3

Fiscal policy

In brief

- The economic outlook has deteriorated significantly since the beginning of the year. Gross tax revenue for the 2017/18 – 2019/20 period is projected to fall short of the 2017 Budget estimates by R209 billion.
- The consolidated budget deficit will widen to 4.3 per cent of GDP in 2017/18, against a 2017 Budget target of 3.1 per cent of GDP. Gross national debt is projected to reach over 60 per cent of GDP by 2022, with debt-service costs reaching 15 per cent of main budget revenue by 2020/21.
- The expenditure ceiling could be breached by R3.9 billion in the current year, mainly as a result of government's recapitalisation of South African Airways and the South African Post Office. Government is considering the disposal of assets to offset these appropriations during the current year.
- Additional risks to the framework include more financial demands from state-owned companies, public-service compensation pressures and new spending commitments, particularly in higher education.
- A presidential task team is considering a range of steps to bring the public finances back onto a sustainable path. Announcements will be made at the time of the 2018 Budget.

Erosion of the fiscal position

Over the past four years, government has followed a path of measured fiscal consolidation, aiming to stabilise the debt-to-GDP ratio by reducing spending and introducing tax increases. This strategy met with some success, reflected in a narrowing primary deficit. But debt has continued to rise as a share of GDP as economic growth rates have declined.

Debt levels have risen as economic growth and revenue collection have deteriorated

This year, a sharp deterioration in revenue collection and further downward revisions to economic growth projections have significantly eroded government's fiscal position. Tax revenue is projected to fall short of the 2017 Budget estimate by R50.8 billion in the current year, the largest under-collection since the 2009 recession. At the same time, additional appropriations of R13.7 billion have been agreed to forestall calls against guaranteed debt by the creditors of South African Airways (SAA) and the South African Post Office

(SAPO). These are partially offset by use of the contingency reserve, as well as projected underspending.

Consolidated budget deficit set to widen to 4.3 per cent of GDP in 2017/18

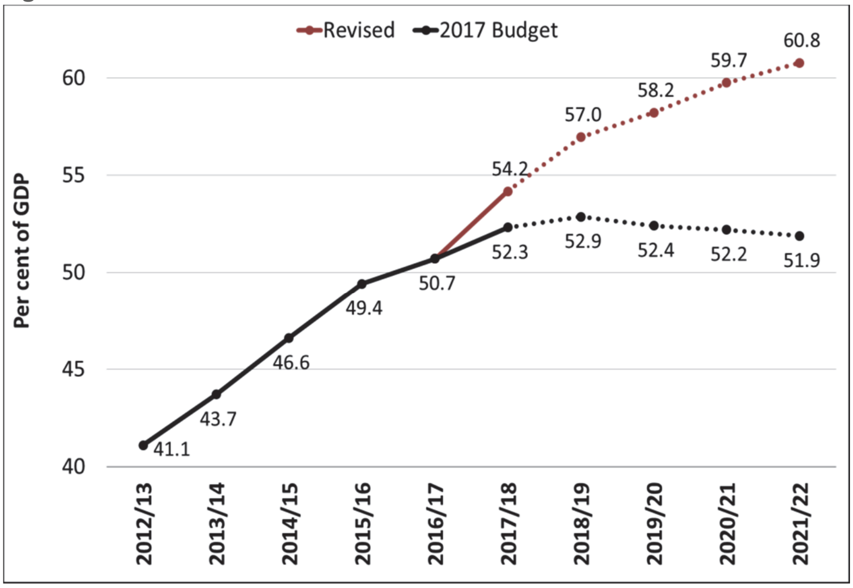
As a result of these developments, the consolidated budget deficit will widen to 4.3 per cent of GDP in 2017/18, against a 2017 Budget target of 3.1 per cent of GDP. Government's short-term options to reverse this situation are limited. Given that per capita income is falling, the economic impact of further expenditure cuts or tax hikes could be counter-productive.

Following several years of expenditure restraint, further budget cuts will involve hard choices and difficult compromises. Sudden or deep additional cuts that are not well-targeted could put severe pressure on already stressed departmental budgets. Some national departments are battling to operate within the compensation limits set by Parliament in the current year. And several provincial departments are running up unpaid bills to maintain service delivery levels.

Stabilising gross debt below 60 per cent of GDP will require large spending cuts or tax hikes

At the same time, government is acutely aware of the dangers of unchecked debt accumulation. Debt-service costs are the fastest-growing category of expenditure, crowding out social and economic spending. By 2020/21, nearly 15 per cent of main budget revenue will be spent servicing debt. The National Treasury estimates that stabilising gross debt below 60 per cent of GDP over the coming decade will require spending cuts or tax hikes amounting to 0.8 per cent of GDP. In 2018/19, 0.8 per cent of GDP would amount to R40 billion.

Figure 3.1 Gross debt-to-GDP outlook without additional fiscal measures



Source: National Treasury

Sustainable public finances require significantly higher economic growth

Over the medium term, government is committed to maintaining the ceiling on non-interest expenditure. New spending priorities will have to be met by funds reallocated from within existing limits. Any adjustments to the ceiling itself would need to be matched by revenue increases.

A team of Cabinet ministers reporting directly to the President is considering a range of proposals to bring the public finances back onto a sustainable path. Announcements are expected to be made at the time of the 2018 Budget. More fundamentally, sustainable public finances require a significant acceleration of economic growth.

Revenue performance and outlook

The trend of buoyant revenue collection has run its course

Over the past five years, despite a declining rate of economic growth, tax revenue continued to grow more rapidly than GDP. This trend came to an abrupt halt towards the end of 2016/17 as South Africa entered a recession. Despite substantial tax increases over the past two years, tax revenue growth has barely exceeded the low rate of economic growth.

In 2016/17, the largest shortfall against the 2017 Budget estimate was in customs duties, which slowed in tandem with falling import growth. Personal income tax, value-added tax (VAT) and corporate income tax also performed below projections. These shortfalls were offset by higher-than-projected dividend withholding taxes amounting to R5.4 billion. This windfall may have resulted from artificial declarations of dividend payments before the effective date to avoid the higher tax rate introduced in the 2017 Budget.

Table 3.1 Gross tax revenue

	2016/17			2017/18		
R billion	**Budget[1]**	**Outcome**	**Deviations**	**Budget[1]**	**Revised**	**Deviations**
Persons and individuals	425.8	424.5	-1.3	482.1	461.3	-20.8
Companies	205.1	204.4	-0.7	218.7	213.9	-4.8
Value-added tax	290.0	289.2	-0.8	312.8	301.3	-11.4
Dividend withholding tax[2]	25.7	31.1	5.4	34.2	31.6	-2.6
Specific excise duties	35.7	35.8	0.1	39.9	37.4	-2.5
Fuel levy	63.0	62.8	-0.2	70.9	70.1	-0.8
Customs duties	47.5	45.6	-1.9	52.6	47.2	-5.4
Ad-valorem excise duties	3.4	3.4	0.0	3.6	3.6	-0.0
Other	48.2	47.3	-0.9	50.7	48.4	-2.3
Gross tax revenue	**1 144.4**	**1 144.1**	**-0.3**	**1 265.5**	**1 214.7**	**-50.8**

1. 2017 Budget figures
2. Includes secondary tax on companies
Source: National Treasury

Factors contributing to poor revenue performance

Projected revenue shortfall of R50.8 billion in current year

The lower outcomes in 2016/17 explain part of the shortfall in the current year. However, revenue growth has remained weak, even as the economy emerged from recession in the second quarter of 2017. For the first six months of 2017/18, gross tax revenue grew by 5.9 per cent year-on-year against a target of 10.7 per cent. All tax instruments are performing poorly, with large shortfalls for personal and corporate income tax, and dividend withholding tax. The National Treasury projects a tax revenue shortfall of R50.8 billion in 2017/18 compared with the 2017 Budget estimate.

Revenue weakness reflects a number of economic factors:

- Growth in key sectors that have supported buoyant revenue collection – such as finance, retail and telecommunications – has slowed.
- Personal income tax collection has been affected by low bonus payments, moderate wage settlements, job losses and a slower expansion of public-sector employment.
- Corporate income tax under-collections in the first half of 2017/18 resulted from persistently weak growth and commodity price volatility.
- Weak investment and household consumption led to a sharp contraction in imports in 2016, affecting VAT and customs duties.

- The stabilisation of the rand has muted the buoyancy of import taxes and revenue on profits in traded sectors, such as mining.

Compliance concerns mounting in face of tax administration challenges and weaker tax morality

Policy and administrative factors may also be contributing to the shortfall. Behavioural responses to tax increases may be larger than anticipated and revenue could perform below expectations even if taxes are hiked. Compliance concerns are mounting in the context of tax administration challenges and weakening tax morality. Implementing the recommendations from the Tax Ombud's report on delays in the payment of VAT refunds by the South African Revenue Service will help to improve taxpayer confidence in revenue administration.

Medium-term revenue outlook

The 2016/17 revenue outcomes, the recent recession and the changing composition of economic growth underline the need for caution when estimating revenue growth in the period ahead. Compared with the 2017 Budget, nominal GDP growth forecasts have been revised down by about 1.5 percentage points per year between 2017/18 and 2019/20. Forecasts for nominal growth in gross tax revenue have been revised down by an annual average of 2.2 per cent over the same period.

Tax buoyancy has fallen significantly over the past two years

Tax buoyancy – the expansion of revenue associated with economic growth – has fallen significantly in the past two years. Between 2010/11 and 2015/16, each percentage point of GDP growth led to a 1.23 per cent growth in gross tax revenue. Last year, tax buoyancy fell to only 1.01, despite tax policy changes intended to raise R18 billion in additional revenue. This year, despite tax policy measures designed to add R28 billion to revenue, buoyancy of only 1.02 is estimated.

The medium-term revenue framework is set out in Table 3.2. It shows the assumptions underlying the projections for each major tax instrument. The framework assumes annual adjustments to thresholds and brackets in line with consumer price index (CPI) inflation projections. It also shows the tax policy measures announced in the 2016 Budget, amounting to R15 billion in 2018/19.

Lower revenue growth in years ahead reflects downward revisions of growth in major tax bases

Excluding the 2018/19 tax increase, gross tax revenue buoyancy averages 1.11 over the medium term. Lower revenue growth in the years ahead reflects the downward revisions to the growth of major tax bases – wages, corporate profits and household consumption spending – as well as expectations of lower tax buoyancy. The medium-term buoyancy of personal income tax has been revised down to 1.15, well below the 2016 MTBPS estimate of 1.28. The buoyancy of corporate income tax is highly uncertain, and projections have been set at a long-run average of 1.0. VAT buoyancy averages 1.17 over the medium term. Last year's VAT buoyancy was muted by the sharp contraction of imports, which is not expected to continue.

These assumptions produce gross tax revenue projections that fall short of 2017 Budget estimates by R50.8 billion in 2017/18, R69.3 billion in 2018/19 and R89.4 billion in 2019/20.

Table 3.2 Medium-term revenue framework

R billion	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
		Outcome		Estimate		Medium-term estimates	
Personal income tax	**353.0**	**388.1**	**424.5**	**461.3**	**499.8**	**544.9**	**595.5**
Wage bill[1]	1 803.6	1 939.3	2 090.7	2 223.3	2 385.0	2 571.9	2 779.6
Buoyancy	*1.61*	*1.32*	*1.20*	*1.36*	*1.15*	*1.15*	*1.15*
Corporate income tax	**184.9**	**191.2**	**204.4**	**213.9**	**223.6**	**236.2**	**251.0**
Net operating surplus	1 064.2	1 090.8	1 158.0	1 238.7	1 294.7	1 367.7	1 453.8
Buoyancy	*1.73*	*1.35*	*1.13*	*0.67*	*1.00*	*1.00*	*1.00*
Value-added tax	**261.3**	**281.1**	**289.2**	**301.3**	**324.8**	**352.1**	**383.3**
Household consumption	2 310.7	2 449.7	2 619.2	2 771.6	2 956.2	3 169.4	3 410.6
Buoyancy	*1.65*	*1.26*	*0.41*	*0.72*	*1.17*	*1.17*	*1.16*
Gross tax revenue (pre-proposals)	**986.3**	**1 070.0**	**1 144.1**	**1 214.7**	**1 300.1**	**1 402.1**	**1 519.0**
Buoyancy	*1.37*	*1.29*	*1.01*	*1.02*	*1.11*	*1.12*	*1.11*
Announced tax policy measures[2]	**–**	**–**	**–**	**–**	**15.0**	**16.0**	**17.3**
Gross tax revenue (post-proposals)	**986.3**	**1 070.0**	**1 144.1**	**1 214.7**	**1 315.1**	**1 418.1**	**1 536.3**
Nominal GDP	3 867.9	4 122.6	4 404.5	4 672.2	4 968.1	5 315.5	5 716.7
Buoyancy	*1.37*	*1.29*	*1.01*	*1.02*	*1.31*	*1.12*	*1.10*
Non-tax revenue	18.3	42.9	18.8	18.0	18.5	19.5	20.7
Southern African Customs Union[3]	-51.7	-51.0	-39.4	-56.0	-48.3	-44.7	-57.8
National Revenue Fund receipts[4]	12.6	14.4	14.2	16.7	9.2	6.0	3.0
Main budget revenue	**965.5**	**1 076.2**	**1 137.6**	**1 193.5**	**1 294.5**	**1 398.9**	**1 502.1**

1. Total remuneration in the formal non-agriculture sector
2. Unspecified tax policy measures announced in the 2016 Budget. The details will be announced in 2018.
The initial tax increase in 2018/19 is carried into the following two years at the same rate as nominal GDP growth
3. Amount made up of payments and other adjustments
4. Mainly revaluation profits on foreign-currency transactions and premiums on loan transactions
Source: National Treasury

Shortfalls over the next two years are partially offset by lower payments to the Southern African Customs Union (SACU), stronger departmental receipts, and mineral and petroleum royalties. More detail on the medium-term revenue framework is contained in Annexure C.

Revisions to Southern African Customs Union outlook

Compared with 2017 Budget estimates, South Africa's projected payments to SACU have been revised down by R14.1 billion in 2018/19 and R19.8 billion in 2019/20. The SACU Common Revenue Pool is expected to shrink as weaker-than-expected imports and household consumption reduce customs and excise duties. South Africa's customs duty – a major driver of payments to SACU – was the poorest-performing tax category in 2016/17.

Changes to the Common Revenue Pool since 2017 Budget

	2017/18			2018/19			2019/20		
R million	2017 Budget	Revised	Deviations	2017 Budget	Revised	Deviations	2017 Budget	Revised	Deviations
Customs duties	52 608	47 162	-5 446	58 059	50 116	-7 942	64 170	54 249	-9 921
Specific excise duties	39 871	37 373	-2 497	42 124	39 403	-2 721	44 497	41 572	-2 925
Ad-valorem duties	3 640	3 603	-37	3 937	3 831	-107	4 257	4 099	-159
Gross tax revenue	**96 118**	**88 138**	**-7 980**	**104 120**	**93 350**	**-10 770**	**112 925**	**99 920**	**-13 004**

To manage the impact of lower collections, the SACU revenue-sharing formula takes account of forecast errors, with a two-year lag. The revision in 2018/19 partly reflects an overpayment from South Africa to other SACU members in 2016/17. Similarly, lower-than-anticipated customs duties in 2017/18 will reduce revenue transfers in 2019/20.

Member states are reviewing the 2002 SACU Agreement with a view to making SACU transfers more stable.

2018/19 SACU revenue shares

R million	Botswana	Lesotho	Namibia	Swaziland	South Africa	Total
2018/19 revenue shares	19 896	5 669	17 769	5 989	43 942	93 265
2016/17 CRP adjustment	-436	-128	-398	-147	-884	-1 993
Total	**19 460**	**5 541**	**17 371**	**5 843**	**43 058**	**91 272**

Weaker-than-expected growth and changes in composition of underlying tax bases are risks to revenue outlook

The primary risks to the revenue outlook are weaker-than-expected economic growth, the effects of changes in the composition of underlying tax bases and deterioration in tax morality, compliance and administration.

Tax policy, expenditure limits and debt stabilisation

To anchor a sustainable budget, structural increases in expenditure must be matched by structural increases in revenue. As stated in the 2015 MTBPS, the expenditure ceiling can be adjusted to accommodate new spending priorities when a permanent source of revenue is found to offset increased spending. For example, government is considering proposals to finance national health insurance (NHI) through adjustments to the medical tax credit, discussed below.

Any additional tax proposals need to be carefully considered in light of economic and fiscal pressures

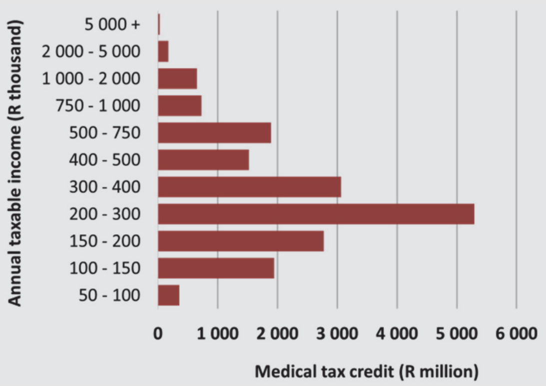
Similar consideration is needed for other emerging policy priorities, such as proposals to increase funding for higher education and defence. Furthermore, additional tax proposals need to be carefully considered in light of overall pressures in the economy and the fiscus, and the need to stabilise the debt-to-GDP ratio.

The Health Promotion Levy, which discourages the consumption of sugary beverages, is under consideration in Parliament, with a proposed start date of 1 April 2018. The revised Carbon Tax Bill will be published shortly.

Medical tax credit

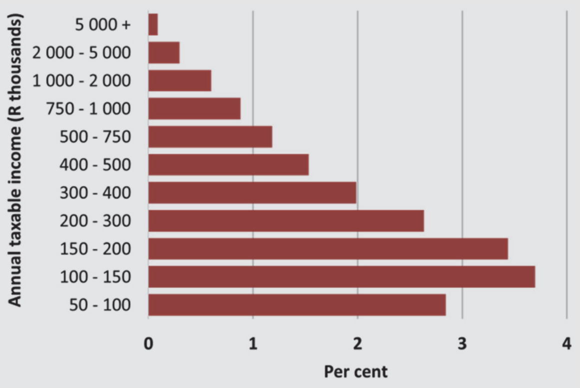
In 2012, government moved from a system of deductions for medical aid contributions and qualifying expenses to a system of tax credits independent of taxable income. In 2014/15, 3 million taxpayers claimed the credit on behalf of 8 million medical scheme members, resulting in a tax expenditure of R18.5 billion. The incidence of these credits is spread across the income distribution: 56 per cent of the total credits claimed accrued to 1.9 million taxpayers who had a taxable income of less than R300 000. This includes many workers who belong to medical aid schemes.

Figure 3.2 Medical tax credit per income group



Source: National Treasury calculations, 2014/15

Figure 3.3 Medical tax credit as percentage of taxable income of taxpayers*



**Sample only includes taxpayers that claimed medical tax credits*

The 2017 Budget Speech stated that “consideration is being given to possible reductions in this subsidy in future, as part of the financing framework for national health insurance”. The National Treasury is considering changes to the design, targeting and value of the medical tax credit as part of the policy development process for the 2018 Budget. Tax data, however, indicates that the programme is well-targeted to lower and middle-income taxpayers. The National Treasury will seek input from the Davis Tax Committee on the feasibility of proposals to adjust the medical tax credit to fund NHI.

Expenditure performance and outlook

Expenditure ceiling

The 2012 Budget introduced expenditure ceilings to enable government to manage departmental spending levels in the context of a constrained fiscal framework. Allocations made over the MTEF period provide an agreed-upon upper limit within which departments prepare their budgets. The expenditure ceiling has been lowered by R7 billion in 2018/19 and R15 billion in 2019/20 as a result of reductions to the contingency reserve.

Table 3.3 Main budget expenditure ceiling[1]

R million	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
2015 Budget Review	1 006 905	1 081 214	1 152 833	1 250 086			
2016 Budget Review	1 001 874	1 076 705	1 152 833	1 240 086	1 339 422		
2016 MTBPS		1 074 992	1 144 353	1 229 742	1 323 465	1 435 314	
2017 Budget Review[2]		1 074 970	1 144 225	1 229 823	1 323 553	1 435 408	
2017 MTBPS		**1 074 970**	**1 141 978**	**1 233 722**	**1 316 553**	**1 420 408**	**1 524 222**

1.The expenditure ceiling differs from main budget non-interest expenditure. The precise definition and calculation of the expenditure ceiling is contained in Annexure C
2. Adjusted for the full amount for New Development Bank in 2015/16 and for the International Oil Pollution Compensation Fund
Source: National Treasury

Interest payments are excluded from the expenditure ceiling. So are payments for financial assets funded by the sale of assets in the same year. This principle was applied to the R23 billion allocation to Eskom in 2015, which was financed by the sale of government's Vodacom shares.

As Table 3.4 shows, expenditure is expected to breach the ceiling by R3.9 billion in the current year. This is the result of large appropriations for SAA and the SAPO. In combination, these allocations amount to R13.7 billion. Government is considering the disposal of assets to offset these appropriations. Should such disposals take place, the breach will not occur.

Asset disposals being considered to rectify potential breach of expenditure ceiling in current year

Table 3.4 Revisions to the 2017/18 expenditure ceiling

	R million
Expenditure ceiling: 2017 Budget Review	**1 229 823**
Upward expenditure adjustments	**16 167**
Roll-over of funds from 2016/17	217
Unforeseeable and unavoidable expenditure	586
Section 16 of the PFMA (SAA recapitalisation)	5 208
Announced in the 2017 Budget[1]	8 609
Self-financing[2]	1 547
Downward expenditure adjustments	**(12 268)**
Declared unspent funds	(1 668)
Direct charges against the National Revenue Fund: Magistrates' salaries	(100)
Contingency reserve	(6 000)
National government projected underspending	(3 000)
Local government repayment to the National Revenue Fund	(1 500)
Revised expenditure ceiling	**1 233 722**

1. Includes the recapitalisation of the SAPO (R3.7 billion) and SAA (R4.8 billion) and the finalisation of the establishment of the Tirisano Construction Fund Trust (R117 million)
2. Spending financed from revenue derived from a vote's specific activities
Source: National Treasury

Medium-term expenditure outlook

Reduction in contingency reserve leaves government little room to manoeuvre if risks materialise

To offset revenue shortfalls and reduce borrowing, the contingency reserve has been pared down to R3 billion in 2018/19, R5 billion in 2019/20 and R8 billion in 2020/21. This leaves government with little room to manoeuvre should risks to the expenditure ceiling materialise. Moreover, further reductions in the ceiling may be required to stabilise national debt. A presidential committee will consider options in this regard to be tabled as part of the MTEF tabled with the 2018 Budget.

Expenditure trends are discussed in Chapter 4. Various risks and pressures need to be taken into account over the medium term:

- Additional spending commitments may emerge from policy processes under way. Government is evaluating the implications of providing fee-free higher education and training to poor and middle-income students. Other policy commitments include NHI, proposals in the Defence Review, improved early childhood development, accelerated land reform and several large infrastructure project proposals.
- The inflation outlook has been revised down compared with the 2017 Budget, relieving pressure on inflation-linked expenditure such as the wage bill. However, public-sector remuneration budgets pose a large and imminent risk, with the possibility that some national and provincial departments will exceed compensation ceilings.
- A new civil service wage agreement in which salary increases exceed CPI inflation, and without headcount reductions, would render the current expenditure limits difficult to achieve. Analysis of compensation trends appears in Annexure B.
- Several state-owned companies persistently demonstrate operational inefficiencies, poor procurement practices, weak corporate governance and failures to abide by fiduciary obligations. The risk here is substantial, as discussed in the box below.

These and other fiscal risks are discussed at length in Annexure A.

Fiscal risks posed by state-owned companies

Since 2012, the profitability of state-owned companies has declined due to a combination of operational inefficiencies, governance failures and weak demand. These factors have increased reliance on borrowing to fund operations, leaving several entities heavily indebted, without sufficient cash to service their debt obligations or even to run their operations.

With no meaningful prospects of a short-term recovery in earnings, lenders are increasingly unwilling to roll over maturing debt or extend new loans, even with government guarantees. State-owned companies that have been able to roll over maturing debt have done so on an increasingly unsustainable basis, with shorter repayment terms, higher interest rates or reliance on government guarantees. Several lenders have declined to roll over debt falling due and required settlement.

Government stepped in to bail out SAA, preventing a call on guarantees or the liquidation of the carrier. It is unlikely that SAPO would have been able to settle its loan without state support given the deficit it has been running for months. Several others, including Denel, South African Express and the South African Broadcasting Corporation face liquidity shortfalls, and will likely require some form of intervention from government.

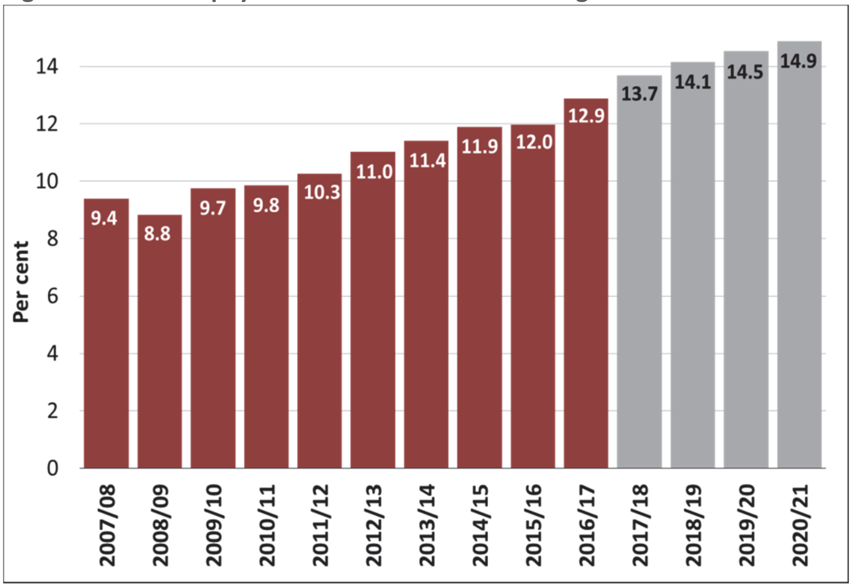
Debt-service costs

At a time when revenue is under pressure, an increasing share of tax collection will be diverted to settle interest payments. As gross debt expands, debt service will remain the fastest-growing category of spending over the next three years.

Mounting debt-service costs crowd out social and economic expenditure

Relative to the 2017 Budget projections, debt-service costs will be R1 billion higher in 2017/18, R2.4 billion higher in 2018/19 and R6 billion higher in 2019/20. By 2020/21, government projects that nearly 15 per cent of main budget revenue will go toward servicing debt. This crowds out the space to fund social and economic priorities.

Figure 3.4 Interest payments as a share of main budget revenue



Source: National Treasury

Over the next two years, the impact of higher borrowing will be partially offset by two factors. Lower interest rates have reduced short-term debt-service costs following the Reserve Bank's decision to cut the repo rate. And the stronger-than-anticipated exchange rate has eased interest payments on debt denominated in foreign currency.

Fiscal framework

Main budget framework

Revenue projected to grow to 26.3 per cent of GDP in 2020/21, while expenditure will rise to 30.9 per cent of GDP

The main budget framework, presented in Table 3.5, summarises expenditure financed from the National Revenue Fund. Main budget revenue is projected to grow from 25.5 per cent of GDP in 2017/18 to 26.3 per cent of GDP in 2020/21. Over the same period, main budget expenditure will grow from 30.2 per cent of GDP to 30.9 per cent of GDP.

The main budget deficit, which is government's net borrowing requirement, will be 4.7 per cent of GDP in 2017/18, compared with a 2017 Budget projection of 3.5 per cent. Borrowing will need to be R52.8 billion higher than projected in the current year, mainly as a result of revenue shortfalls. Over the medium term, the main budget deficit is expected to stabilise at 4.6 per cent of GDP. The primary balance – the difference between revenue and non-interest spending – had been projected to continue narrowing. However, revenue shortfalls now result in the primary deficit stabilising at 0.7 per cent of GDP.

Table 3.5 Main budget framework

R billion/percentage of GDP	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
		Outcome		Revised	Medium-term estimates		
Main budget revenue	**965.5**	**1 076.2**	**1 137.6**	**1 193.5**	**1 294.5**	**1 398.9**	**1 502.1**
	25.0%	*26.1%*	*25.8%*	*25.5%*	*26.1%*	*26.3%*	*26.3%*
Main budget expenditure	**1 131.9**	**1 244.6**	**1 305.5**	**1 413.1**	**1 516.6**	**1 642.0**	**1 767.4**
	29.3%	*30.2%*	*29.6%*	*30.2%*	*30.5%*	*30.9%*	*30.9%*
Non-interest expenditure	1 017.1	1 115.8	1 159.0	1 249.8	1 333.5	1 438.7	1 544.1
	26.3%	*27.1%*	*26.3%*	*26.7%*	*26.8%*	*27.1%*	*27.0%*
Debt-service costs	114.8	128.8	146.5	163.3	183.1	203.3	223.4
	3.0%	*3.1%*	*3.3%*	*3.5%*	*3.7%*	*3.8%*	*3.9%*
Main budget balance	**-166.4**	**-168.4**	**-167.8**	**-219.6**	**-222.0**	**-243.1**	**-265.3**
	-4.3%	*-4.1%*	*-3.8%*	*-4.7%*	*-4.5%*	*-4.6%*	*-4.6%*
Primary balance	**-51.6**	**-39.6**	**-21.3**	**-56.3**	**-39.0**	**-39.8**	**-42.0**
	-1.3%	*-1.0%*	*-0.5%*	*-1.2%*	*-0.8%*	*-0.7%*	*-0.7%*

Source: National Treasury

Consolidated budget framework

The consolidated budget includes the main budget and spending financed from the revenues raised directly by provinces, social security funds and public entities.

Social security funds, primarily the Unemployment Insurance Fund, continue to run a surplus

The estimates for social security funds and public entities over the 2017/18 – 2019/20 period remain unchanged from the 2017 Budget. Social security funds are expected to continue operating with an annual cash surplus, the bulk of which comes from the Unemployment Insurance Fund. Public entities are government agencies that largely operate on the basis of transfers from the fiscus, supported in some cases by user charges. The deficit of public entities in the current year reflects the financing of increased allocations of the National Student Financial Aid Scheme from the retained surpluses of the National Skills Fund, as announced at the time of the 2017 Budget. Otherwise, public entities collectively continue to operate with an annual cash surplus.

Provincial data has been revised in line with tabled provincial budgets and annual financial statements. Reduced allocations to provinces last year were cushioned by running down cash reserves previously built up by provincial governments. The Reconstruction and Development Fund is the statutory conduit for resources donated by international development partners, which are received up front and run down over time.

Taken together, the annual cash balances of the social security funds and public entities offset the deficit on the main budget. The consolidated deficit is now projected at 4.3 per cent of GDP compared with a 2017 Budget estimate of 3.1 per cent of GDP. Over the next two years, the consolidated budget deficit is projected to be 1.2 per cent of GDP wider than the 2017 Budget estimate.

Table 3.6 Consolidated fiscal framework

R billion/percentage of GDP	2014/15	2015/16 Outcome	2016/17	2017/18 Revised	2018/19	2019/20 Medium-term estimates	2020/21
Main budget							
Revenue	965.5	1 076.2	1 137.6	1 193.5	1 294.5	1 398.9	1 502.1
Expenditure	1 131.9	1 244.6	1 305.5	1 413.1	1 516.6	1 642.0	1 767.4
Balance	**-166.4**	**-168.4**	**-167.8**	**-219.6**	**-222.0**	**-243.1**	**-265.3**
Social security funds							
Revenue	51.3	63.9	72.9	76.9	81.6	86.1	90.8
Expenditure	35.5	45.0	53.1	55.5	58.3	61.7	65.2
Balance	**15.8**	**18.9**	**19.8**	**21.4**	**23.2**	**24.4**	**25.7**
Public entities							
Revenue	63.5	62.8	66.9	73.5	79.2	86.3	92.4
Expenditure	54.0	55.7	64.3	77.6	73.5	76.5	81.9
Balance	**9.5**	**7.1**	**2.6**	**-4.1**	**5.7**	**9.9**	**10.6**
Other balances							
Provinces	6.2	0.6	-2.6	-0.8	0.3	1.1	3.6
RDP Fund	0.4	-0.5	0.6	0.1	-0.3	-0.3	-0.3
Consolidated budget							
Revenue	1 098.9	1 222.0	1 298.2	1 363.6	1 477.5	1 594.2	1 709.3
Expenditure	1 233.5	1 364.2	1 445.7	1 566.6	1 670.6	1 802.3	1 935.1
Balance	**-134.6**	**-142.2**	**-147.5**	**-203.0**	**-193.1**	**-208.1**	**-225.8**
	-3.5%	*-3.4%*	*-3.3%*	*-4.3%*	*-3.9%*	*-3.9%*	*-3.9%*

Source: National Treasury

Financing and debt management strategy

Gross loan debt is expected to increase from R2.5 trillion or 54.2 per cent of GDP in 2017/18 to R3.4 trillion or 59.7 per cent of GDP in 2020/21. Absent higher economic growth or additional steps to narrow the budget deficit, the debt-to-GDP ratio is unlikely to stabilise over the medium term.

Table 3.7 Total national government debt

End of period R billion	2016/17 Outcome	2017/18 Estimate	2018/19	2019/20 Medium-term estimates	2020/21
Domestic loans[1]	**2 020.1**	**2 281.2**	**2 529.9**	**2 793.0**	**3 075.7**
Short-term	277.2	310.1	331.7	360.7	396.7
Long-term	1 742.9	1 971.1	2 198.2	2 432.3	2 679.0
Fixed-rate	*1 300.3*	*1 452.5*	*1 605.1*	*1 757.0*	*1 915.4*
Inflation-linked	*442.6*	*518.6*	*593.1*	*675.3*	*763.6*
Foreign loans[1]	**212.8**	**249.3**	**299.7**	**301.2**	**339.9**
Gross loan debt	**2 232.9**	**2 530.5**	**2 829.6**	**3 094.2**	**3 415.6**
Less: National Revenue Fund bank balances	-224.6	-236.3	-261.1	-230.6	-236.2
Net loan debt[2]	**2 008.3**	**2 294.2**	**2 568.5**	**2 863.6**	**3 179.4**
As percentage of GDP:					
Gross loan debt	*50.7%*	*54.2%*	*57.0%*	*58.2%*	*59.7%*
Net loan debt	*45.6%*	*49.1%*	*51.7%*	*53.9%*	*55.6%*

1. Estimates include revaluations based on National Treasury's projections of inflation and exchange rates
2. Net loan debt is gross loan debt minus the bank balances of the National Revenue Fund
Source: National Treasury

In addition to the main budget deficit, government needs to refinance maturing debt. Debt redemptions that need to be rolled over increase to R109.3 billion in 2019/20, mainly due to large foreign loan redemptions. This refinancing will be done at higher forecasted long-term interest rates.

Over medium term, gross borrowing requirement is nearly R1 trillion

The gross borrowing requirement – defined as the sum of budget deficits and funds required to roll over (refinance) debt that matures during a year – is projected to increase from R248.3 billion in 2017/18 to R333.5 billion in 2020/21. Over the medium term, the gross borrowing requirement is close to R1 trillion. The refinancing of Treasury bills with maturities of less than a year is not included in the table below. These amount to R1.6 trillion over the same period.

Table 3.8 Gross borrowing requirement

	2016/17	2017/18		2018/19	2019/20	2020/21
R billion	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Main budget deficit	**167.8**	**166.8**	**219.6**	**222.0**	**243.1**	**265.3**
Redemptions	**73.1**	**54.1**	**28.7**	**48.7**	**109.4**	**68.2**
Domestic long-term loans	57.4	49.5	24.6	46.4	58.9	55.9
Foreign loans	15.7	4.6	4.1	2.3	50.5	12.3
Total	**240.9**	**220.9**	**248.3**	**270.7**	**352.5**	**333.5**
Percentage of GDP	*5.5%*	*4.7%*	*5.3%*	*5.4%*	*6.6%*	*5.8%*

Source: National Treasury

Government's borrowing programme is underpinned by prudent benchmarks for refinancing, interest, inflation and currency risks, which ensure the debt portfolio remains well-structured.

In response to the widening deficit, government has adjusted its funding strategy, but will remain within its benchmarks. Adjustments include:

- Increasing Treasury bill issuance to use as bridging finance and to fund part of the higher borrowing requirement.
- Raising the amount of debt issued in weekly auctions for both fixed-rate and inflation-linked bonds.
- Increasing borrowing from global markets to pre-fund foreign-currency redemptions in 2019/20, and to fully cover government's foreign-currency commitments.

Details of government's financing of the borrowing requirement by instrument are shown in Annexure C.