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Recovery, stability, reform and growth

In brief

- The COVID-19 pandemic has magnified South Africa's social and economic crises, further straining the public finances.
- Over the next three years, government will balance support for economic recovery and reconstruction – through both short-term spending measures and structural reforms – with rebuilding the public finances.
- The economy has recovered more quickly than anticipated. Nevertheless, the recent spike in commodity prices, which has supported GDP growth and tax revenues, is considered temporary. Long-term structural constraints and scarring from the effects of the pandemic weigh on the outlook. Fiscal risks have increased.
- Fiscal consolidation is critical to reduce the public debt burden, restore investor confidence and avoid overexposure to global and domestic risks.
- The *Medium Term Budget Policy Statement* (MTBPS) proposes to maintain restraint in public expenditure. Government will not commit to new long-term spending in response to temporary revenue windfalls. No additional funding is provided to state-owned companies over the medium term.

Introduction

As South Africa begins to emerge from the shadow of COVID-19, it confronts deep-rooted social and economic problems. Foremost among these are the crises of poverty and unemployment.

To address these realities, the national budget is highly redistributive. Personal income tax, which accounts for an average of 38.4 per cent of revenue over the next three years, is structured in a progressive manner. And the social wage – combined public expenditure on health, education, housing, social protection, transport, employment programmes and local amenities – averages R1.06 trillion or 59.5 per cent of consolidated non-interest spending per year over the next three years.

Government responded to the pandemic with emergency fiscal support to households and businesses. This included the *special COVID-19 social relief of distress grant*, whose 9.5 million beneficiaries bring the number of social grant recipients to 27.8 million. Yet after a decade of declining economic growth, the public finances are in a weakened state, limiting government's ability to provide additional targeted social and economic support.

The unemployment crisis has escalated, especially among young people. Over the last two years, government has augmented existing fiscal measures to mitigate joblessness with additional funding for the presidential employment initiative in the 2021 Budget and an expanded employment tax incentive. While government will continue to consider measures to support employment growth, joblessness cannot be solved by fiscal resources: it requires strong and sustained economic growth.

GDP growth is expected to recover to 5.1 per cent in 2021 before declining to average 1.7 per cent over the next two years, a rate that is too low to meet the country's development needs. Gross debt is forecast to grow from 69.9 per cent of GDP in 2021/22 to 77.8 per cent of GDP in 2024/25 – the outer year of the medium-term expenditure framework (MTEF) period. Rising debt-service costs consume an increasing share of national income, crowding out spending on critical programmes necessary to alleviate poverty and create a foundation for faster economic growth.

The long-term decline in South Africa's GDP growth rate (Figure 1.1) is the result of structural weaknesses in the economy – including poor education outcomes – and external shocks. Weak growth is compounded by the rapid increase in public debt (Figure 1.2), which has raised borrowing costs across the economy. Faster economic growth requires determined implementation of policy reforms to promote confidence, investment, competitiveness, entrepreneurship and job creation.

During 2021, the economy has recovered more quickly than expected. Tax revenue is higher than projected in the 2021 Budget on the strength of the global commodity price surge, but these gains are temporary. The revenue outlook remains well below pre-pandemic estimates. There is profound uncertainty about the durability of the economic recovery, mainly due to renewed volatility in global conditions and the risk of renewed Eskom power cuts. In addition, certain domestic risks identified in the 2021 Budget have begun to materialise. These include the recent public-service wage agreement, which breached the budget ceiling for compensation of employees by R20.5 billion, and continued deterioration in the financial position of several major state-owned companies.

Accordingly, the 2021 MTBPS charts a course to ensure sound public finances and long-term economic growth by narrowing the budget deficit and stabilising debt. Gross tax revenues are expected to exceed the estimates presented at the time of the 2021 Budget by R120.3 billion in 2021/22. Government will use the higher-than-expected tax revenue to reduce the deficit and provide additional short-term support for health, social protection, job creation, and peace and security. This fiscal course will be maintained over the MTEF period, resulting in a primary budget surplus – where revenue is higher than non-interest spending – by 2024/25, bringing the period of fiscal consolidation to an end (Figure 1.3). Gross debt is expected to peak at 78.1 per cent of GDP in 2025/26 and decline thereafter. Debt-service costs will fall below 22 per cent of main budget revenue by 2026/27. This consolidation will be supported by structural reforms that unlock private-sector investment and job creation.

Sustainable public finances support growth

Macroeconomic stability – including low and stable inflation, a flexible exchange rate and sustainable fiscal balances – protects the economy from external shocks and promotes investment. It is a precondition – but not a substitute – for faster growth. Countries with unsustainable public finances are at greater risk of economic crises and loss of fiscal sovereignty.

The fiscal framework supports macroeconomic stability by providing planning certainty and a buffer to the unexpected costs that may arise from global or domestic shocks. In recent years, South Africa has experienced several such shocks, including the near-collapse of Eskom and continued electricity supply constraints, the COVID-19 pandemic, and the outbreak of public violence in Gauteng and KwaZulu-Natal in July of this year. These events, combined with existing weakness in the public finances, have virtually eliminated the fiscal space government requires to respond effectively to future crises.

Figure 1.1 Real GDP growth and projections*

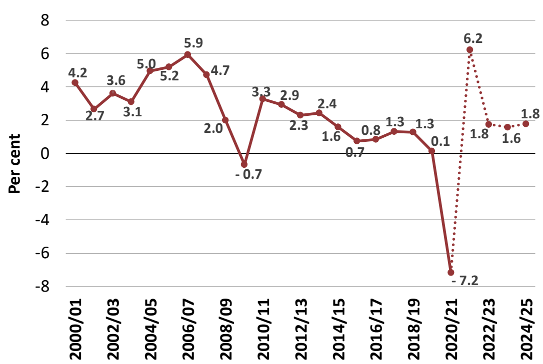


Figure 1.2 Projected three-year change in debt-to-GDP ratio, selected developing countries

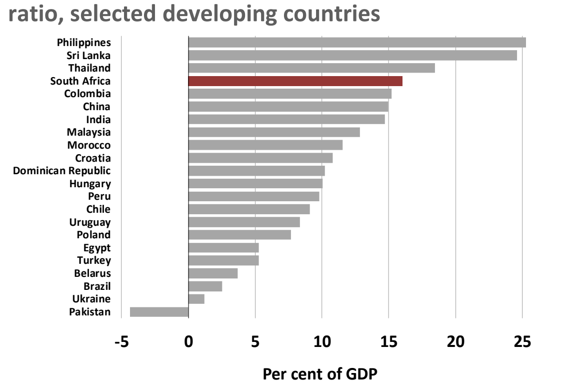


Figure 1.3 Main budget revenue and expenditure**

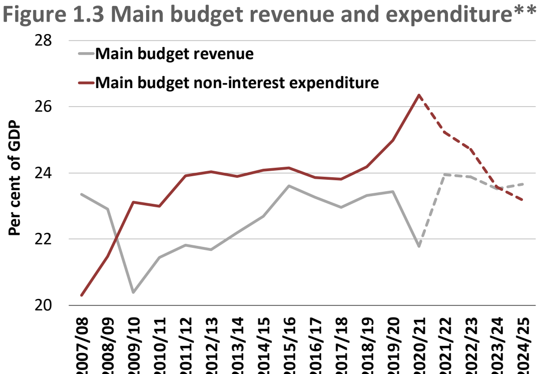
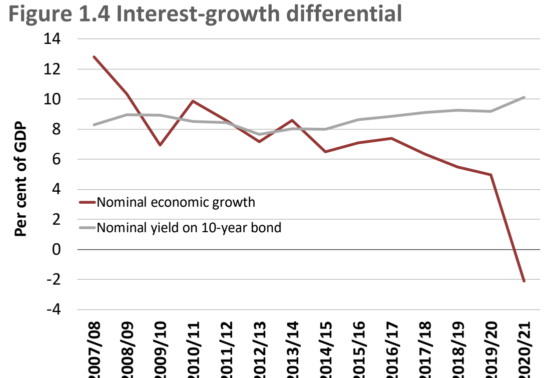


Figure 1.4 Interest-growth differential



**All GDP data in this MTBPS is recalculated in line with Statistics South Africa's 2021 rebasing and benchmarking exercise. It is therefore not directly comparable with GDP data from earlier budget documentation. For more information, see Annexure C*

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

Source: Statistics South Africa, National Treasury forecast

Government expenditure has exceeded revenue in every year since 2008/09. In that time, the consolidated budget has grown from R712.8 billion in 2008/09 to R2.13 trillion in 2021/22 – an average increase of 8.8 per cent per year. Higher expenditure has not always been efficient or effective. Much of the increase was absorbed by a rising public-service wage bill, averaging about 35 per cent of expenditure. The effectiveness of several large spending programmes is questionable, and state procurement systems often fail to deliver value for money.

At the same time, debt-service costs will on average consume 21 cents of every rand collected in main budget revenue over the MTEF period. This crowds out spending on essential public services such as health, social development, and peace and security. Elevated debt redemptions will further reduce fiscal space over the medium term as R423.4 billion of debt borrowed in previous years matures. In addition, the interest rate that government pays on its debt is higher than the GDP growth rate (Figure 1.4). In these circumstances, it is not possible to reduce the ratio of debt to GDP without running a primary budget surplus, as the stock of debt is increasing more quickly than the economy is growing.

In summary, the position of the public finances is a brake on growth. Committing to higher levels of spending in the absence of faster economic growth will further undermine macroeconomic credibility, with increasingly detrimental effects on the economy.

Light at the end of the fiscal consolidation tunnel

The 2021 MTBPS reaffirms the fiscal strategy set out in the 2021 Budget. Barring major new shocks or unbudgeted spending commitments, staying the course will lead to a primary fiscal surplus in 2024/25, bringing an end to fiscal consolidation at the end of the MTEF period.

Over the next three years, spending will remain restrained. Government will avoid permanent increases in departmental or programme baselines, or further bailouts of state-owned companies, which would compromise fiscal sustainability. Instead, short-term tax windfalls will be targeted to reduce the budget deficit and fund temporary priorities, such as extended support for poor households and public employment. In line with government's commitment to support vulnerable households, particularly given the impact of COVID-19, additional resources for social relief will be considered if the fiscal situation improves by February 2022.

As noted earlier, rising government expenditure has not been matched by higher economic growth, increased productivity, or greater efficiency. Over the medium term, government will use the results of recent spending reviews to implement zero-based budgeting. This will shift the budget process from an incremental approach to baseline funding towards a more stringent approach that assesses programme effectiveness and realises greater value for public money.

Structural reforms to be accelerated

Government remains committed to structural reforms designed to lower the cost of doing business and create a more competitive economy. Over the medium term, the following reforms will be accelerated:

- Diversifying energy generation to alleviate electricity supply shortages, and taking additional steps towards a competitive energy market.
- Releasing broadband spectrum, with the auction process starting on 1 March 2022.

- Opening third-party access to the freight rail network by the end of 2022 to increase capacity.
- Starting the eVisa system rollout by March 2022 to promote tourism.
- Reviewing the legal regime governing skilled migration.
- Accelerating infrastructure investment.

Capital investment has been adversely affected by the national lockdowns, contributing to underspending. Joint initiatives by the National Treasury, the Infrastructure Fund and Infrastructure South Africa aim to improve the scale, speed, quality and efficiency of infrastructure spending. This mainly involves creating a credible pipeline of projects, conducting project appraisal and technical analysis, and attracting private-sector participation and financing.

Over the next three years, general government infrastructure investment is estimated at R500 billion. Government has also committed R100 billion over a decade from 2019/20 to the Infrastructure Fund to leverage private-sector and development finance, with R24 billion allocated over the 2022 MTEF period.

Operation Vulindlela, a joint initiative of the Presidency and the National Treasury, oversees the implementation of critical reforms.

Protecting the integrity of South Africa's financial system

During 2021, the Financial Action Task Force (FATF) concluded a mutual evaluation (peer review) of South Africa. The FATF is the global standards-setting body for combating money laundering and terrorism financing, and South Africa is its only African member state.

The FATF report, released last month, identified significant weaknesses in the country's anti-money laundering and counter-financing of terrorism systems. Many of these weaknesses developed between 2009 and 2018, coinciding with the period of state capture. The National Treasury will work with the Reserve Bank, the Financial Intelligence Centre and other departments to address the deficiencies identified within the 18-month timeframe established by the FATF. As acknowledged in the report, South Africa is rebuilding the institutional integrity and capacity of key agencies weakened by state capture. Government remains committed to strengthening the country's well-regarded and resilient financial system, which is central to preventing finance-related abuse and sustaining capital flows for investment.

Risks and spending pressures

Significant risks to the economic and fiscal outlook include the following:

- Uncertainty in the global outlook, particularly the risk of higher inflation and tighter monetary policy. South Africa's cost of borrowing remains elevated. Debt-service costs will consume an average of 20.9 per cent of main budget revenue per year over the medium term and market conditions for issuing further debt are unfavourable. Slower global growth, or a reversal of the commodity cycle, would negatively affect revenue collection.
- The evolution of the COVID-19 pandemic and slow progress in the rollout of vaccines, which poses risks to economic recovery.
- Delayed implementation of structural reforms. The slow pace of reform continues to sap business confidence, private investment, productivity and competitiveness. Electricity supply constraints, which could worsen over the short term, are a drag on growth. In contrast, progress on energy reforms poses upside risks to fixed investment and the overall economic outlook.

- Sharp declines in revenue alongside high demand for support over the past year from provinces and municipalities, many of which were experiencing governance, financial and operational problems before COVID-19. Many require greater capacity to deliver services.
- The poor financial condition and operational performance of several large state-owned companies. The fiscal framework provides no support to state-owned companies over the medium term, but these entities remain a large contingent liability risk.

Government's strict enforcement of minimum criteria before guaranteeing state-owned company debt, as outlined in the 2021 Budget, has led to a decline in bailout requests. Yet the broader context of financial distress, poor governance and unsustainable operations in many entities remains unaddressed.

Chapter 3 outlines the fiscal policy stance and the medium-term strategy, taking into account short-term risks. The fiscal risk statement (Annexure A) focuses on medium- and longer-term risks that could affect baseline projections for economic growth and the public finances.

Assessing proposals for new spending commitments

The COVID-19 pandemic increased national debate on the possibility of a universal basic income grant. Social protection programmes should ideally complement a vibrant, job-creating economy, and policy options need to consider the implications for overall economic activity. South Africa spends a higher percentage of GDP on cash grants than the vast majority of developing countries, and the social protection system accounts for 13.9 per cent of consolidated non-interest spending in 2021/22. Excluding beneficiaries of the *special COVID-19 social relief of distress grant*, 18.3 million people receive some form of grant. In the absence of faster, job-creating growth, it is essential to maintain social protection in a sustainable way. Any proposals to expand this system should meet the test of sustainability and effectiveness by being:

- Fully and appropriately financed to ensure that the fiscal balance does not deteriorate.
- Evaluated against pre-existing priorities of government that remain unfunded, including in basic services, education and healthcare.

These principles have not been applied consistently to new spending programmes in recent years, contributing to fiscal deterioration without increasing economic growth or reducing poverty. Given the weakened public finances, new spending commitments can only be funded by closing existing programmes to free up revenue, or through permanent increases in revenue collection. New tax proposals must also be assessed against their revenue-raising potential, and wider effects on economic activity and growth.

Fiscal response to COVID-19 and social needs

The COVID-19 pandemic and restrictions to slow the spread of infections caused widespread social and economic distress. Government's policy stance has been to ensure stability while saving lives and jobs. Spending to support public services was maintained, even as tax revenues plummeted. Substantial fiscal relief measures were introduced in 2020/21.

In the current year, higher-than-expected revenue collection enabled government to respond with a fiscal relief package amounting to R37.9 billion (Table 1.1). This included extending the *special COVID-19 social relief of distress grant* to end-March 2022. The employment tax incentive has been expanded from 1 August to 30 November at a cost of R5 billion in lost tax revenue. Decisions on the presidential employment initiative and additional funding for social grants beyond the current year are dependent on revenue outcomes, and will be announced in the 2022 Budget.

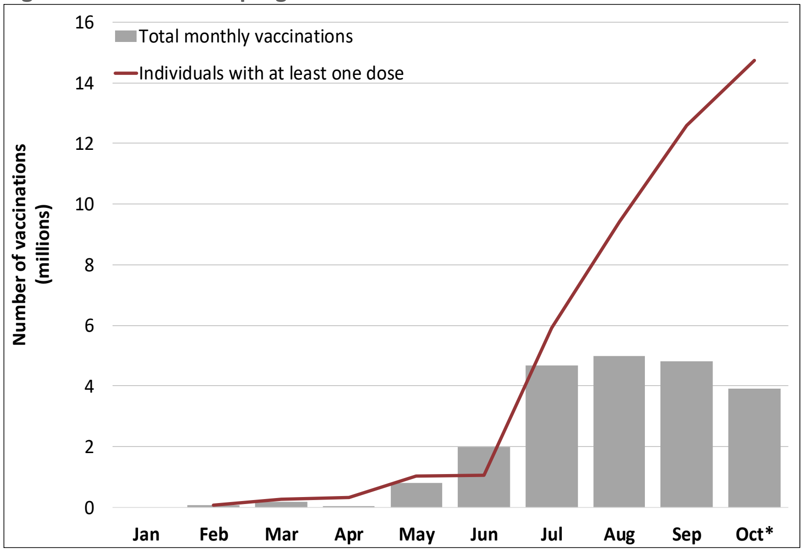
Table 1.1 Fiscal relief package, 2021/22

R million	2021/22
Fiscal response measures	**32 850**
Social grants additions[1]	26 700
SASRIA	3 900
Business support[2]	2 300
Reprioritisation from DTIC and DSBD	-1 000
South African National Defence Force	700
South African Police Service	250
Increase in spending ceiling	**32 850**
Revenue measures	**5 000**
Employment tax incentive	5 000
Total, financed through higher-than-expected revenue collection	**37 850**

1. Of which R500 million is for grants administration
2. Department of Trade, Industry and Competition (DTIC), Department of Small Business Development (DSBD)
Source: National Treasury

The public vaccination programme is facilitating a reopening of the economy. The 2021 Budget made provisions on the basis of an estimated R19.3 billion in costs for vaccines. Since then, 73 million vaccine doses have been ordered, and a further 5 million doses have been donated. As at 23 October 2021, 14.7 million individuals had received at least one dose.

Figure 1.5 Vaccination progress in South Africa



**The number of vaccinated people as at 23 October 2021*
Source: Department of Health and Our World in Data

Overview of the 2021 MTBPS

Economic outlook

Chapter 2 reviews economic performance and the medium-term outlook. Following the sharp economic contraction in 2020, real GDP is forecast to grow by 5.1 per cent in 2021, revised up by 1.8 percentage points since the 2021 *Budget Review*. However, the growth rate is expected to decline to an average of 1.7 per cent over the next two years.

Table 1.2 Macroeconomic projections

	2020	2021	2022	2023	2024
Calendar year	**Actual**	**Estimate**		**Forecast**	
Percentage change unless otherwise indicated					
Household consumption	-6.5	5.7	2.0	1.9	1.9
Gross fixed-capital formation	-14.9	1.2	3.1	3.4	3.5
Real GDP growth	**-6.4**	**5.1**	**1.8**	**1.6**	**1.7**
GDP at current prices (R billion)	**5 521**	**6 112**	**6 304**	**6 607**	**7 018**
CPI inflation	3.3	4.5	4.2	4.3	4.5
Current account balance (% of GDP)	2.0	3.8	0.4	-1.5	-1.7

Source: Reserve Bank and National Treasury

Fiscal policy

Chapter 3 outlines the fiscal policy stance over the medium term. The fiscal strategy remains broadly unchanged, with a focus on achieving a primary budget surplus from 2024/25. The consolidated budget deficit narrows to 4.9 per cent in the outer year. Gross loan debt is forecast to stabilise at 78.1 per cent of GDP in 2025/26.

Table 1.3 Consolidated government fiscal framework

R billion/percentage of GDP	2020/21 Outcome	2021/22 Revised	2022/23	2023/24 Medium-term estimates	2024/25
Revenue	**1 414.1**	**1 648.8**	**1 695.7**	**1 772.7**	**1 890.9**
	25.4%	*26.7%*	*26.7%*	*26.5%*	*26.6%*
Expenditure	**1 971.8**	**2 128.5**	**2 075.0**	**2 126.3**	**2 239.8**
	35.4%	*34.5%*	*32.7%*	*31.7%*	*31.5%*
Budget balance	**-557.7**	**-479.7**	**-379.3**	**-353.6**	**-348.9**
	-10.0%	*-7.8%*	*-6.0%*	*-5.3%*	*-4.9%*
Total gross loan debt	**3 935.7**	**4 313.9**	**4 744.7**	**5 144.4**	**5 537.6**
	70.7%	*69.9%*	*74.7%*	*76.8%*	*77.8%*

Source: National Treasury

Spending priorities

Chapter 4 outlines spending priorities by function group. It includes the in-year adjustments to spending in 2021/22, and more information on spending in subnational government. Total expenditure by function declines by an annual average of 0.4 per cent, while debt-service costs increase by an average of 10.8 per cent over the MTEF period.

Table 1.4 Consolidated government expenditure

R billion	2021/22 Revised	2022/23	2023/24 Medium-term estimates	2024/25	Average annual growth 2021/22 – 2024/25
Learning and culture	417.8	414.3	415.6	434.8	1.3%
Health	259.0	247.8	243.6	254.7	-0.6%
Social development	399.6	321.5	320.4	333.2	-5.9%
Community development	218.0	235.9	243.5	256.2	5.5%
Economic development	206.3	217.8	227.6	241.8	5.4%
Peace and security	219.3	218.2	213.3	222.8	0.5%
General public services	70.8	68.9	68.8	71.0	0.1%
Payments for financial assets	68.4	27.5	25.1	25.2	–
Total expenditure by function	**1 859.3**	**1 751.8**	**1 758.0**	**1 839.7**	**-0.4%**
Debt-service costs	269.2	303.1	334.6	365.8	10.8%
Unallocated reserve	–	15.1	28.8	29.3	–
Contingency reserve	–	5.0	5.0	5.0	–
Total expenditure	**2 128.5**	**2 075.0**	**2 126.3**	**2 239.8**	**1.7%**

Source: National Treasury

Additional information

The 2021 MTBPS includes the following annexures:

- Annexure A contains the fiscal risk statement.
- Annexure B discusses public-service compensation trends.
- Annexure C provides technical information and data.
- Annexure D is the glossary.

Conclusion

The MTBPS proposes to keep fiscal consolidation on course, reducing the budget deficit and stabilising debt, while allocating additional resources to support low-income households. This will release additional resources into the framework and enable government to end the consolidation of the public finances by 2024/25.