1

Risk, renewal and growth

The 2019 Budget outlines a series of economic and fiscal measures intended to move the economy onto a new trajectory and reduce the long-term risks to South Africa's public finances.

Government's central economic policy goal is to accelerate inclusive growth and create jobs. Its main fiscal objective is to ensure sustainable finances by containing the budget deficit and stabilising public debt. The Budget proposals support these goals.

The Constitution requires the national budget and budgetary processes to promote transparency and accountability, along with effective management of the economy, debt and the public sector. This year's Budget underlines the National Treasury's continued commitment to these requirements in a difficult environment in which economic growth remains weak, public debt and debt-service costs have accelerated, and governance and operational concerns are manifest across the public sector.

The 2019 Budget confronts these challenges by addressing the central risks to South Africa's economy and its public finances, supporting growth-enhancing reforms and maintaining real growth in expenditure on social and economic priorities. Education, health, social development and community development account for the majority of spending, and continue to grow strongly over the next three years. Over the past two decades, real government spending on social services has doubled, from R8 700 per person in 1996/97 to R16 500 per person in 2017/18.

Overview

Over the past year, government has worked to end the policy inertia and uncertainty that have undermined confidence and constrained investment in the economy. New partnerships with the private sector have led to large-scale investment commitments. As several commissions probing allegations of corruption and wrongdoing continue their work, a special directorate is being established to investigate and prosecute serious crimes that have been brought to light. Government is reforming state-owned companies, with Eskom as its immediate focus.

Government has strengthened policy certainty, developed new investment partnerships, and is reconfiguring Eskom

The environment remains challenging. The medium-term economic outlook has been revised down, with GDP growth forecast to reach 1.5 per cent in 2019, rising to 2.1 per cent in 2021. Weak economic performance and residual problems in tax administration have resulted in large revenue shortfalls. The deteriorating financial position of state-owned companies has put additional pressure on the public finances.

Fiscal sustainability, restructuring electricity sector and renewing economic growth are at heart of budget

In light of these considerations, the 2019 Budget priorities are to:

- Narrow the budget deficit and stabilise the national debt-to-GDP ratio.
- Support restructuring of the electricity sector, and reduce the immediate risks Eskom poses to the economy and the public finances.
- Renew economic growth by strengthening private-sector investment, improving the planning and implementation of infrastructure projects, and rebuilding state institutions.

As the State of the Nation Address noted, faster growth is needed to expand employment and raise the revenues needed to support social development. While progress is being made on various short-term initiatives, South Africa needs to implement a range of structural reforms that will bolster confidence, investment and economic growth. The state's capacity to implement policy also needs to be strengthened.

Figure 1.1 Real GDP growth rate

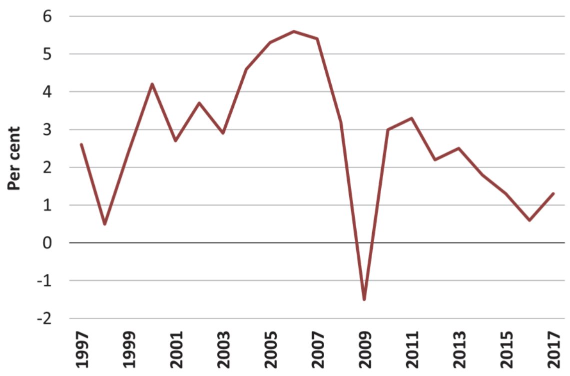


Figure 1.2 Performance of state-owned companies

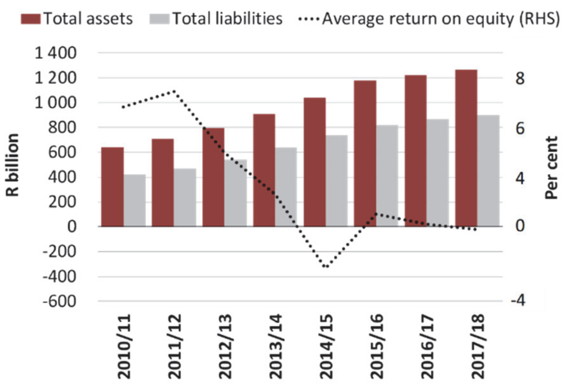


Figure 1.3 Gross debt-to-GDP outlook

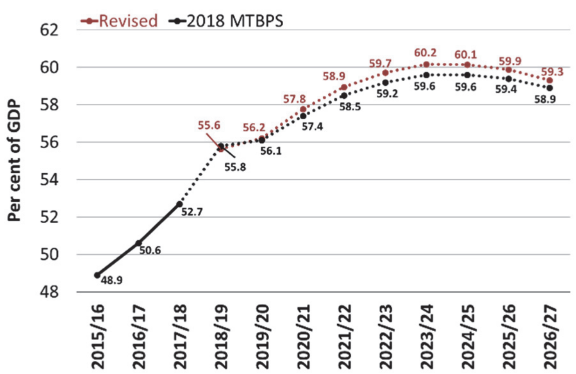
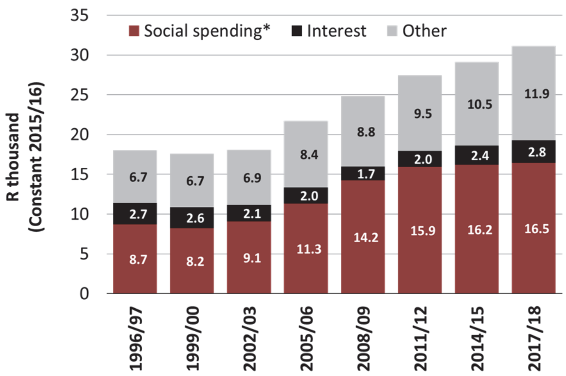


Figure 1.4 Per capita social development spend*



**Annual per capita general government spending, including education, health, social protection, community development, economic development as well as recreation and culture*
Source: South African Reserve Bank and National Treasury

Narrowing the budget deficit and stabilising debt

Expenditure ceiling maintained in current year, and compensation likely to be lower than budgeted

In the current year, the expenditure ceiling has been maintained, and national and provincial compensation is likely to be lower than budgeted. In light of the deteriorating economic environment and the need to address the considerable risks posed by Eskom, the 2019 Budget proposes reprioritisation of expenditure and tax measures to contain the budget deficit and stabilise debt.

Since the 2018 MTBPS, government has revised its baseline expenditure down by R9 billion in 2019/20, R19.7 billion in 2020/21 and R21.6 billion in 2021/22. About half of these reductions are applied to compensation budgets, reflecting faster-than-expected declines in headcounts, as well as the anticipated effects of other interventions, including early retirement without penalties.

These reductions are offset by provisional allocations for Eskom, the new infrastructure fund and the 2021 Census. As a result, the expenditure ceiling is revised upwards by R14 billion in 2019/20, R1.3 billion in 2020/21 and R732 million in 2021/22. In addition, government proposes tax measures amounting to R15 billion in 2019/20 and R10 billion in 2020/21.

Debt-to-GDP increases slightly relative to MTBPS, and gross debt stabilises at 60.2 per cent of GDP in 2023/24

As Figure 1.3 shows, the revised fiscal framework results in a slightly higher debt-to-GDP ratio than was projected at the time of the 2018 MTBPS. Gross debt-to-GDP stabilises at 60.2 per cent of GDP in 2023/24, marginally above the MTBPS estimates.

Several other state-owned companies are also in financial distress and have requested government support. As a result, the contingency reserve has been revised up by R6 billion in 2019/20, and any funding provided will be offset by the sale of non-core assets. Additional reforms to strengthen the governance, finances and operations of state-owned companies will be announced in the months ahead.

Restructuring the electricity sector

Government addressing major risks posed by state-owned companies, beginning with Eskom

Government's immediate focus is to address the substantial risks that Eskom poses to the economy and the public finances. In its current form, South Africa's state-owned power utility is not financially sustainable, nor can it meet the country's electricity needs.

The State of the Nation Address emphasised the urgent need to restructure the electricity sector, including separating Eskom into three divisions.

The depth of the financial crisis at Eskom requires government to support the utility's balance sheet, with amounts of R23 billion per year provisionally allocated over the medium term. These amounts will allow Eskom to service its debts and meet redemption requirements, while making resources available for urgent operational improvements.

Competitive electricity sector will encourage expansion of renewable energy and create jobs

Establishing a more competitive electricity sector will improve business and consumer confidence, encourage private investment and reduce upward pressure on prices. Over time, this reform will encourage the expansion of renewable energy sources in the country's energy mix. To date, government's renewable energy power producer programme has procured 6 422MW of electricity from 112 independent power producers.

Fiscal support for electricity market reform

As announced during the State of the Nation Address, Eskom is being reconfigured. The utility will be split into three viable operating entities under a single state-owned holding company.

The Eskom board is developing a sustainable operational plan for each business. Government will give consideration to these proposals within the next three months.

The first step in the separation process will be to transfer a portion of Eskom's assets to a new transmission company. In line with the President's statement, the new company will invite the participation of strategic equity partners that will provide capital for the business and strengthen oversight.

The financial support package, with strict conditions attached, will enable Eskom to restore positive cash flows, and secure the necessary liquidity to undertake urgent maintenance to restore stable electricity supply.

Further steps in restructuring the electricity market will be announced in the months ahead. Government will require Eskom's board to sign a new shareholder compact. Executive remuneration will be tied to performance and streamlining of mid-level management will continue. Additional information is provided in Annexure W3: *Fiscal support for electricity market reform*, on the National Treasury website.

Implementing growth-enhancing reforms

Progress has been made on reforms affecting tourism, mining, telecommunications

The 2018 MTBPS announced the first steps to implement the President's economic stimulus and recovery plan. To date:

- Progress has been made on growth-enhancing reforms, including preparations to allocate telecommunications spectrum, reform visa requirements and remove barriers to mining investment.
- Spending has been reprioritised to support black commercial farmers, revitalise townships and industrial parks, and rebuild the South African Revenue Service (SARS).
- The design of a blended-finance infrastructure fund is under way.
- Funding has been provided to address urgent matters in health and education, including filling critical medical posts and completing school sanitation projects.
- Changes are being made to local government infrastructure grants to incentivise investment from other sources for municipal infrastructure projects, and to improve operations and maintenance.

Improving infrastructure planning and delivery

South Africa's public infrastructure investments over the past two decades amounted to about R3 trillion. The speed, quality and efficiency of many of these projects, however, has not matched the level of investment. Project planning at all levels, including for long-term maintenance, has proven inadequate.

Capacity to assess, plan and budget for complex capital projects has strengthened

Several initiatives are under way to improve planning and value for money in capital expenditure:

- The Budget Facility for Infrastructure is a technical task team that reviews complex capital projects. It has already strengthened state capacity to consider and budget for large infrastructure projects, and to turn down projects that do not represent value for money. The Development Bank of Southern Africa (DBSA), the Government Technical Advisory Centre and the Presidential Infrastructure

Coordinating Commission receive R625 million for project preparation and implementation.

- Local government infrastructure grants are being changed to increase flexibility and incentivise private financing. Municipal borrowing policy is being reviewed, and well-governed cities are encouraged to expand borrowing for infrastructure projects. Regulation of development charges is being reformed, with the potential to increase local government capital spending by as much as R20 billion per year.
- Government's urban reforms aim to promote faster growth and densification. Metropolitan municipalities have identified integrated public land development programmes that will generate mixed-use, mixed-income living environments. The intention is to attract substantial contributions from the private sector over the long term. Taken together, seven priority programmes under way in the metros are worth an estimated R32.6 billion.

Expanding partnerships to build infrastructure

Government is stepping up its infrastructure build programme by partnering with the private sector, development finance institutions and multilateral development banks to create an infrastructure fund. The fund will increase the number of blended-finance projects to enhance oversight, improve the speed and quality of spending, and reduce costs in public infrastructure. The fund will draw on global expertise to strengthen project preparation and implementation. Discussions are already under way with the DBSA, the World Bank and the New Development Bank.

Over the next three years, general government infrastructure investment plans amount to R526 billion. Work is under way to support some existing projects and programmes with blended finance. Government will seek out private-sector skills in the design, construction and operation of key projects.

Government intends to commit at least R100 billion to the fund over the coming decade to leverage private-sector and development finance funding for well-planned capital projects. The support will take different forms, including blended co-funding, capital subsidies, and long-term interest rate subsidies and guarantees.

As a first step, the DBSA, in partnership with the National Treasury, will step up infrastructure lending. Blended-finance projects ready for implementation – including student housing projects – will be expanded, with R1 billion added in 2019/20 for this purpose. A further R4 billion is added in the outer year of the fiscal framework for projects that have complied with the requirements of the Budget Facility for Infrastructure.

The DBSA's experience with independent power producers suggests that the blended-finance approach can be applied in wastewater treatment, broadband connectivity and public transport. The National Treasury will review existing legislation to determine how existing processes may be able to incorporate blended-finance arrangements.

The National Treasury has begun the process of drafting legislation to support the fund.

Summary of the budget

Economic outlook

GDP growth outlook revised down to 1.5 per cent in 2019, with global trends becoming less supportive

The economic outlook has weakened since the 2018 MTBPS, with growth now projected to increase from 1.5 per cent in 2019 to 2.1 per cent in 2021. The revisions take into account weaker investment outcomes in 2018, a more fragile recovery in household income and slower export demand than expected due to moderating global growth. Consumer price index inflation is expected to average 5.2 per cent in 2019, up from 4.7 per cent in 2018, in response to rising food prices. The global outlook is becoming less supportive of South Africa's economy, with signs of slower growth in China and Europe.

Structural reforms and more capable state needed to improve confidence and raise growth rate

Chapter 2 provides an economic overview. It reports on progress made in reducing policy uncertainty in several sectors. Structural reforms and a more capable state are required to improve confidence in the economy and raise the economic growth rate.

Table 1.1 Macroeconomic outlook – summary

Real percentage growth	2018 Estimate	2019	2020 Forecast	2021
Household consumption	1.5	1.5	2.0	2.3
Gross fixed-capital formation	-0.2	1.5	2.1	3.0
Exports	2.0	2.3	2.7	2.8
Imports	3.8	1.7	3.2	3.3
Real GDP growth	**0.7**	**1.5**	**1.7**	**2.1**
Consumer price index (CPI) inflation	4.7	5.2	5.4	5.4
Current account balance (% of GDP)	-3.5	-3.4	-3.8	-4.0

Across all tables in the Budget Review, the use of "0" refers to a value of small magnitude that is rounded up or down to zero. If a value is exactly zero, it will be denoted by "–". If data is not available it is denoted by "N/A"
Source: National Treasury

Fiscal policy

Budget deficit projected to narrow over medium term and gross debt to stabilise in 2023/24

The budget deficit is projected to narrow from an estimated 4.2 per cent of GDP in 2018/19 to 4 per cent of GDP in 2021/22. Gross debt is projected to stabilise at 60.2 per cent of GDP in 2023/24, with net debt stabilising at 57.3 per cent of GDP a year later. The main risks to the fiscal outlook are uncertainty in the growth and revenue forecasts, the contingent liabilities of state-owned companies and the public-service compensation budget. The medium-term expenditure framework (MTEF) reflects progress in slowing growth in the wage bill and reducing compensation as a share of expenditure.

Table 1.2 Consolidated government fiscal framework

R billion/percentage of GDP	2018/19 Revised estimate	2019/20	2020/21 Medium-term estimates	2021/22
Revenue	**1 455.2**	**1 583.8**	**1 696.4**	**1 836.6**
	28.8%	*29.3%*	*29.2%*	*29.4%*
Expenditure	**1 665.4**	**1 826.6**	**1 948.9**	**2 089.0**
	32.9%	*33.7%*	*33.5%*	*33.4%*
Budget balance	**-210.2**	**-242.7**	**-252.6**	**-252.4**
	-4.2%	*-4.5%*	*-4.3%*	*-4.0%*

Source: National Treasury

Revenue trends and tax proposals

Despite several years of tax increases, the tax-to-GDP ratio has declined

Chapter 4 discusses revenue trends and tax policy. The tax revenue estimate for 2018/19 has been revised down by R15.4 billion, relative to the 2018 MTBPS. The revision reflects a weaker economic outlook, and further increases to value-added tax refunds. Despite several years of tax increases, the tax-to-GDP ratio is declining.

Problems with tax administration, as highlighted in the findings of the Commission of Inquiry into Tax Administration and Governance by SARS, partly explain revenue shortfalls. These problems are being addressed. The process to appoint a new SARS Commissioner is under way and the institution has begun implementing operational reforms to improve its performance. SARS governance reforms will be considered in amended legislation.

Tax measures amounting to R15 billion in 2019/20 and R10 billion in 2020/21 are proposed to offset the combined effect of revenue shortfalls and additional expenditure.

Table 1.3 Impact of tax proposals on 2019/20 revenue[1]

R million		
Gross tax revenue (before tax proposals)		**1 407 208**
Budget 2019/20 proposals		**15 000**
Direct taxes		**13 800**
Taxes on individuals and companies		
Personal income tax	**13 800**	
Revenue from not fully adjusting for inflation	12 800	
Revenue if no adjustment is made	*14 000*	
Partial bracket creep for personal income tax	*-1 200*	
No adjustment to medical tax credit	1 000	
Indirect taxes		**1 200**
General fuel levy adjustment	-500	
Introduction of carbon tax on fuel	1 800	
Additional VAT zero-rated items	-1 100	
Increase in excise duties on tobacco products	400	
Increase in excise duties on alcoholic beverages	600	
Gross tax revenue (after tax proposals)		**1 422 208**

1. Revenue changes are in relation to thresholds that have been fully adjusted for inflation
Source: National Treasury

Medium-term spending plans

Consolidated government expenditure is set to increase from R1.67 trillion in 2018/19 to R2.09 trillion in 2021/22. Real growth in non-interest expenditure averages 2 per cent per year.

Despite fiscal constraints, real expenditure growth averages 2 per cent over medium term

The fiscal framework continues to provide for real growth in social expenditure, including health, social grants and community development. The fastest-growing area of spending is community development, which includes funding for free basic services and human settlements. Over the next three years, more than half of government spending will be allocated to basic education, community development, health and social protection.

At the time of the 2018 MTBPS, funding was prioritised to improve service delivery, mainly in informal settlements and in road, transport and educational infrastructure. The 2019 Budget proposes additional spending of R75.3 billion over the next three years, of which R69 billion is a provisional allocation for reconfiguring Eskom, R5 billion is for the infrastructure fund and R1.3 billion is for the 2021 Census. To partially offset these increases, medium-term baselines have been reduced by R50.3 billion, and the contingency reserve has been decreased by R2 billion in aggregate over the period.

Table 1.4 Consolidated government expenditure by function

R billion	2018/19 Revised estimate	2019/20 Budget estimate	Average growth 2018/19 – 2021/22
Learning and culture	354.8	386.4	7.6%
Health	208.8	222.6	7.0%
Social development	256.9	278.4	7.3%
Community development	186.4	208.5	9.3%
Economic development	192.4	209.2	7.0%
Peace and security	203.5	211.0	4.6%
General public services	65.0	65.3	5.8%
Payments for financial assets	15.5	29.8	
Allocated expenditure	**1 483.2**	**1 611.3**	**7.4%**
Debt-service costs	182.2	202.2	10.7%
Contingency reserve	–	13.0	
Consolidated expenditure[1]	**1 665.4**	**1 826.6**	**7.8%**

1. Consisting of national, provincial, social security funds and selected public entities
See Annexure W2 on the National Treasury website for a full list of entities included
Source: National Treasury

Division of revenue

Over the MTEF period ahead, after budgeting for debt-service costs and the contingency reserve, 47.9 per cent of nationally raised funds are allocated to national government, 43 per cent to provinces and 9.1 per cent to local government.

Provinces continue to balance rising costs and growing demand for services within tight budgets. Sound financial management by provincial treasuries, and national interventions where necessary, have ensured that provincial finances remain sustainable.

Remedial actions designed to address widespread disarray in municipal finances

Financial management in local government has deteriorated, as reflected in the widespread adoption of unfunded budgets across all types of municipalities. National government has stepped up its commitment to assist with a series of remedial actions.

Table 1.5 Division of revenue

R billion	2018/19	2019/20	2020/21	2021/22
National allocations	638.2	684.7	733.1	777.7
Provincial allocations	572.2	612.3	657.1	701.0
Equitable share	*470.3*	*505.6*	*542.9*	*578.6*
Conditional grants	*101.9*	*106.7*	*114.2*	*122.4*
Local government allocations	117.3	127.3	137.9	149.5
Provisional allocations not assigned to votes	–	19.2	11.4	18.9
Total allocations	**1 327.6**	**1 443.5**	**1 539.5**	**1 647.1**
Percentage shares				
National	*48.1%*	*48.1%*	*48.0%*	*47.8%*
Provincial	*43.1%*	*43.0%*	*43.0%*	*43.1%*
Local government	*8.8%*	*8.9%*	*9.0%*	*9.2%*

Source: National Treasury

Government debt and contingent liabilities

Borrowing strategy uses broad range of funding instruments in domestic and global markets

Government's medium-term financing strategy reflects a prudent approach to managing debt in an environment of great uncertainty. The strategy maintains a broad range of funding instruments in the domestic and global markets. It includes measures to manage refinancing risk by adjusting the composition and maturity of the debt portfolio.

Over the past year, government's gross borrowing requirement has risen by R15.3 billion to R239.5 billion. This was mainly the result of lower-than-expected revenue collection. The domestic capital market finances most of government's borrowing requirement.

Net debt is expected to reach R2.52 trillion in 2018/19, or 49.9 per cent of GDP, increasing to R3.47 trillion or 55.5 per cent of GDP by 2021/22. Net debt is expected to stabilise at 57.3 per cent of GDP in 2024/25. Debt-service costs rise to 4 per cent of GDP by 2021/22.

Table 1.6 Projected state debt and debt-service costs

R billion/percentage of GDP	2018/19	2019/20	2020/21	2021/22
Gross loan debt	**2 814.3**	**3 042.9**	**3 357.8**	**3 683.6**
	55.6%	*56.2%*	*57.8%*	*58.9%*
Debt-service costs	**182.2**	**202.2**	**224.1**	**247.4**
	3.6%	*3.7%*	*3.9%*	*4.0%*

Source: National Treasury

Financial position of public-sector institutions

Several large state-owned companies and the Road Accident Fund confront severe financial and administrative difficulties. Over the year ahead, government will initiate reforms to strengthen the governance, financial management and operations of state-owned companies. In the interim, these institutions continue to pose risks to the public finances and the economy.

Table 1.7 Combined financial position of public institutions

R billion/net asset value	2015/16	2016/17	2017/18
State-owned companies	360.4	355.5	368.3
Development finance institutions[1]	120.2	126.8	133.2
Social security funds	-4.6	-19.9	-26.6
Other public entities[2]	625.3	675.0	714.8

1. Institutions listed in schedule 2 of the PFMA
2. State-owned institutions without a commercial mandate and listed in either schedule 1 or 3 of the PFMA such as the National Library of South Africa
Source: National Treasury

Budget documentation

The 2019 *Budget Review* accompanies several other documents and submissions tabled in Parliament on Budget Day. These include:

- The Budget Speech
- The Division of Revenue Bill
- The Appropriation Bill
- The Estimates of National Expenditure.

These and other fiscal and financial publications, including the *People's Guide* to the Budget, are available at www.treasury.gov.za.

As part of commitment to transparent budgeting, new online infrastructure tool is unveiled

As part of the National Treasury's commitment to transparent budgeting, it has worked with civil society organisations to expand the vulekamali.gov.za budget data portal. On Budget Day, the portal launches a new tool that allows users to see the geographic position, budget allocation and implementation stage of national government infrastructure projects.