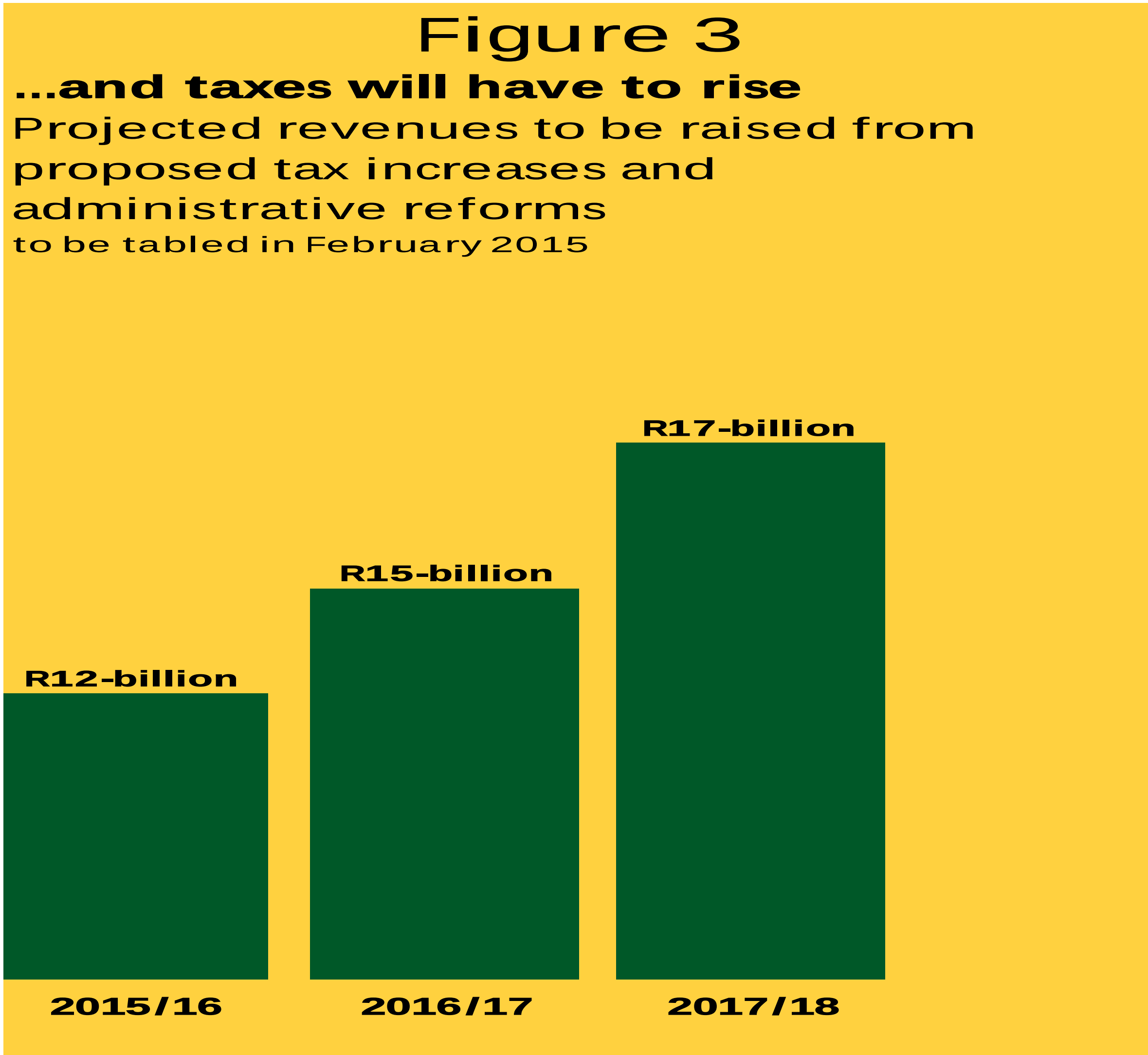


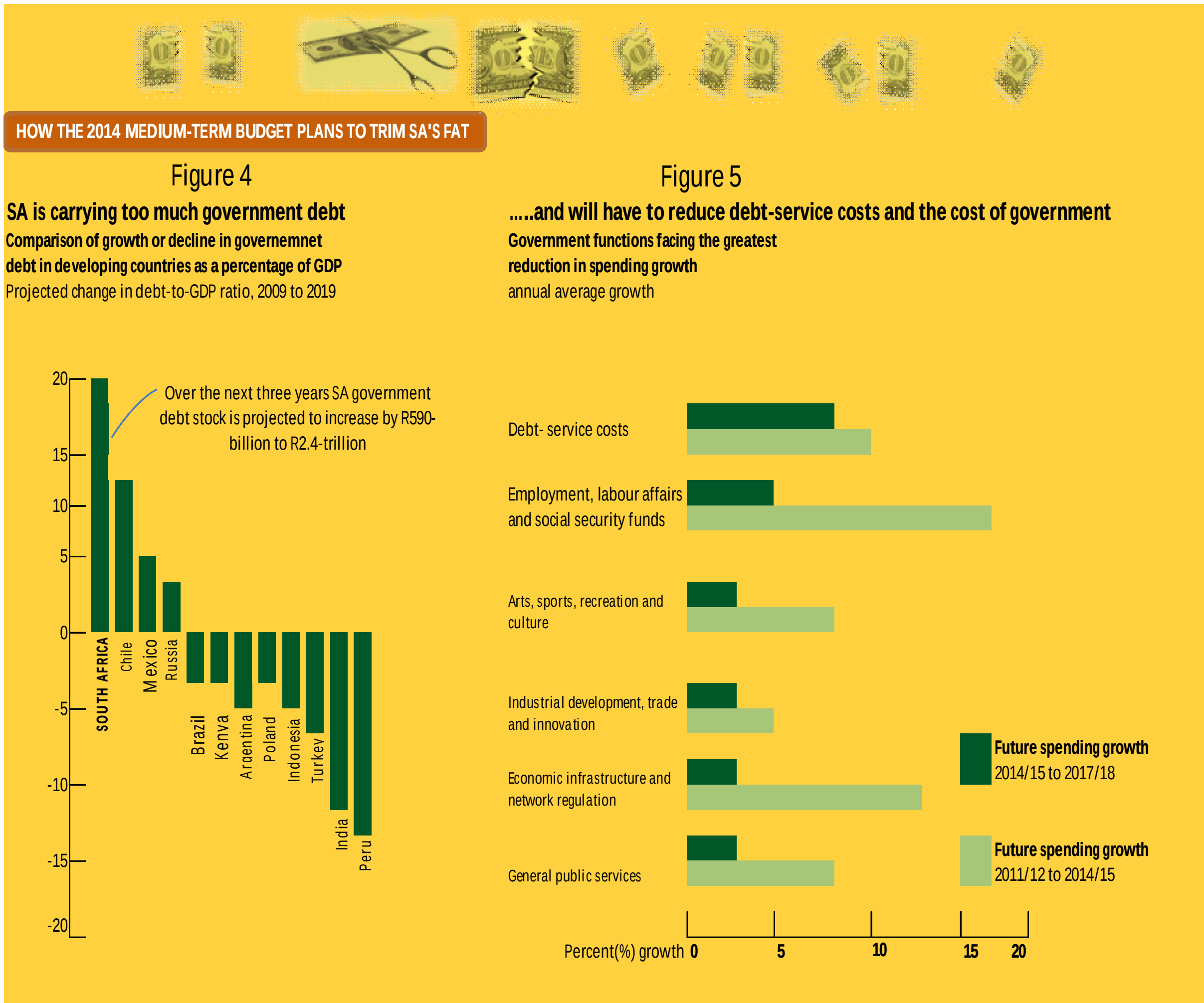
Figure 3: Taxes will have to Rise Projected revenues to be raised from proposed tax increases and administrative reforms to be tabled in February 2015



Source: Medium – Term Budget Policy Statement 2014

HOW THE 2014 MEDIUM-TERM BUDGET PLANS TO TRIM SA'S FAT

Figure 4 and 5: South Africa is carrying too much government debt and will have to reduce debt-service costs and the cost of government



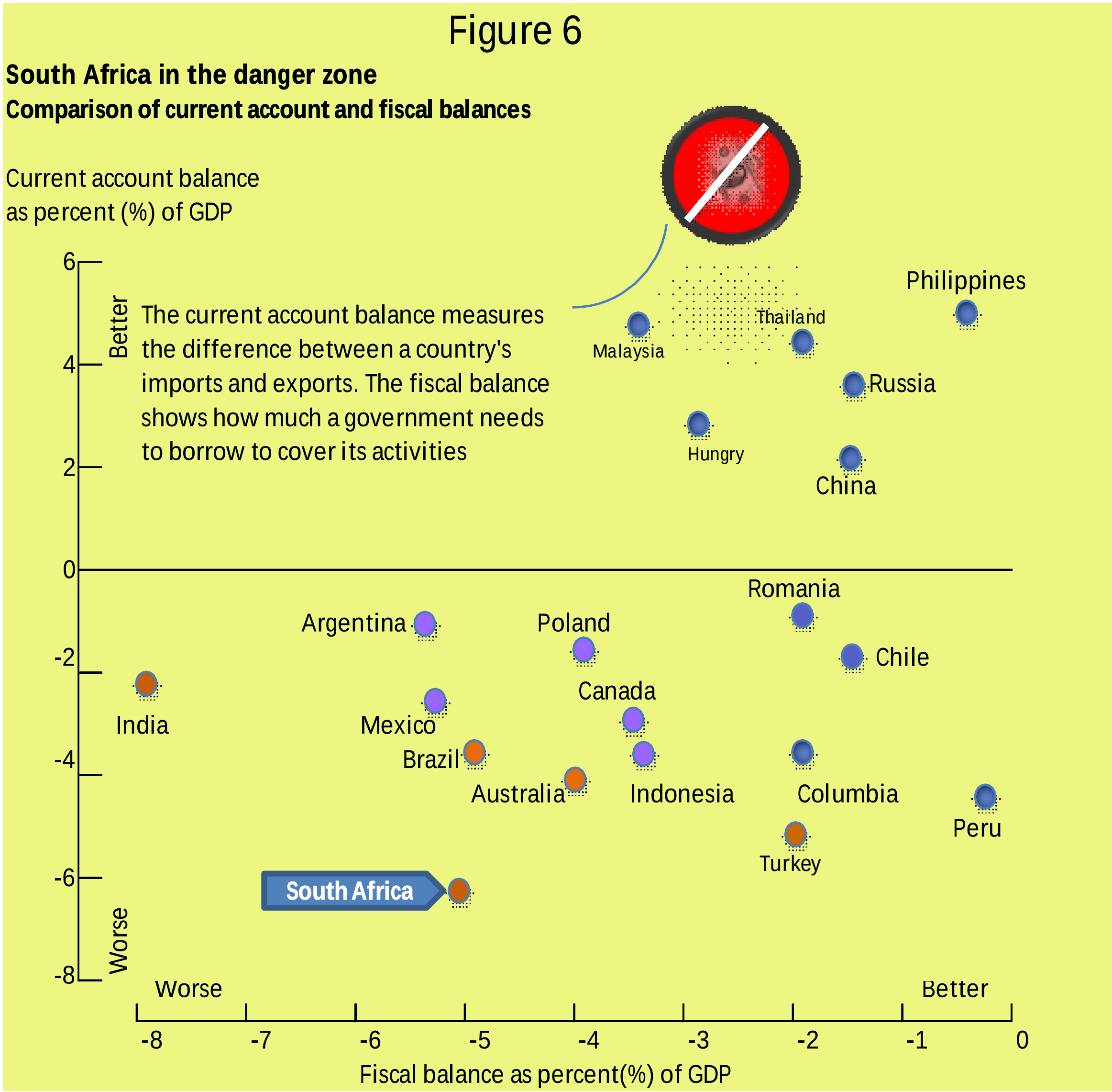
Source: Medium – Term Budget Policy Statement 2014

NEW FINANCE MINISTER'S DIAGNOSIS IS DISCONCERTING

There has been general agreement in South Africa for many years that infrastructure development is essential for economic growth and development, job creation and confidence and Finance Minister Nene's medium – term budget policy statement is the first to set out some goals and put aside money, although some may say he could have gone further. According to Benjamin (2014: 6) "the budget policy statement said infrastructure development remained the country's second biggest challenge after the number one need, which was to encourage more private investment in the country. The economy had reached a point where radical changes had to be made. Since the government announced the National Development Plan (NDP), construction companies and investors have waited for years for the commissioning of new infrastructure projects. They have either failed to materialize or have been trickling through." The Minister said (In Benjamin, 2014) that "recent supply failures in electricity, water and postal services, for example, have hurt the economy and worn down public confidence. Greater state capacity and efficiency are prerequisites for more rapid development.” The budget statement further adds that the government’s medium – term statement framework for 2014 to 2019 provided a road map to address these challenges. It is the first five year policy framework designed in synchronization with the 2030 vision of the National Development Plan (NDP).

There is no doubt that South Africa’s economic performance has and had deteriorated over the past several years. Its further serious problem lies in the reality that it’s economy has of November, 2014 again been downgraded by the rating agency Moody’s and, it appears that other rating agencies such as Standard and Poor and Fitch will follow suit. This will soon lead to a complete loss in investor confidence as the economy is now in the very dangerous and precarious position of reaching a rating of junk status. It is obvious therefore that, faster economic growth should be a key objective of the NDP and a necessary condition to raise the resources needed to fund the country’s social and economic transformation. On the other hand given government corruption, political patronage, and nepotism and so on, it is essential that social and economic transformation can only be achieved if there is political transformation, thus holding politicians and the bureaucracy accountable in terms of good governance and, in terms of the rule of law which is sorely lacking in South Africa. There is therefore a dramatic and necessary intervention strategy that is required to save South Africa and pull it out of its economic woes. The issue is simple, has the government of South Africa have the capability and capacity to deal with the situation? As things now stand, it does not appear that the government has the political will to do so and it does not have the willingness to do so because, it is very much a part of maintaining the status quo, ineffective in dealing with corruption decisively and, therefore, does not have the required strategies in order to intervene, as the growth rate has been downgraded and adjusted by the Minister of Finance to only 1.6 percent from the target of 2.7 percent. This was the motivating factor on the part of the rating agency to downgrade the economy to almost junk status. The reality is in the open for all to see, in that the Finance Minister has been hobbled by old tusker. What then is this old tusker? It is the disastrous consequences of the country’s President, in terms of “poor and costly leadership and the African National Congress’s calamitous policy flops that are now beginning to show” according the Mail and Guardian (2014: 36). This is exemplified by the all embracing reality that the president of the country has always put his own interests ahead of those of the country.

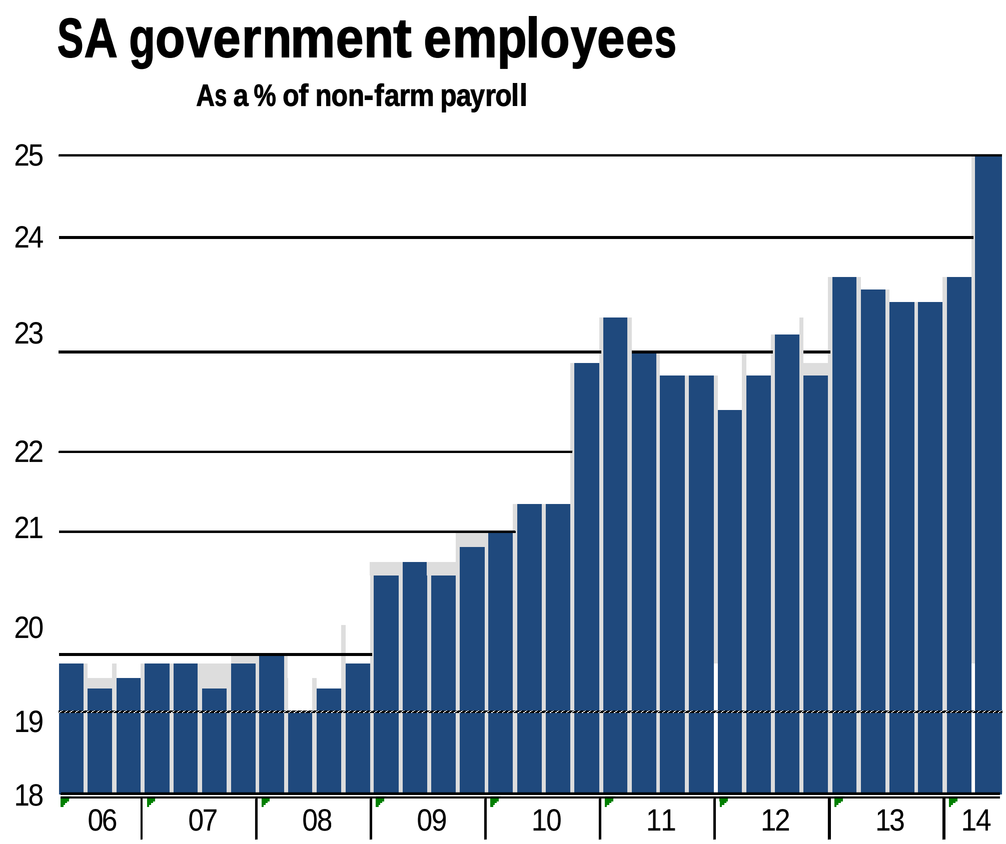
Figure 6: South Africa in the Danger Zone



Source: IMF World economic outlook 2014

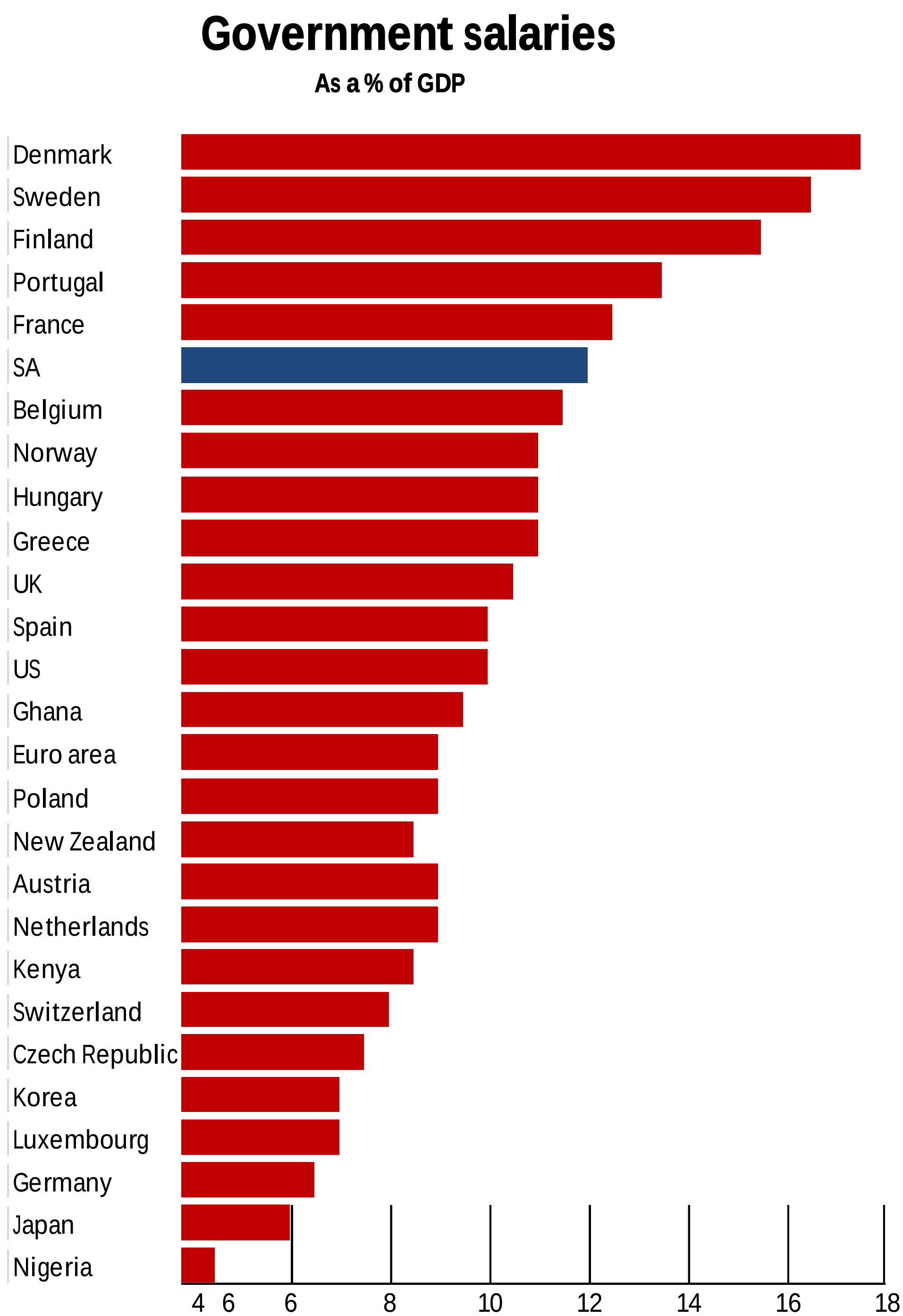
The figures 7and 8 depicted below further exemplifies South Africa being in the danger zone in terms of South African government employees as a percentage of total non-farm payroll and government salaries as a percentage of GDP

Figure 7



Source: Business Times, Sunday Times, October 26 2014

Figure 8



Source: Business Times, Sunday Times, October 26 2014

SOCIAL SERVICES AND TAX TRANSFERS

In terms of the medium – term budget, there is no doubt that the money flowing back into social services has reduced inequality somewhat slowly but by the same token a sluggish South African economy threatens these gains. Lynley Donnelley (2014: 7) states that "without tax transfers to the poor, research shows that that the country's Gini coefficient (a ratio showing to what extent income within an economy is equitably distributed) would be around 0.71 but is instead closer to 0.59." Although this is an unacceptable level of inequality and better than many other countries in the so – called "Third World," it indicates that the government's social policies has a long way to go in redressing the substantial impact on inequality. It is obvious therefore that the higher or closer to one, a country's Gini coefficient is, the greater the inequality levels are in a country. However, even if the tax system is working well as the government of South Africa purports and states, it has to be understood by the state and its bureaucracy that a Gini coefficient of 0.59 is still far too great and points to areas that the country through government can do much better. The reality is the all embracing fact that economic growth is nowhere near the estimated 5 percent that is needed by South Africa to generate sufficient revenues to address South Africa's grave and manifest, social, economic and political problems. The reality is that the country is battling persistent inequality, poverty and very high levels of unemployment. On the other hand it faces "dual deficits, a fiscal deficit as well as a widening current account deficit, according to Lynley Donnelley (2014: 7).

It is obvious that the ways to address these manifest problems, an examination of government expenditure, tackling corruption and exploring the potential for rational, modest tax increases must become an imperative that needs to guide government intervention strategies. On the other hand, it must be a carefully thought out strategy because the cutting of capital expenditure will retard growth. "The size of the government must be cut because it drives public expenditure and compromises government. Corruption that burdens the state to the tune of R100 billion a year are issues that need to be addressed" according to Davis (In Donnelley, 2014: 7). However, it must be realized that increasing any type of tax would have complex consequences. Government and by implication the Finance Minister will have to think through whether the benefits would outweigh the disadvantages and how it could recycle the money. The issue is can the Minister of Finance make a dent in South Africa's deficit? The issue is simple will he be supported by his Cabinet, by his political party the ANC and will he be able to bring the finances of South Africa under control? As matters stand this is a tall task and there seems to be no light at the end of the tunnel. The Finance Minister is actually in the doldrums and is walking a very thin and tight financial rope.

LESS POLITICS AND FEWER DEFICITS

Taking from the rich to give to the state will not be enough to shrink the budget. According to Strydom (2014:9) "Finance Minister Nhlanhla Nene announced in the mini – budget that the government aims to raise an additional R44 billion to prevent its debt burden from becoming unsustainable." At the moment in South Africa those earning more than R1 million a year pay 45 percent tax and those earning above R2 million pay 50 percent tax. The highest marginal tax rate at this stage is 40 percent. In this way, it would raise R6.7 billion while increasing Value Added Tax (VAT) to 15 percent from 14 percent would bring in another R17.2 billion. Strydom (2014: 9) further states that "raising the tax on companies to 30 –percent from 28 percent would net R12. 8 billion and the rest it would have to raise through excise duties (R2.8 billion) and an even higher fuel levy (R4.2 billion). The danger is the public service fiscal cliff which comprises civil service remuneration, plus social grants, both which are unaffordable in the long run, is most dangerous because they are reaching or equaling government revenue. Currently there seems to be unwillingness on the part of government to make the necessary expenditure cuts such as a reduction in the size of the cabinet, having moratorium on filling government vacancies, curbing corruption, cutting public servant salaries and lessening social grants and so on.

On the other side of the equation is untaxed wealth which is a real issue. There are many in the country, black, Indian, Coloured and White citizens and even foreigners who have and continue to stash away 'black' money in foreign shores. Such individuals must be prosecuted but there are also many culprits amongst the ranks of government politicians, their friends, families and the bureaucracy, but the government cannot see the wood from the trees. The concentration should also be on untaxed wealth which is equally rampant. Tougher legislation needs to be passed to impede this crime. International bank accounts must be inspected even if it is a tedious and difficult exercise. It remains to be seen if the Finance Minister will address this vexing issue.

Government procurement has potential adverse consequences and is a gold mine for corruption by the bureaucracy, by politicians, by large companies, by political cronies and so on. It enables companies to charge excessive prices for low – quality goods or even non – delivery of services in South Africa, while facilitating corruption, abuses of power and tremendous waste. To mitigate this there has to be an onslaught on this type of corruption and non – delivery of goods and services by means of open bidding processes and no interference by government, which is currently the order of the day. "There has to be strict transparency rules for government purchases. Countries that forego open bidding processes like in India, South Africa, Russia, Vietnam, and Venezuela have ended up with large scale theft" (Hausmann, 2014: 10). This government gold mine that involves billions of rands must be regulated and carefully regulated and monitored because, it can bring in the much required revenue that the minister of finance requires to uplift the economy of the country.

THE POOR IN SOUTH AFRICA BEING LEFT BEHIND

The mid – term policy statement has been weak in addressing the issue of inequality. The Minister of Finance has to pay special attention to inequality in order to avoid a looming catastrophe that could confront the country, in terms of violence and civil unrest. It has been often stated in post apartheid South Africa that inequality is now worse under democracy than at the end of the apartheid era in 1994. Poppy Louw (2014: 30) points out that "the South African Revenue Services (SARS) has found that only 300 of the 9300 richest people in South Africa have paid their taxes and that inequality is greater today than at the end of the apartheid era and that the two richest people in the country are believed to possess more wealth than the poorest 50 percent of the population combined." The gap between rich and poor has grown to unprecedented levels in the past 30 years and the Global Report on inequality (In Louw, 2014: 2) states that "it would take a South African platinum miner 93 years to earn what the average mining company CEO receives as an annual bonus. It is obvious therefore that the government must target tax evasion According to Moodley (In Louw, 2014: 2) "SARS investigations found tax evasion is costing the country an estimated R48 billion a year in potential revenue and that, the current economic model is not working for the poor but in reality works for the rich, who just keep increasing their wealth. It is only once South Africa has a model that ensures that everyone's basic needs are met that there will be a fairer distribution of wealth that will make a dent in inequality."

It is obvious that there has to be a minimum wage and access for all to education and the right to jobs. Tax loopholes have to be closed to ensure that companies and the rich pay their taxes. Education has failed young South Africans and those in government are very rich and the rest are poor. It has been estimated by Oxfam (in Louw. 2014: 2) that "Africans will constitute 80 percent or more of the world's poor by 2030 and that the wealth of the richest 85 people in the world was found to have collectively increased by $668 million a day between March 2013 and March 2014." "Some of them can spend $1million a day for 218 years according to the Global Report on Inequality, (in Louw, 2014: 2) and that the report added that "23 million people in the poorest 49 countries could have been saved by more investment in healthcare paid for by a 1.5 percent tax on the wealth of the world's billionaires and that there are currently 1645 billionaires globally, and 16 in sub – Saharan Africa living among 358 million people in extreme poverty." This is the vulgarity of wealth at the expense of the world's poor and it could lead to devastating consequences for the world's poor and at the same time we could witness mass uprisings throughout the world in both developed and developing countries. Governments have to intervene and streamline their budgets in order to deal with increasing poverty, inequality and unemployment.

Given the above scenarios, Christensen of the Harvard Business School (In Reddy, 2014: 11) argues that "financial capital as the bottleneck of performance has had a significant effect on how investors and managers assess opportunities and is termed the capitalist dilemma and this dilemma applies to so – call developing countries also." There is enough capital in South Africa because there is an abundance sitting on corporate balance sheets that works for shareholders only, not for the country and its poor in terms of their obligations for social responsibility programmes. Financial capital should be thrown at enterprise development. Are the markets creating innovation to assist the country grow its economy and thus assisting the development of the country and particularly the poor? In this regard South African Business Schools, management departments and commerce faculties have not helped. Why? This is because the historic White Universities steeped in apartheid history and ideology continue to maintain the status quo of privilege, do not allow access to black students, charge exorbitant fees and it appears that government supports them without the required controls and do not support historically disadvantaged higher education institutions operating privately and investing large amounts of money without any aid from government subsidies. These institutions in the realm of the public higher education universities have not really created market – creating innovations. Generous endowments are also required for private higher education institutions that are playing a significant role in the development of South Africa and Africa.

Charity begins at home, so apart from removing the human capital bottleneck, we must in South Africa reflect and understand on how we use the financial capital we are already blessed with. Any intervention will require the government to address the problematic of development and review its mid – term policy statements and the budget in terms of the use of the financial capital for migratory, timid or enterprise capital purposes, in order to address the problems of inequality, poverty, unemployment and thus secure the development processes that country is in dire need of. Thus to resolve the capitalist dilemma, one needs to persuade migratory and timid capital to become enterprise capital. South Africa therefore should not be intimidated by its concentrated banking sector and should engage with the banks from a position of strength, in order to address its developmental agenda.

TOUGH TASK FOR THE FINANCE MINISTER AND HE MUST EASE OFF ON TAXES

Given the woes of the South African economy the Finance Minister should reject the idea to lift taxes. However, how can he cope with financial shambles, the government of South Africa have caused? As Finance Minister, he has neither control nor the power to control government expenditure in terms of the bloated and overpaid staff of government departments and parastatals, excessive bureaucrats and a large Cabinet, which will continue to burden the state and the economy. As an example, Michael Reid (2014: 10) states that "the average number of staff employed by British Airways per aircraft in service numbered 250 compared with more than 900 employed by South African Airways per aircraft in service. South African

Airways is owned by the government and shows losses every year and has to be bailed out by government with billions of rands. The free housing, and social grants provided to South Africa's unemployed is another burden that will not go away soon. Media opinion states that Value Added Tax (VAT) cannot be increased because of the effect that would have on the poor. It is scary to think by how much personal income tax will increase in order to make a meaningful dent on the large deficit. South Africa sits on a time bomb and technically the Minister is in a catch twenty two situation. It would be most difficult for him to balance the books and give meaning to the demands of the wrestles population.

The question is where the South African government is going with the economy? Who is it trying to empower? These questions are posed because it increasingly seems as if the average South African, poor as they may be or whether they have a job or not, is being fleeced of more of their income in overt and latent taxes. Even those unfortunate citizens dependent on social grants are expected to return a portion of that much – needed cash in value – added tax. How has this become unacceptable? The Minister of Finance would have to back off when he presents his 2015 budget in February and must cut the rate of taxes the national government takes from citizens. Equally, his government needs to cut its fruitless and wasteful expenditure and dump and drop the money hungry state – owned enterprises such as Eskom and South African Airways but to mention only a few. The question that needs to be answered is why should South Africans including the poor citizens have to give up building their household savings in order to fund the national government's largesse and wasteful priorities? Simply put, our economy needs individuals, poor and rich to be given the liberty to build household savings and, in essence, wealth, and to preserve it. This is economic freedom, not stifling statism. As things stand the government of South Africa and its Minister of Finance cannot guarantee a semblance of economic freedom and by the same token they cannot bring about sustained economic and general development. All of this is further exacerbated by the most recent rating downgrade by Moody's. Downgrades have been constant by all three rating agencies. This downgrade now places South Africa on the brink of 'Junk Status.' It is possible that other rating agencies will do the same. This was precipitated by the Minister downgrading the economic growth from the projected 2.7 percent for the year to 1.6 percent. The issue is can South Africa recover? Possibly not because of government's propensity to overspend, its excessive borrowing, its inability to curb inflation, its lack of creating employment, the increasing crime rates and a widening deficit, a bloated civil service and high levels of corruption.

SOUTH AFRICA IS HEADING TO ITS ARAB SPRING

South Africa, given the discussion undertaken in this paper is heading into a violent storm without a captain to steer the boat and political analyst Moeletsi Mbeki had famously warned in February 2011 that South Africa's "Tunisia Day" will arrive in 2020. Max du Preez (2014: 1) reports that "the year 2020 is when China estimates that the current minerals – intensive industrialization phase will be concluded, a process that forced up the prices of South African minerals according to Mbeki. When that happens, the ANC government will have to cut back on social grants "which it uses to placate the black poor and to get their votes." That is the day "when the masses rise against the powers that be" (Mbeki, in du Preez, 2014:1). Tunisia Day refers to the start, in 2010, of what became the violent Arab Spring. It led to the overthrow of the Tunisian government, a month later, and was followed by turmoil, and in some cases civil war, in Egypt, Syria, Morocco, Libya and Yemen. "The crisis is homemade and South Africa sits on a perfect storm and will not be in a position to blame anyone. This storm could lead to a fundamental reorganization of political forces and could result in the end of ANC rule and will lead to instability," according to du Preez (2014: 1).

All of this began, in terms of a spiraling decline since December 2007 when President Jacob Zuma was elected President of the ANC at its Polokwane congress. Former President Thabo Mbeki was removed unceremoniously and the Zuma government over the last six years has wasted billions of rands through corruption, personal monetary gain by politicians, vanity projects and overt maladministration. Huge projects were spectacularly mismanaged and national policies became contradictory and confusing. The health and education systems are on the brink of total collapse and local government is a corrupt and mismanaged entity with a total lack of services to particularly semi – urban and rural areas. The judicial system is in chaos and cadre deployment into influential positions has destroyed the very fabric of the rule of law and tarnished the great constitutional democracy that was ushered in, in 1994 by the struggle icon Nelson Mandela. There is so much to state and report upon and finally the chickens have come home to roost. The lives of ordinary South Africans have deteriorated and there is frustration on the streets and villages. People have no hope. The state coffers have run dry and the national debt is reaching half of our GDP. There is an energy crisis within the country. Inflation is high, food prices are by far too high, and petrol prices are exorbitant and out of reach for the ordinary person and for small businesses. The government has been unable to curb the entry of millions of immigrants from all over the world and this has fuelled anger with the unemployed locals. The middle class is restless and resentful because tax money is being wasted. At the moment there is no hope of a decent life.

South African politics is in a state of flux with very serious problems within the labour unions led by Cosatu and it appears that the ANC alliance is on the verge of a very serious split. The platinum strikes have been a dampener on the government of the day. All of this has slowed economic growth and created a loss in investor confidence. In the first four years of President Zuma's term in office according to du Preez (2014: 3), "the salary bill of civil servants rose by 76 percent and for every R100 generated by the economy, R14 goes to paying bureaucrats. In Russia it is R3.70, in Brazil R4.60 and in Nigeria R4. 0. The South African civil service is the most expensive in the world, and some 17 million people get social grants, which costs more than R390 billion. Welfare payments and public service salaries consume 56.4 percent of all state revenue. The Finance Minister only last month could not curb the employment of 700 more people in the Presidency. The Minister will not be in a position to cut state expenditure and costs will continue to escalate to the peril of the people and the economy. The big issue is can the country be saved? Can South Africa avoid its Tunisia day and its own Arab Spring? Time will only tell.

HARD TO FUND ALL NEW SOCIAL REFORMS

New spending pressures are likely to emerge in the area of unemployed youth. "South Africa could sustain its social spending commitments for decades but would be hard – pressed to implement all the new social policy proposals that the National Development Plan envisages," according to the Treasury (Paton, 2014: 2). There is no doubt according to Michael Sachs (In Paton, 2014: 2) that "South Africa's huge expansion of social spending since the dawn of democracy in 1994 has now raised concerns among some commentators that it will face a 'fiscal cliff' at some point and be unable to sustain current or expanded spending levels on health, education and welfare." Sachs presented the South African Treasury Model to answer the questions raised by the World Bank – National Treasury workshop in November, 2014 on South Africa's fiscal framework. The model projected spending into coming decades. In a scenario of moderate economic growth of about 3 percent and moderate population growth, current levels of spending are sustainable. However, should growth stagnate at 2 percent, as downgraded by the Minister of Finance in his mid – term budget policy statement to 1.6 percent and the population growth grows much faster than anticipated, then social spending levels would be difficult to maintain. It is therefore most obvious that that a sustainable path, according to the proposed model, is one where South Africa's debt level stabilizes or declines. In all spheres such as health, and basic education would need to increase to maintain current levels of service or in the event of the introduction of the National Health Insurance Scheme (NHI). In this regard Sachs (In Paton, 2014: 2) states that " a growth rate of 3 percent would require a structural increase in revenue as health expenditure would need to rise 6 percent of GDP for an NHI scheme from current levels which hover below 4 percent. Additional revenue would be required through taxation or a reprioritization of expenditure." Raising taxes amidst poverty and the fact that South Africa's taxes are too high could have adverse effects on the economy. It would be a dangerous intervention strategy. However, according to Sachs (2014) a host of the suggested proposals have not been costed. It will indeed be a tall order for the Treasury." The Minister of Finance, it is now obvious cannot meet the aspirations of the government and his spending priorities will have to be cut drastically.

IMF WARNS BANKS ON RISKS IN AFRICA

The paper has concentrated on the fiscal crisis in South Africa with particular reference to the new Minister of Finances mid – term budget statements and outlined the difficulties and challenges that confront him and the South African economy in the short and long term. It has argued that the Minister of Finances intervention in turning the South African economy would not pay dividends when he presents his 2015 budget to parliament in February of 2015. This has been exacerbated and compromised by a government that is out of tune with the fiscal realities that confront the country. Further exacerbated by a lack of fiscal prudence, political patronage, endemic corruption, an increasing social welfare system, excessive borrowing, high interest rates to service debt, too large a public service sector, the lack of productivity, corrupt politicians and so on. The International Monetary Fund (IMF) warns that the "rapid expansion of South African Banks into the rest of Africa chasing growth, may increase the risk to the financial sector. Other African countries tend to have weak rules for money laundering and combating the financing of terrorism, raising the risk to South Africa indicates the IMF in its report on South Africa's financial system" (IMF Report, 2014). This 5 year assessment has been agreed to by South Africa because it is a member of the Group of 20 and the assessment is intended to help countries identify risks to the financial system and implement policies to deal with the financial shocks and contagion. The IMF (2014) report further added that "after stress – testing major banks and insurers that, banks operating in the rest of Africa might incur extra costs due to the less developed infrastructure on the continent, while their information technology platforms might not be able to cope with increased volumes from their African businesses." This is a matter of concern and although South Africa is desirous of investing in infrastructure which has been neglected over the last two decades since democracy in 1995; it is unlikely that this would reap benefits given the county's propensity to increase and service debt. Its intentions are noble but there is more lip service than coordinated and sustained action.

South Africa has massive problems in terms of financing the approved National Development Plan (NDP) which has been rejected by many internal formations including organized labour, the implementation of the National Health Insurance Scheme (NHI) has still not materialized because of the exorbitant costs to implement the programme, the poor performance of the Electricity Supply Commission with constant load shedding that is crippling the economy and indeed styming foreign investment and the clandestine power brokering with China and Russia to introduce nuclear energy. Amidst a host of South Africa's wish list, there has to be a realization that all of this will cost trillion of rands in the medium term and thus it is at the moment 'pie in the sky." This reality, it appears has not come home in terms of realization by the ruling government. The only way it could finance these multiple projects will be undertaken by increased massive borrowing from lending agencies. If this does happen, ordinary and poor South Africans will bear the brunt of the inefficient handling of the economy with devastating consequences. In other words increased borrowing will bring the country to its knees and lead it to a path of total destruction, causing greater inequality, wider poverty and the inability to deal with unemployment. More importantly, it has to be realized by the South African government according to Gillian Jones (2014:1) that “ South Africa’s four largest banks – First Rand, Standard Bank, Barclays Africa Group and Nedbank, have all put emphasis on growing their operations in the rest of Africa, as it offers higher growth rates than their home market.” This is a clear indication of the lack of confidence with the local markets, the government and major labour union challenges, increasing unrest and civil disobedience and the higher transaction costs at the moment.

South Africa is expecting tepid growth of about 1.4 percent for 2014 but the IMF predicts that Sub – Saharan Africa will grow by 5.1 percent in 2014 and 5.8 percent in 2015. The issue that arises is why South Africa cannot grow like the expected growth in other parts of Africa. The paper has in many ways answered this vexing question. In reality therefore, South Africa in real and practical economic terms has become a burden to itself and to the rest of Africa and cannot contribute at the moment and for the foreseeable future to the narrative of Africa rising and cannot give practical inputs to the development of Africa as a whole.

All of this makes Africa an attractive and necessary growth market for South Africa’s major banks. Standard Bank according to Gillian Jones (2014: 1) “is the largest bank in Africa by assets and operates in 20 countries, while Barclays Africa Group has a presence in 12. First Rand, through RMB also operates extensively across the continent. Many of these banks have acquired high stakes within Banking Groups in Africa and the core strategy is to increase incrementally the earnings contribution of their operations in Africa and is a core focus area for South Africa’s major banks. However, Gillian Jones (2014: 1) indicates that “the IMF has warned that South African Banks acquiring or entering into partnerships with banks in Africa with poor credit quality or weak risk practices could result in capital loses to the group. This is exemplified by the all embracing reality that South Africa’s four largest banks have 46 foreign subsidiaries, of which 39 are in Africa. South Africa has to consider all of these variables and set out on a trajectory to grow its economy or face a very bleak future when the Minister tables his 2015 budget to the nation.

CONCLUSION

South Africa should not consume the future. There are tremendous limitations of fiscal policy and the bravery of the Minister of Finance should be commended in his mid – term policy statement. However, he will not be able to do much when he presents his 2015 budget in 2015, because the local elections are around the corner and is the most contested tier of government with widespread corruption, inefficiency and drastically poor service delivery. If South Africa is to address poverty and inequality, lessen corruption, it will require that it accepts some hard truths. These truths as the situation stands currently is not acknowledged by a corrupt coterie of ruling party members of parliament and the Cabinet. The constraints to growth and unemployment are in fact structural not cyclical. The issues that have constrained South Africa's growth are the prolonged work stoppages, constrained electricity supply and these issues including overt and endemic corruption and the propensity to overspend by government without accountability, the increased burden of debt servicing, a bloated and underperforming public service, the huge amounts used on social; grants, a bloated and inefficient Cabinet and a myriad of other problems cannot be addressed overnight and therefore the mid – term future of South Africa looks very bleak. Moody's which downgraded South Africa's sovereign debt rating to Baa2 from Baa1 cited the prospect of further rises in the government debt – to GDP ratio which indicates a low – growth economy, perilous in nature and very serious for the country. The rating agency also expressed concern about potential delays in the implementation of the NDP. A credit downgrade from rating agencies eventually leads to higher interest rates on government debt, and more demands on taxpayers to pay this bill. Further downgrades by rating agencies in the case of South Africa are inevitable and it is a reality that the Finance Minister will not be in a position to deal with this. Changes in economic policy will meet with resistance from the labour unions. The unions have rejected the NDP and have rejected the blueprint in its entirety as a plot to undermine the working class or fundamentally oppose certain aspects of it, because they don't fit the trade union agenda.

Another panacea that the trade unions advocate is nationalization. The government has to broker an agreement with the labour unions and deal with inflation the enemy of the poor. This is the reality and if nothing is done, South Africa is moving into a dangerous terrain of the rising wrath of the working class and this will scupper the objectives of the development trajectory that it has chartered for itself. As things stand currently, it appears that the government has no answers to deal with the issues raised in this paper and, South Africa as a 'ship' is rapidly sinking into murky waters.

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