2019 MTBPS

MEDIUM TERM BUDGET POLICY STATEMENT

GROWTH, SUSTAINABILITY AND RENEWAL

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Main messages

2019 MTBPS MEDIUM TERM BUDGET POLICY STATEMENT

- 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 2019 MTBPS proposes an approach over the medium term that, effectively implemented, will restore the momentum of economic growth and stabilise the public finances.
- Over the next three years, consolidated spending will total R6.3 trillion, with 48 per cent of this amount going towards social grants, education and health. Revenue shortfalls and rising spending pressures are threatening government's ability to maintain existing levels of service provision and infrastructure investment.
- The consolidated budget deficit averages 6.2 per cent of GDP over the next three years. Debt and debt-service costs will continue to increase, with the debt-to-GDP ratio now estimated at 71.3 per cent in 2022/23.
- Government has clawed back some of the revenue shortfall through reductions to departmental baselines and slower spending growth in 2022/23. Alone, these reductions are insufficient. Additional measures, particularly on the wage bill, will be required to stabilise the debt outlook and improve the composition of spending. Tax measures are also being considered.
- In August 2019, 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 are beginning to show some results. 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. Debt relief will only be considered once operational efficiencies have been achieved.

World economic growth is slowing

- Lower growth in both developed and developing economies in response to mounting global risks
- Global economic growth in 2019 projected at 3 per cent, the lowest figure since 2008 financial crisis
- Relative to the 2018 average, South Africa's risk premium has risen by about 0.3 percentage points, compared to an average decline of 0.3 percentage points in peer countries

Economic growth in selected countries

Region/country Percentage	2018 Actual	2019	2020 Average GDP (forecast)	2021	2022-2024
World	**3.6**	**3.0**	**3.4**	**3.6**	**3.6**
Advanced economies	**2.3**	**1.7**	**1.7**	**1.6**	**1.6**
United States	2.9	2.4	2.1	1.7	1.6
Euro area	1.9	1.2	1.4	1.4	1.3
United Kingdom	1.4	1.2	1.4	1.5	1.5
Japan	0.8	0.9	0.5	0.5	0.5
Developing countries	**4.5**	**3.9**	**4.6**	**4.8**	**4.8**
China	6.6	6.1	5.8	5.9	5.6
India	6.8	6.1	7.0	7.4	7.4
Brazil	1.1	0.9	2.0	2.4	2.4
Russia	2.3	1.1	1.9	2.0	1.9
Mexico	2.0	0.4	1.3	1.9	2.3
Sub-Saharan Africa	**3.2**	**3.2**	**3.6**	**3.7**	**4.1**
South Africa[1]	0.8	0.5	1.2	1.6	1.7

1. National Treasury forecasts. Note: Final numbers are for 2022

Source: IMF World Economic Outlook, October 2019, and IMF World Economic Outlook database

Domestic growth outlook is revised down

- 2019 GDP growth revised down from 1.5 per cent at the time of the 2019 Budget, to 0.5 per cent, mainly reflecting weaker total investment, exports and global growth
- The current account deficit is expected to remain at 3.5 per cent of GDP over the next three years, reflecting low import growth due to weaker domestic demand

Macroeconomic performance and projections

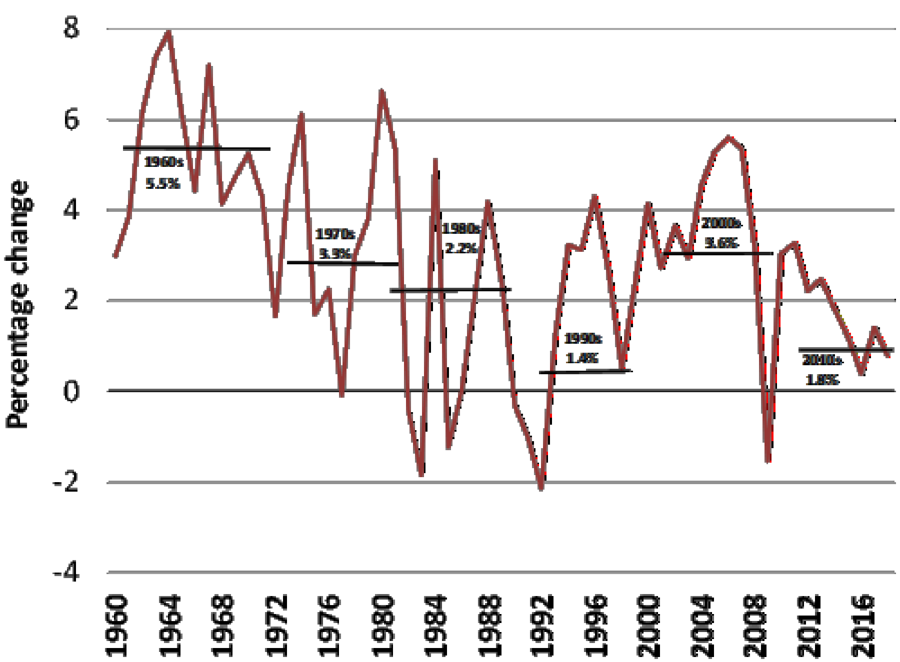
Calendar year	2017	2018	2019	2020	2021	2022
Percentage change	**Actual**		**Estimate**		**Forecast**	
Final household consumption	2.1	1.8	1.3	1.3	1.5	1.7
Final government consumption	0.2	1.9	1.8	1.8	1.1	0.6
Gross fixed-capital formation	1.0	-1.4	-0.8	0.8	1.3	1.8
Gross domestic expenditure	1.9	1.0	1.4	1.1	1.5	1.7
Exports	-0.7	2.6	-1.7	2.5	2.8	3.1
Imports	1.0	3.3	1.1	1.9	2.6	3.0
Real GDP growth	**1.4**	**0.8**	**0.5**	**1.2**	**1.6**	**1.7**
GDP inflation	5.3	3.9	4.8	4.9	4.9	4.8
GDP at current prices (R billion)	**4 654**	**4 874**	**5 132**	**5 449**	**5 804**	**6 187**
CPI inflation	5.3	4.7	4.3	4.9	4.8	4.8
Current account balance (% of GDP)	-2.5	-3.5	-3.4	-3.5	-3.5	-3.5

Source: National Treasury, Reserve Bank and Statistics South Africa

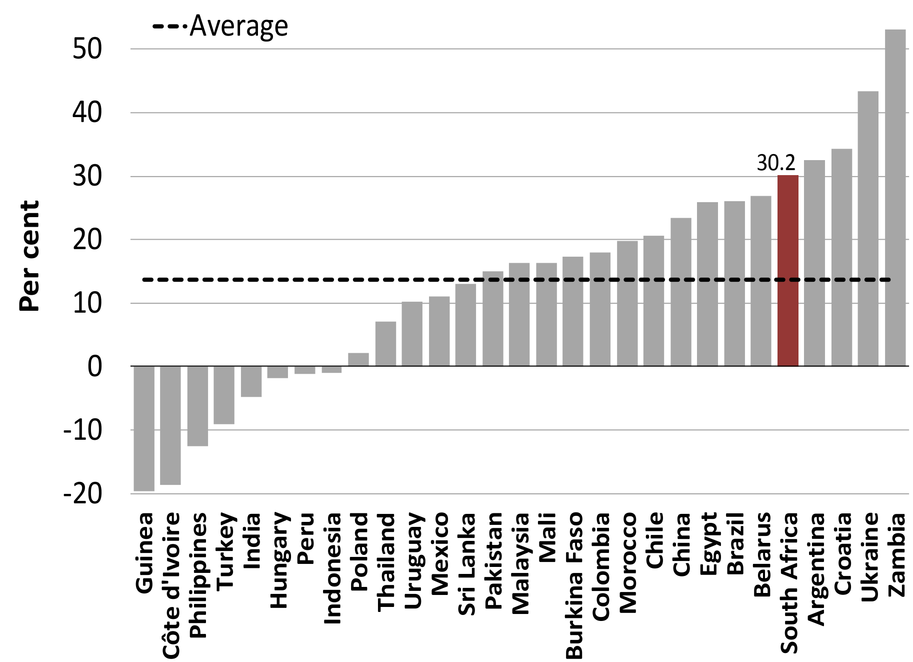
South Africa’s GDP growth trend has continued to decline and debt has risen

- Declining trend growth reflects many factors, including policy uncertainty, electricity supply shocks, lower investment levels, inefficient SOC investments and poor education outcomes
- Relative competitiveness has declined due to slower implementation of reforms than our peers
- 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

Long-term GDP growth



Ten-year change in debt-to-GDP ratio



Economic reforms are urgently required to raise GDP growth

- Discussion document titled *Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa* sets out short- and medium-term growth reforms
- Short-term reforms can be implemented immediately, without significant state resources:
  - Support tourism by reducing cost of traveling to South Africa, cutting red tape for small business in the tourism sector
  - Diversify power generation by granting licences for small-scale power generation projects approved by the Minister of Energy
  - Expand telecommunications services by allowing the rapid expansion of fibre infrastructure
  - Lowering the cost of doing business by automating registration and filing processes.
- Medium-term reforms should begin immediately in transport, water, telecommunications, and industrial and trade policy
- Government continues to work with private sector to strengthen investment
  - The Infrastructure Fund's implementation unit has been established, housed within the DBSA
  - Review of public-private partnership regulation is under way to streamline approval processes and reduce implementation timeframes

Revenue outlook has deteriorated

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- Compared with the 2019 Budget estimates, total revenue shortfall for 2019/20 will amount to R52.5 billion, reflecting:
  - A poor employment outlook, with job losses, lower wage settlements and smaller bonuses reducing personal income tax collection.
  - Reduced profitability in a difficult trading environment, resulting in lower-than-expected corporate income tax collections.
  - Weak household consumption, which moderates the increase in domestic VAT collection.
- Large downward revisions to tax revenue over the medium term

Revised revenue projections

R billion	2019/20	2020/21	2021/22	2022/23
2019 Budget	**1 422.2**	**1 544.9**	**1 670.4**	
Buoyancy	*1.31*	*1.17*	*1.08*	
Revised estimates	**1 369.7**	**1 460.9**	**1 555.7**	**1 658.2**
Buoyancy	*1.08*	*1.09*	*0.99*	*1.00*
Change since 2019 Budget	**-52.5**	**-84.0**	**-114.7**	

Source: National Treasury

Fiscal framework

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- The consolidated deficit includes national and provincial government, public entities and social security funds
- The consolidated deficit narrows from 6.5 per cent in 2020/21 to 5.9 per cent in 2022/23

Consolidated government fiscal framework

	2018/19	2019/20	2020/21	2021/22	2022/23
R billion/percentage of GDP	**Outcome**	**Revised**	**Medium-term estimates**		
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

In-year main budget non-interest expenditure adjustments

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Revisions to 2019/20 main budget non-interest expenditure

	R million
Non-interest expenditure (2019 Budget Review)	**1 456 500**
Upward expenditure adjustments	**44 527**
Budget Facility for Infrastructure projects and project preparation	630
Financial support to state-owned companies:	
Eskom Special Appropriation Bill	26 000
South African Airways	5 500
South African Broadcasting Corporation	3 200
Denel	1 800
South African Express	300
Self-financing[1]	1 655
Provisional downward adjustment not effected on compensation	4 800
Roll-overs	345
National Revenue Fund payments adjustment	224
Revision to members of Parliament remuneration	73
Downward expenditure adjustments	**(21 405)**
Declared unspent funds and revision to magistrates' salaries	(4 029)
Contingency reserve	(13 000)
Skills development levy	(182)
Provisional allocation not assigned to votes	(1 010)
National government projected underspending	(1 184)
Local government repayment to the National Revenue Fund	(2 000)
Revised non-interest expenditure (2019 MTBPS)	**1 479 622**
Change in non-interest expenditure from 2019 Budget	23 122
Change in non-interest expenditure excluding Eskom	(2 878)

1. Spending financed from revenue derived from departments' specific activities
Source: National Treasury

- Non-interest spending has increased by R23 billion in the current year, mainly due to a Special Appropriation Bill that allocates R26 billion to Eskom
- Government has accommodated all other expenditure pressures within budget baselines
- In-year adjustments are partially offset by the use of the contingency reserve, provisional allocations, projected underspending and declared unspent funds

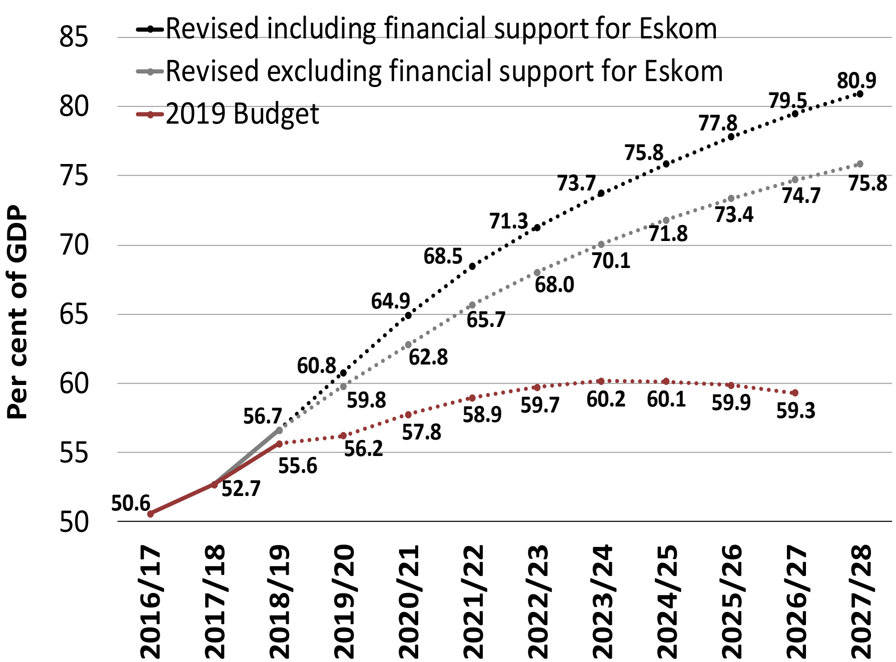
Medium-term non-interest expenditure adjustments

- Relative to the 2019 Budget, main budget non-interest expenditure increases by R23 billion in 2020/21, and decreases by R8.2 billion in 2021/22. These net changes include:
  - Increases in non-interest spending of R45 billion and R22 billion over the next two years, mainly as a result of additional support to Eskom.
  - Reductions of R21 billion in 2020/21 and R28.5 billion in 2021/22, mostly falling on goods and services, and current and capital transfers. Compensation is revised down marginally in line with lower CPI projections.
- The expected savings from compensation and other measures announced in the 2019 Budget – amounting to R12 billion annually over the next two years – have been reversed. Compensation measures will be included in a broader discussion between government and labour on future adjustments to wage bill growth
- In 2022/23, main budget non-interest spending will be contained in line with consumer price index (CPI) inflation

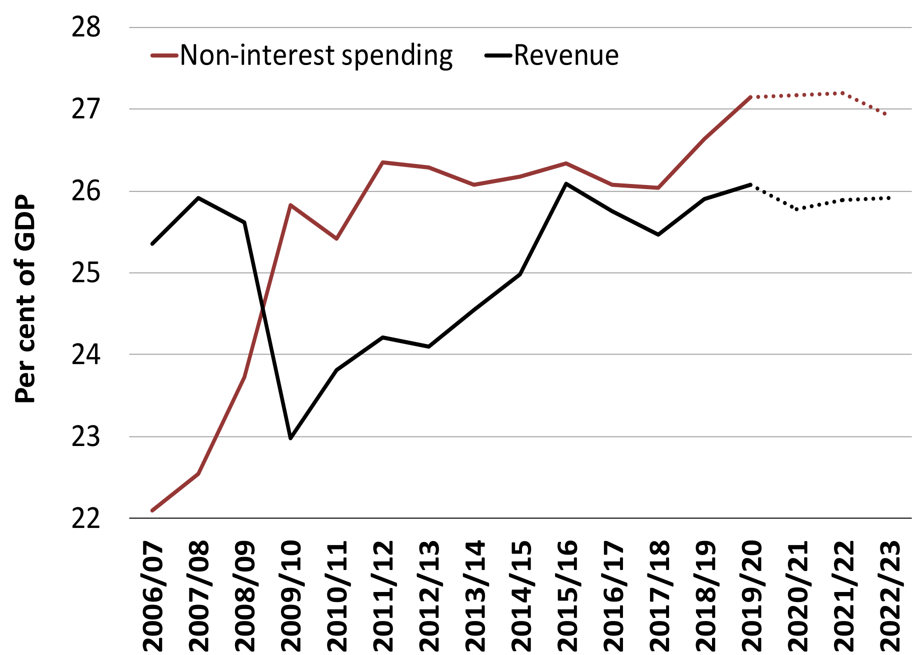
Main budget primary deficit and debt outlook

- Real main budget non-interest spending grows at 1.2 per cent in 2020/21, 0.1 per cent in 2021/22, and -0.2 per cent in 2022/23
- Main budget primary deficit narrows to 1.4 per cent of GDP in 2022/23
- Debt-to-GDP reaches 71.3 per cent in 2022/23 and, without additional measures, will continue to grow

Gross debt-to-GDP outlook



Main budget primary balance*

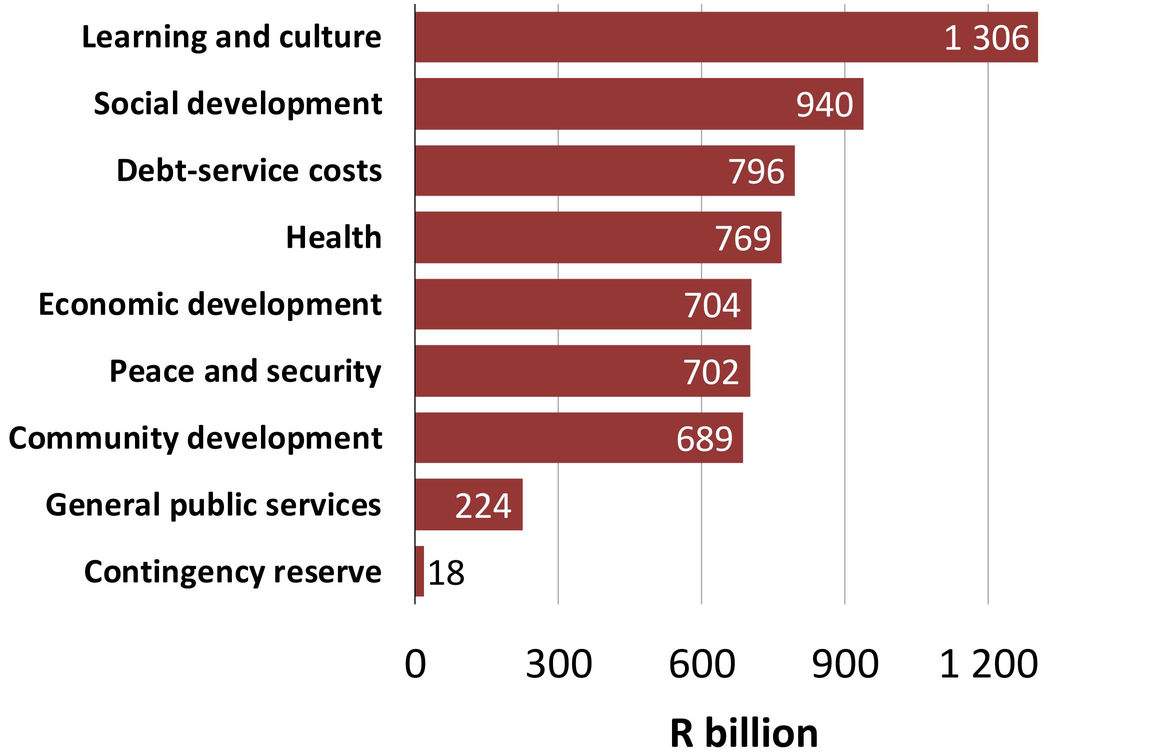


**Excluding Eskom financial support and transactions in financial assets and liabilities*

Expenditure priorities

- Consolidated government spending is expected to total R6.3 trillion over the MTEF period, growing at an average annual growth rate of 6.3 per cent
- Learning and culture, social development and health receive the largest allocations, amounting to R3 trillion over the next three years
- By 2022/23, debt-service costs are expected to exceed spending in areas such as health and economic development

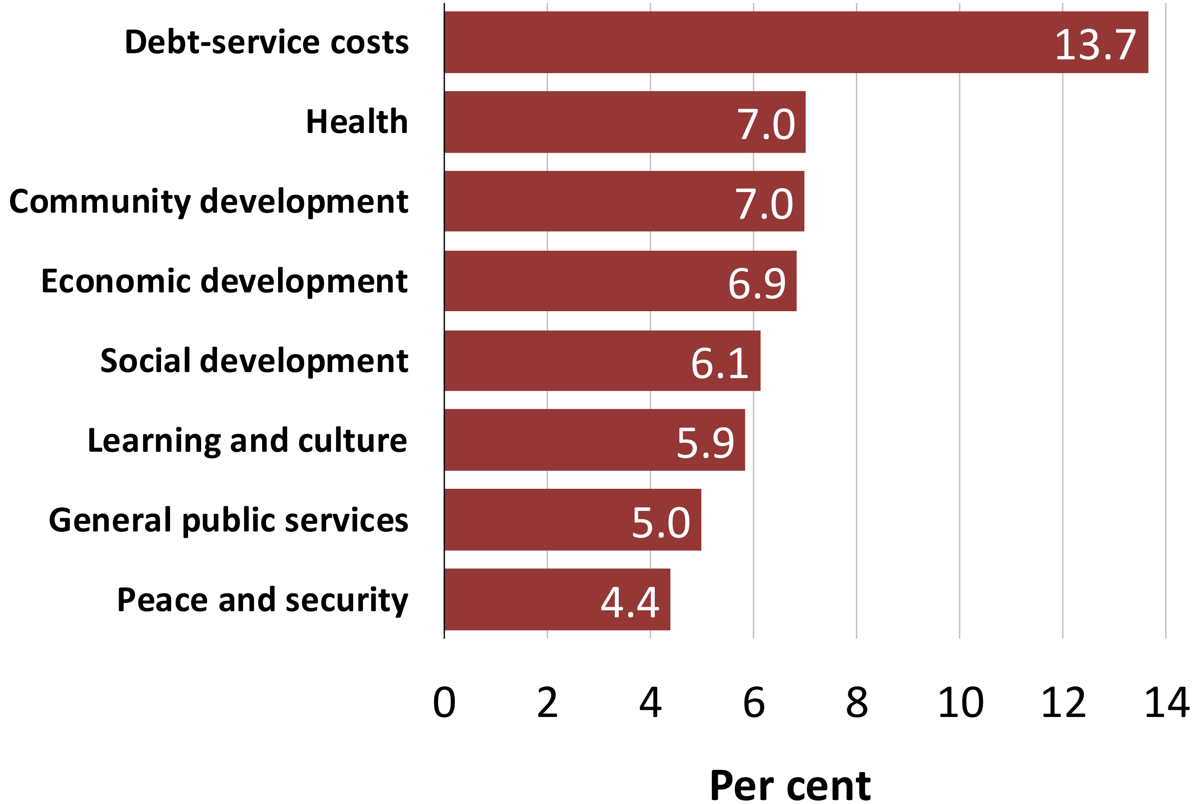
Consolidated government expenditure by function, 2020/21 – 22/23



Fastest growing areas of spending

- Financial payments (mostly support for state-owned companies), debt-service costs and wages are the fastest-growing areas of expenditure

Average nominal growth in consolidated spending, 2020/21 – 22/23



Division of revenue

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- Over the medium term, government proposes to allocate 48.1 per cent of available non-interest expenditure to national departments, 43 per cent to provinces and 8.9 per cent to local government
- Over this period, national government resources grow at an annual average of 2.3 per cent, provincial resources by 6.1 per cent and local government resources by 6.2 per cent

Division of revenue framework

R billion	2016/17	2017/18 Outcome	2018/19	2019/20 Revised	2020/21	2021/22 Medium-term estimates	2022/23
Division of available funds							
National departments	**555.7**	**592.7**	**634.4**	**742.8**	**757.4**	**766.2**	**796.2**
Provinces	**500.4**	**538.6**	**572.0**	**612.8**	**651.5**	**694.8**	**731.1**
Equitable share	410.7	441.3	470.3	505.6	541.0	576.7	607.6
Conditional grants	89.7	97.2	101.7	107.3	110.5	118.2	123.5
Local government	**102.9**	**111.1**	**118.5**	**127.2**	**132.4**	**143.0**	**152.2**
Equitable share	50.7	55.6	60.8	69.0	74.7	81.1	87.2
General fuel levy sharing with metropolitan municipalities	11.2	11.8	12.5	13.2	14.0	15.2	16.1
Conditional grants	40.9	43.7	45.3	45.1	43.7	46.8	49.0
Provisional allocations not assigned to votes	–	–	–	–	21.2	34.9	33.1
Projected underspending	–	–	–	-3.2	–	–	–
Total	**1 159.0**	**1 242.3**	**1 324.9**	**1 479.6**	**1 562.5**	**1 638.9**	**1 712.6**
Percentage shares							
National departments	48.0%	47.7%	47.9%	50.1%	49.1%	47.8%	47.4%
Provinces	43.2%	43.3%	43.2%	41.3%	42.3%	43.3%	43.5%
Local government	8.9%	8.9%	8.9%	8.6%	8.6%	8.9%	9.1%

Source: National Treasury

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Additional measures are needed to stabilise the public finances

- 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.
- 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.

Several state-owned companies are facing difficulties

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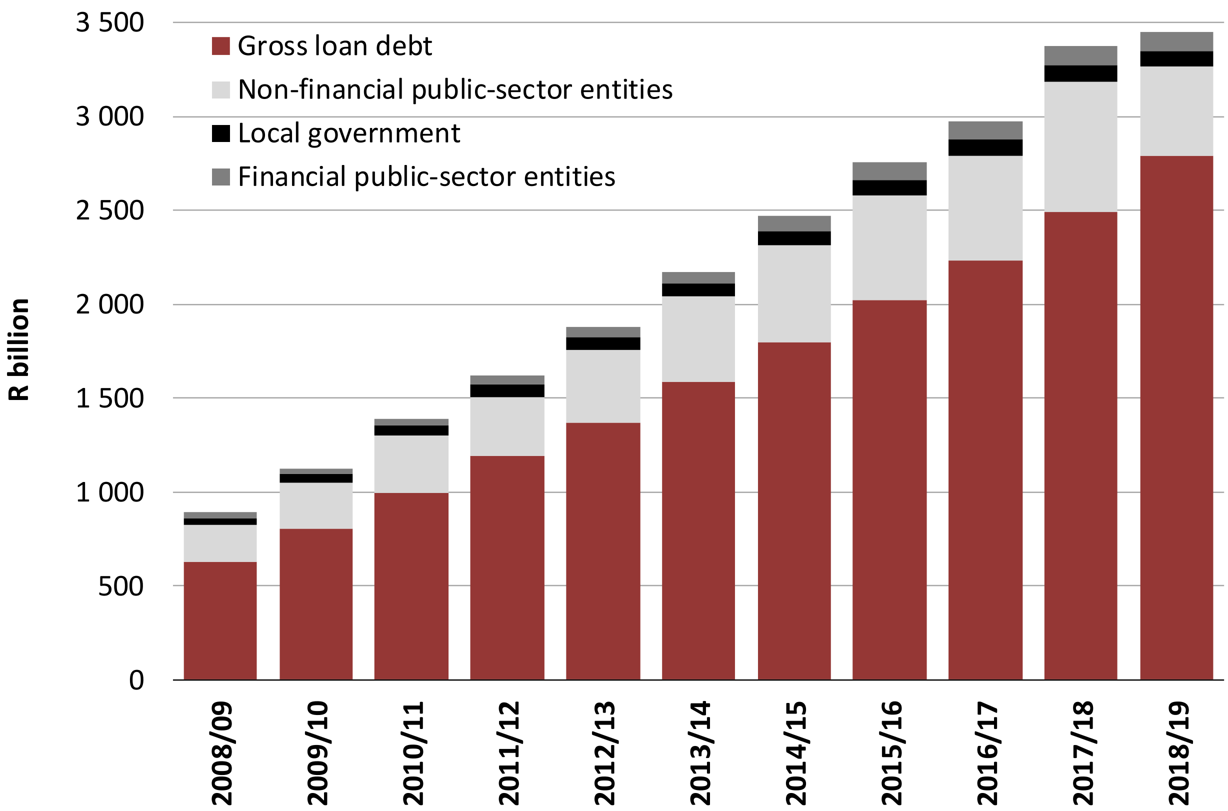
- Several large state-owned companies are in crisis as a result of governance failures, poor operational performance and resultant unsustainable debt burdens
- SOCs debts grown alongside government debt
- Government has increased spending to meet its obligations for guaranteed debt, but decisions are 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

Public-sector debt



Interventions to stabilise Eskom and other state-owned companies

- Government is committed to the separation of Eskom into three functions (generation, transmission, distribution) in conjunction with necessary organisational reforms to achieve operational efficiency.
- National Treasury and Department of Public Enterprises are working with Eskom to implement the plan, announced in February 2019 State of the Nation Address, to achieve this.
- The immediate 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.
- 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.
- SAA unlikely to generate sufficient cash flow to sustain operations in its current configuration. Government will repay SAA's outstanding government guaranteed debt of R9.2 billion over the next three years to honour its contractual obligation. Operational changes at SAA are required urgently

Improving spending efficiency and reducing waste

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- 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, to bolster efforts to combat corruption and improve revenue collection
- In order to improve efficiency and reduce wasteful expenditure, government will:
  - Standardise the regulation of development charges through the Municipal Fiscal Powers and Functions Amendment Bill, which will be tabled shortly.
  - Suspend implementation of new public transport networks in cities that have been in the planning stage for over a decade with no roll-out of services to residents.
  - Merge and consolidate entities and regulatory agencies, and 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.
  - Manage benefits received by political office bearers, through reforms to the Ministerial Handbook.
  - Review existing procurement regulatory framework, through the Public Procurement Bill, to simplify procurement processes and governance.

Conclusion

2019 MTBPS MEDIUM TERM BUDGET POLICY STATEMENT

- South Africa's growth outlook has been revised down sharply, and revenue shortfalls for 2019/20 — 2021/22 remain significant. The deficit is expected to widen substantially over the next three years relative to 2019 Budget estimates. Debt and debt-service costs will continue to increase.
- Over the medium term, consolidated spending will total R6.3 trillion, with 48 per cent of this amount going towards social grants, education and health. The worsening fiscal position is threatening government's ability to maintain existing levels of service provision and infrastructure investment.
- To stabilise the debt-to-GDP ratio over the coming decade, large additional measures are needed. Government is proposing a fiscal target: a main budget primary balance, excluding financial support for Eskom, by 2022/23. This target is expected to result in debt stabilising by 2025/26. This will require reductions to wage bill growth. Tax measures are also being considered.
- 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
- Short- and medium-term reforms are urgently required to improve economic performance over the next several years. The discussion document released by the National Treasury in August 2019 put forward an approach to restore growth momentum.
- Key fiscal risks in the period ahead include weaker economic growth, uncertainty in the revenue outlook and a worsening of Eskom's financial and operational position