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Growth, sustainability and renewal

The *Medium Term Budget Policy Statement* (MTBPS) aims to communicate government's policy stance, and to encourage Parliament and the public to debate options for the economy and the public finances. The 2019 MTBPS proposes an approach over the medium term that, effectively implemented, will restore the momentum of economic growth and stabilise the public finances.

South Africa's economic growth is now projected at 0.5 per cent for 2019, as long-term growth estimates have fallen. As a result, revenue projections have been sharply reduced. Spending pressures continue to mount, led by the public-service wage bill and state-owned companies in crisis. The combination of lower revenue and increased spending widens the budget deficit to an average of 6.2 per cent over the next three years. Debt and debt-service costs will continue to increase. Globally, a synchronised economic slowdown has caused downward revisions to growth in both developed and developing countries.

South Africa's macroeconomic framework remains broadly supportive of investment and growth. The flexible exchange rate acts as a shock absorber and monetary policy has kept inflation contained within the 3 to 6 per cent target band. But this framework cannot substitute for necessary economic reforms. Persistent growth in the wage bill has worsened the composition of spending, while spending outcomes continue to disappoint. As a result, fiscal deficits have not raised long-run growth, and have begun to undermine confidence, push up interest rates and reduce the space for new priorities.

The MTBPS sets out measures to boost the economy, narrow the fiscal deficit and raise the quality of spending, particularly on large infrastructure projects. To mitigate the immediate risk that Eskom poses to the economy, the utility receives assistance to service its debt obligations. Addressing Eskom's underlying problems requires reinvigorated governance, operational efficiencies and restructuring.

Introduction

Government allocates funds to its central policy objectives – reducing poverty and inequality – through the budget. Over the next three years, spending will total R6.3 trillion, with 48 per cent of this amount going towards social grants, education and health. In the context of weak growth, however, revenue shortfalls and rising spending pressures are threatening government's ability to maintain existing levels of service provision and infrastructure investment.

Almost half of budget is allocated to social grants, education and health

South Africa's long-run economic growth has been slowing alongside productivity and competitiveness. In the decade since the global financial crisis, government has run large budget deficits, raising its borrowing and making the increase in South Africa's debt-to-GDP ratio among the highest of peer countries.

Yet this spending has not translated into stronger economic growth. Revenue growth has also been lower than expected, despite tax measures. Without intervention, the persistent gap between revenue and expenditure now puts government debt on an upward trajectory over the next 10 years.

Figure 1.1 Ten-year change in debt-to-GDP ratio

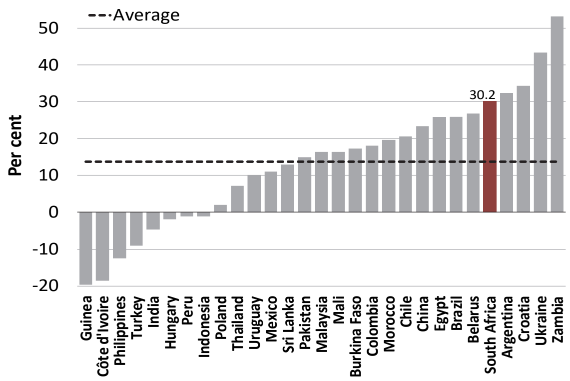


Figure 1.2 Real GDP growth

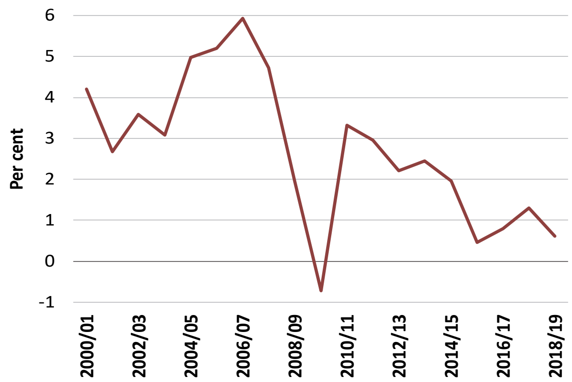


Figure 1.3 Main budget revenue and spending

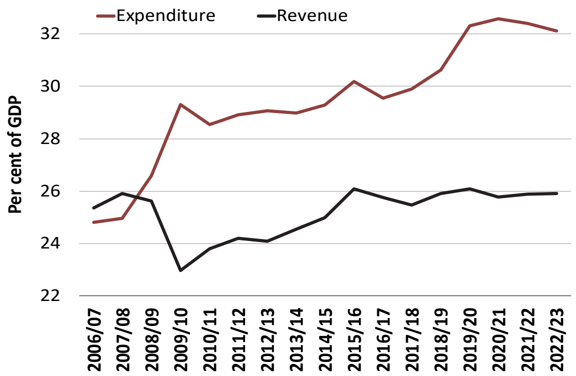
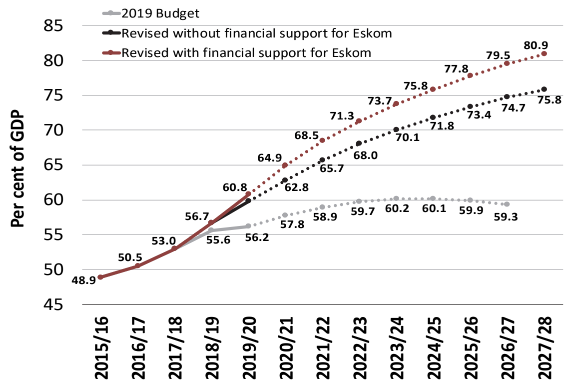


Figure 1.4 Debt-to-GDP outlook



Source: IMF World Economic Outlook, April 2019, and National Treasury

Growth in debt and debt-service costs is unsustainable and requires difficult decisions

This approach cannot be sustained. Main budget expenditure has been revised up since the 2019 *Budget Review*, primarily as a result of additional support for Eskom. In total, this support now amounts to R49 billion in 2019/20 and R56 billion in 2020/21. Excluding these amounts, debt-service costs is the fastest-growing area of spending and reaches R204 billion in the current year. Gross tax revenue is projected to fall short of the 2019 Budget estimates by R52.5 billion in 2019/20 and R84 billion in 2020/21, reflecting the weaker economic environment.

The deficit is expected to widen substantially over the next three years relative to 2019 Budget estimates. Difficult decisions are now required to stabilise the public finances.

The 2019 MTBPS proposes measures to narrow the fiscal deficit, boost the economy and improve the quality of spending, particularly on large infrastructure projects.

Departmental baselines reduced and slower spending in outer year

As a first step, government is clawing back some of the revenue shortfall through reductions to departmental baselines and slower spending growth in the outer year of the medium-term expenditure framework (MTEF). Alone, these reductions are insufficient. Additional measures, particularly on the wage bill, will be required to narrow the deficit and improve the composition of spending.

In August, the paper released by the National Treasury outlined short- and medium-term reforms that can boost economic growth, many of which do not require significant state resources. Interventions to improve the quality of infrastructure planning, including the Budget Facility for Infrastructure, are beginning to show results. Government continues to work with the private sector through the Infrastructure Fund and other initiatives. Further measures to reduce wasteful expenditure, including by limiting claims against the state, will be implemented in the coming year.

Government is providing medium-term support to Eskom to secure energy supply and to honour the state's contractual obligations. The National Treasury, in partnership with the Department of Public Enterprises, is instituting a series of measures to bring discipline to the utility's finances, and to step up the timeline for restructuring.

Stabilising the public finances

Relative to the 2019 Budget, the MTBPS shows an increase in main budget non-interest spending of R23 billion in 2020/21 and a reduction of R8.2 billion in 2021/22. These changes reflect the net impact of spending additions, mainly financial support for Eskom, and the baseline reductions made to goods and services, and transfers. In 2022/23, spending will be contained in line with consumer price index (CPI) inflation.

Proposed fiscal target is a main budget primary balance by 2022/23

Stabilising government's debt-to-GDP ratio requires narrowing the gap between revenue and expenditure further. Accordingly, government proposes a fiscal target of achieving a main budget primary balance – in other words, revenue equal to non-interest expenditure – by 2022/23. This metric excludes financial support for Eskom, which will be addressed through separate operational and financial reforms.

Achieving the fiscal target requires large additional adjustments exceeding R150 billion in total over the medium term. The following elements will be critical:

- Growth in the public-service wage bill needs to decline to reduce the pressure on goods and services and infrastructure. The wage bill accounts for 46 per cent of tax revenue in 2019/20, primarily because of above-inflation increases in average remuneration over the past decade.
- Significant tax increases over the past several years leave only moderate scope to boost tax revenue at this time. Given the size of the required adjustment, however, additional tax measures are under consideration.
- To reduce future transfers, a sustainable plan for state-owned companies is required. It should include the disposal of non-core assets and options for private-sector participation.

Near-term costs of fiscal adjustment outweighed by need to ensure sustainable public finances

The final adjustments will be announced in the 2020 Budget. These measures require difficult decisions that will affect the economy and the distribution of public resources. The short-term costs, however, are outweighed by the need to ensure sustainable public finances for decades to come, ensuring intergenerational fairness.

Promoting investment and economic growth

Government's economic policy priority is to enact reforms that will enable South Africa to break from the spiral of anaemic growth, promoting investment and job creation.

Policy certainty and a conducive business environment are critical to support the confidence of businesses and households. A robust monetary policy framework has provided certainty but needs to be complemented with a range of reforms that are within government's control and do not require significant funding. These would help to raise long-term growth.

Some short-term growth reforms do not require significant resources

The paper titled *Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa*, which the National Treasury released in 2019, has begun a vigorous national debate on the reforms required to raise growth. The interventions consider strengthening network industries, such as road and rail; enhancing South Africa's export competitiveness to boost exports, employment and innovation; and promoting greater competition within the economy, enabling small firms to grow and compete with dominant players. Many of these overlap with the package of measures announced in the 2018 MTBPS. Several reforms do not require significant state resources. These include:

- Supporting tourism by reducing the cost of traveling to South Africa, and cutting red tape for small businesses in the tourism sector.
- Diversifying power generation by granting licences for small-scale power generation projects approved by the Minister of Energy.
- Expanding telecommunications services by allowing for the rapid expansion of fibre infrastructure.
- Lowering the cost of doing business by automating various registration and filing processes.

Reforms should be enacted now in transport, water, telecommunications and industrial and trade policy

Medium-term reforms also need to begin immediately in transport, water, telecommunications, and industrial and trade policy, although they will likely only be completed over the next three years.

Government continues to work with the private sector to strengthen infrastructure investment. Efforts are focused on raising the efficiency of spending and crowding in private-sector investment. The National Treasury has begun a review of public-private partnership regulation aimed at merging approval processes and reducing implementation timeframes. This project is already under way and its findings will be published by September 2020.

Improving the pipeline of infrastructure projects with the Infrastructure Fund

Over the past year, government has made progress in setting up a blended-finance Infrastructure Fund. The fund's implementation unit has been established and is housed within the Development Bank of Southern Africa (DBSA). Its aim is to fast-track the development of projects and programmes by drawing on existing capacity in the Presidential Infrastructure Coordinating Commission, the National Treasury, the Government Technical Advisory Centre (GTAC) and the Independent Power Producers Office.

The unit is also identifying policy and regulatory hurdles in the public sector that hamper private and public investment. It is collaborating with the private sector through associations such as the Banking Association South Africa, the Association for Savings and Investment South Africa, and the Public Private Growth Initiative.

Government set aside R100 billion over a decade to co-finance programmes and projects that blend public and private resources, with R10 billion in the baseline for the next three years. Pilot projects, including the Student Housing Infrastructure Programme and Small Harbours Programme, receive R529.8 million in the current year. The implementation unit is developing a pipeline of projects for funding that includes proposals from government, the private sector and the DBSA. To date, the implementation unit for the Infrastructure Fund has identified possible projects and programmes amounting to more than R500 billion.

Public-sector infrastructure projects are plagued by poor planning and implementation. This is reflected in continued underspending, which reached 20 per cent of capital budgets in 2018/19.

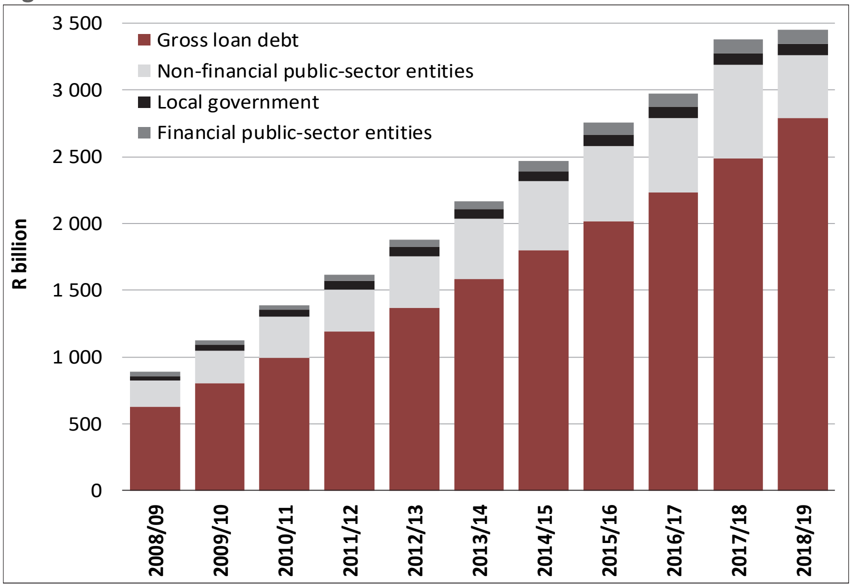
Marked progress in quality of infrastructure proposals, with associated reduction in rejection rates

The Budget Facility for Infrastructure, a technical entity that reviews complex capital projects, has strengthened state capacity to consider and budget for large infrastructure projects and programmes. These interventions have begun to yield results, such as an improvement in the quality of budget bids and an associated reduction in rejection rates. The 2019 MTBPS proposes allocations of R3.4 billion over the next three years for these projects, including student housing at three universities, school facilities and health infrastructure.

Stabilising state-owned companies

Several large state-owned companies are in crisis as a result of governance failures, poor operational performance and resultant unsustainable debt burdens. Figure 1.5 shows how these debts have grown alongside government debt. Government has increased spending to meet its obligations for guaranteed debt, but decisions are required to manage the ongoing impact of these entities on the fiscus. A programme of reforms is being enacted to strengthen governance and operations at these entities, and to stabilise those in financial distress.

Figure 1.5 Public-sector debt



Source: Reserve Bank

Managing the Eskom risk

Over the medium term and beyond, government will manage the massive risk to the economy and the fiscus associated with Eskom. This requires addressing the utility's operational viability, which has a significant impact on its debt profile.

Faster progress needed to effect separation of Eskom into three entities

The National Treasury and the Department of Public Enterprises are working with the utility to implement the plan, announced in the February 2019 State of the Nation Address, to separate Eskom into three distinct entities (generation, transmission, distribution) and conduct wide-ranging reforms to achieve operational efficiency.

The Ministers of Finance and Public Enterprises have appointed independent experts to conduct rigorous assessments at Eskom. These include analysing the utility's daily cash-flow management and assessing the implementation of operational efficiencies, which include considering whether capital expenditure can be stopped or deferred.

Reduction of Eskom's debt burden will only be considered after it cuts costs and starts unbundling

The short-term priority is to stabilise Eskom's cash-flow management, while undertaking the separation. Government has made provisional support of R49 billion available in 2019/20, R56 billion in 2020/21 and R33 billion in 2021/22. Should Eskom be unable to issue debt, government may be called upon to provide further support to enable the company to meet its obligations. Additional reforms to reduce Eskom's debt burden will only be considered once the utility reduces costs and makes progress in the unbundling process.

Government is committed to the separation of the three functions in conjunction with the necessary organisational reforms. Implementing this major reform successfully and timeously will require focus from Eskom management and the Board, and work across government to resolve structural issues that affect Eskom's financial viability.

This separation will mark the beginning of a transition in the electricity sector from the dominance of an inefficient, vertically integrated monopoly to a competitive sector that includes a financially viable utility with clear lines of accountability. Annexure C reviews the status of the Eskom restructuring, discusses government interventions to date and outlines projections for medium-term fiscal support.

Reforms support creation of financially viable and accountable electricity utility

Other state-owned companies

Other state-owned companies are also adding to spending pressures on government. Funding for South African Airways (SAA), the South African Broadcasting Corporation, Denel and South African Express amounts to R10.8 billion in the current year, almost the entire contingency reserve for 2019/20.

In its current configuration, SAA is unlikely to generate sufficient cash flow to sustain operations. It is unable to repay outstanding government guaranteed debt of R9.2 billion. Government will repay this debt over the next three years to honour its contractual obligation. Operational changes at SAA are required urgently.

Improving spending efficiency and reducing waste

Unsustainable fiscal finances harm South Africans by raising real spending on interest costs. Inefficient and ineffective spending harms South Africans by wasting limited public resources. Given South Africa’s progressive budgetary spending, the poor are most severely affected by these challenges.

Where possible given budgetary constraints, government is shifting resources to areas that urgently need to strengthen capacity. Through reprioritisation, the National Prosecuting Authority receives an additional R1.3 billion, and the South African Revenue Service receives an additional R1 billion for the period 2019/20 to 2022/23. These funding shifts will bolster efforts to combat corruption and improve revenue collection.

Over the coming year, as part of its effort to improve efficiency and reduce wasteful expenditure, government will:

Overlapping agencies to be merged, unused land to be sold, new road accident scheme to be accelerated

- Merge and consolidate entities and regulatory agencies, as well as consider salary controls at a wider range of public entities.
- Dispose of unused land and other assets.
- Initiate work to limit claims against the state, including through a review of medico-legal claims and accelerated implementation of the Road Accident Benefit Scheme.
- Implement recommendations from expenditure reviews to identify cost savings and improve efficiency.
- Manage the benefits received by political office bearers, through reforms to the Ministerial Handbook.
- Review the existing procurement regulatory framework, through the Public Procurement Bill, to simplify procurement processes and governance. The bill will be gazetted for public comment once Cabinet grants approval to do so.

Overview of the 2019 MTBPS

Economic overview

Gradual recovery in confidence and investment expected over medium term

Chapter 2 sets out the medium-term economic forecast, alongside proposals to accelerate economic growth. The GDP growth forecast for 2019 has been revised down from 1.5 per cent in the 2019 Budget to 0.5 per cent, with growth expected to reach 1.7 per cent in 2022. Inflation is expected to remain within the 3 to 6 per cent target band over the medium term. Weakening global growth, associated with rising trade conflicts alongside low levels of competitiveness, moderate growth in the forecast. A gradual recovery in confidence and investment is expected over the medium term.

Table 1.1 Macroeconomic projections

Calendar year	2018 Actual	2019 Estimate	2020	2021 Forecast	2022
Percentage change unless otherwise indicated					
Household consumption	1.8	1.3	1.3	1.5	1.7
Gross fixed-capital formation	-1.4	-0.8	0.8	1.3	1.8
Real GDP growth	**0.8**	**0.5**	**1.2**	**1.6**	**1.7**
GDP at current prices (R billion)	**4 874.0**	**5 131.7**	**5 448.9**	**5 804.4**	**6 187.4**
CPI inflation	4.7	4.3	4.9	4.8	4.8
Current account balance (% of GDP)	-3.5	-3.4	-3.5	-3.5	-3.5

Source: Reserve Bank and National Treasury

Fiscal policy

Chapter 3 provides an overview of fiscal policy, including proposals to reduce expenditure growth and manage the wage bill in order to achieve the fiscal target.

The expenditure ceiling – which excludes support to Eskom – is revised down for this year and the next two years, relative to the 2019 Budget. The consolidated deficit, which includes national and provincial government, public entities and social security funds, is projected to narrow from 6.5 per cent of GDP in 2020/21 to 5.9 per cent of GDP in 2022/23.

Table 1.2 Consolidated government fiscal framework

R billion/percentage of GDP	2018/19 Outcome	2019/20 Revised	2020/21	2021/22 Medium-term estimates	2022/23
Revenue	**1 445.4**	**1 537.8**	**1 618.5**	**1 729.6**	**1 841.2**
	29.4%	*29.5%*	*29.3%*	*29.4%*	*29.3%*
Expenditure	**1 652.8**	**1 844.1**	**1 978.7**	**2 097.5**	**2 214.9**
	33.6%	*35.4%*	*35.8%*	*35.6%*	*35.3%*
Budget balance	**-207.5**	**-306.2**	**-360.2**	**-367.9**	**-373.7**
	-4.2%	*-5.9%*	*-6.5%*	*-6.2%*	*-5.9%*
Total gross loan debt	**2 788.4**	**3 167.6**	**3 590.8**	**4 035.7**	**4 477.7**
	56.7%	*60.8%*	*64.9%*	*68.5%*	*71.3%*

Source: National Treasury

Expenditure priorities

Chapter 4 outlines government’s three-year spending priorities and explains how nationally raised funding is divided between national, provincial and local government. The budget continues to prioritise education, health and social assistance. Despite baseline reductions, consolidated non-interest spending grows by 0.5 per cent in real terms over the medium term. Excluding support for Eskom and other payments for financial assets, real non-interest spending growth averages 1.4 per cent over the next three years. Financial payments (mostly support for state-owned companies), debt-service costs and wages are the fastest-growing areas of expenditure.

Table 1.3 Consolidated government expenditure

R billion	2019/20 Revised	2020/21	2021/22	2022/23	Average annual growth 2019/20 – 2022/23
		Medium-term estimates			
Learning and culture	386.0	411.0	437.6	457.8	5.9%
Health	222.7	238.5	257.2	272.9	7.0%
Social development	277.1	295.6	312.9	331.3	6.1%
Community development	200.2	213.3	230.2	245.1	7.0%
Economic development	205.8	217.5	235.5	251.1	6.9%
Peace and security	214.3	224.9	233.5	243.8	4.4%
General public services	67.0	71.3	75.5	77.5	5.0%
Payments for financial assets	67.1	67.9	44.6	30.0	–
Total expenditure by function	**1 640.3**	**1 740.0**	**1 827.0**	**1 909.8**	**5.2%**
Debt-service costs	203.7	232.8	264.6	299.1	13.7%
Contingency reserve	–	6.0	6.0	6.0	–
Total expenditure	**1 844.1**	**1 978.7**	**2 097.5**	**2 214.9**	**6.3%**

Source: National Treasury

Additional information

The MTBPS includes five annexures:

- Annexure A contains the fiscal risk statement, which outlines events that could affect baseline projections for economic growth, revenue and spending.
- Annexure B presents data on the compensation of public-service employees.
- Annexure C discusses the status of Eskom's restructuring and government support to stabilise the utility.
- Annexure D presents technical information and data.
- Annexure E is the glossary.

Conclusion

The 2019 MTBPS proposals are intended to promote economic growth and fiscal sustainability. Doing both will require difficult decisions that can no longer be postponed.

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