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Renewing the economy and restoring the public finances

In brief

- Government's immediate priority is to support a rapid return to economic growth in the wake of the COVID-19 lockdowns. A mass vaccination programme, provided free of charge, will support a reopening of the economy and GDP growth of 3.3 per cent this year.
- Fiscal policy continues to focus on short-term economic support, pro-growth fiscal consolidation and debt stabilisation. The consolidated budget deficit, which reaches a record 14 per cent of GDP in 2020/21, will narrow to 6.3 per cent of GDP in 2023/24. Government remains on track to achieve a primary fiscal surplus by 2024/25 and stabilise debt in the following year.
- Tax revenue estimates, while higher than projected in October 2020, are R213.2 billion lower than projected in the 2020 Budget. To support the economy, R40 billion in previously proposed tax measures will be withdrawn.
- The 2021 Budget proposes total consolidated spending of R2.02 trillion in 2021/22, with 56.8 per cent of allocations going to learning and culture (R402.9 billion), health (R248.8 billion) and social development (R335.3 billion). Rising debt-service costs consume R269.7 billion, or 13.4 per cent of the budget.
- Excluding compensation reductions, real consolidated non-interest expenditure grows by an annual average of 0.4 per cent between 2020/21 and 2023/24.

Overview

The 2021 Budget is framed by the two policy objectives set out in the 2020 *Medium Term Budget Policy Statement* (MTBPS): promoting economic recovery and returning the public finances to a sustainable position.

The COVID-19 shock is estimated to have led to a 7.2 per cent contraction in GDP growth in 2020. The economy has started to recover in response to improved global conditions and the easing of lockdown restrictions – and in the months ahead, a mass vaccine rollout will support a full reopening of the economy. GDP growth of 3.3 per cent is projected for 2021, moderating to an average of 1.9 per cent in 2022 and 2023.

Government's balanced and prudent fiscal strategy is designed to stabilise the public finances. The 2021 Budget provides continued support to the economy and public health in the short term without adding to long-term spending pressures. Capital spending is the fastest-growing component of non-interest spending. The main budget primary deficit narrows from 7.5 per cent of GDP in 2020/21 to 0.8 per cent of GDP in 2023/24, and gross government debt stabilises at 88.9 per cent of GDP in 2025/26. At the same time, the 2021 Budget avoids adding to the tax burden, withdrawing previously announced tax increases of R40 billion.

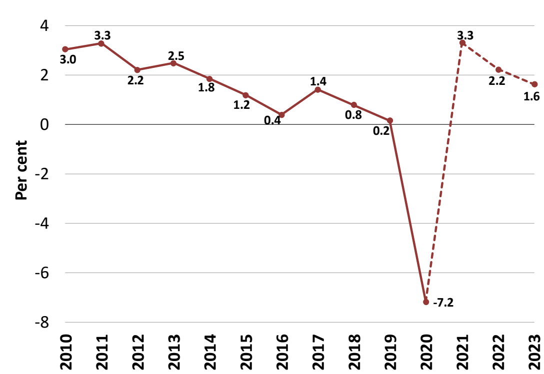
But the outlook remains highly uncertain and the economic effects of the pandemic are far-reaching. By the third quarter of 2020, there were 1.7 million fewer jobs than in the same period in 2019. Rising unemployment and income losses have entrenched existing inequalities. GDP is only expected to recover to pre-pandemic levels in late 2023. Given South Africa's structural constraints, its recovery will be slower than many of its developing-country peers.

Alongside a robust public health response to the pandemic and immediate support to households and businesses, government's recovery plan focuses on raising the economy's long-term growth rate. Structural reforms will lower barriers to faster, inclusive growth by improving access to reliable electricity, water and sanitation services; enabling cost-effective digital services; promoting the green economy; and supporting industries with high employment potential, such as tourism and agriculture.

Given these circumstances, the 2021 Budget strikes a difficult balance between providing immediate support for the economy and shoring up the country's public finances. Medium-term fiscal policy focuses on:

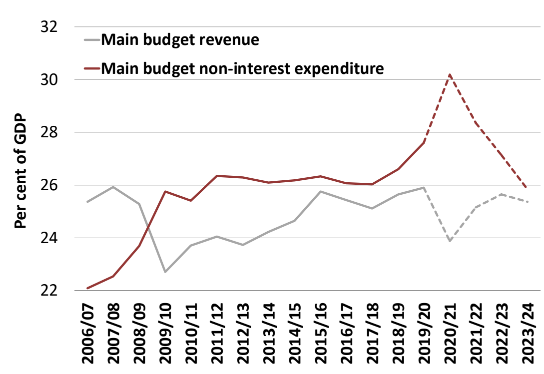
- Extending temporary support in response to COVID-19
- Narrowing the budget deficit and stabilising debt
- Exercising continued restraint in non-interest expenditure growth while improving the composition of expenditure.

Figure 1.1 Real GDP growth and projections



Source: Statistics South Africa, National Treasury forecast

Figure 1.2 Main budget revenue and expenditure*



**Excludes Eskom financial support and transactions in financial assets and liabilities*
Source: National Treasury

Promoting economic recovery: COVID-19 and beyond

The 2021 Budget addresses urgent economic needs while targeting long-term structural shortcomings.

As an immediate priority, government will roll out a mass COVID-19 vaccination campaign to the public free of charge. This will save many lives and support a full reopening of the economy. Over time, as global lockdowns are phased out in response to vaccination efforts, South Africa will benefit from the resumption of international goods trade and a resurgence in tourism.

Government is also continuing temporary support for low-income households and unemployed workers. The *special COVID-19 social relief of distress grant* is extended for an additional three months, as are unemployment benefits under the temporary employment relief scheme. To boost short-term employment, R11 billion is added to the spending framework in 2021/22 to fund the public employment initiative.

Financing and rolling out the COVID-19 vaccination programme

Vaccines will play a pivotal role in saving lives and livelihoods, and supporting economic recovery. Ensuring access to COVID-19 vaccines is government's immediate priority. As announced by the Minister of Health in January 2021, South Africa's three-phase vaccine rollout strategy aims to vaccinate 67 per cent of the population over 12 months.

Access to vaccinations will be provided free of charge, in line with need and the rollout schedule. Funding for vaccine procurement and rollout is drawn from the national budget. Since the state is procuring vaccines on behalf of both the public and private sectors, some revenue will return to the fiscus when private providers buy vaccines from the state.

Over the medium term, R9 billion is allocated for vaccine rollout. Of this amount, the Department of Health is allocated R6.5 billion to procure and distribute vaccines. An amount of R100 million will be transferred to the South African Medical Research Council for vaccine research. Provincial health departments are allocated R2.4 billion to administer vaccines. The Government Communication and Information System is allocated R50 million for an associated communications campaign. National department allocations are ring-fenced. Additional allocations are made through the COVID-19 component of the *HIV, tuberculosis, malaria and community outreach grant* introduced in the June 2020 special adjustments budget.

Government allocated R1.3 billion in the current year for vaccine purchases. Given uncertainty around final costs, an estimated R9 billion could be drawn on from the contingency reserve and emergency allocations, bringing total potential funding for the vaccination programme to about R19.3 billion.

Funding vaccine rollout

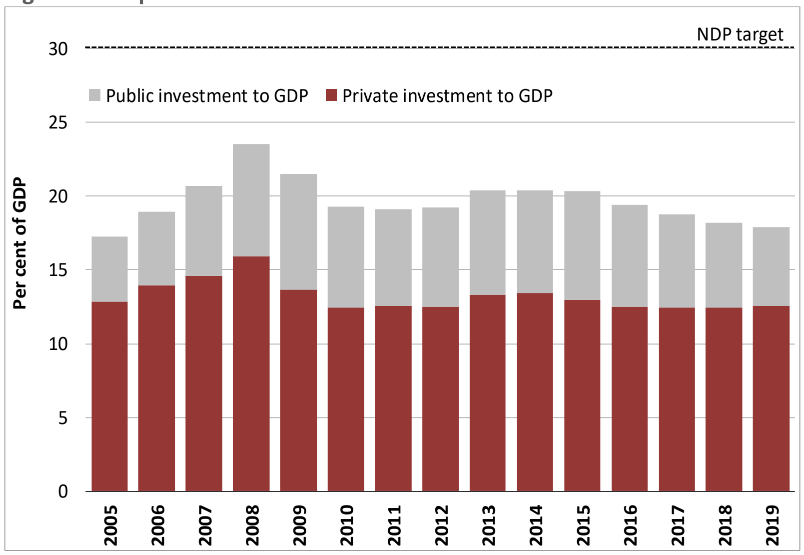
R million	2021/22	2022/23	2023/24	Total	Funding mechanism
	Medium-term estimates				
Department of Health	4 350	2 100	–	6 450	Main budget
Provincial departments of health	1 500	900	–	2 400	HIV, TB, malaria and community outreach grant
South African Medical Research Council	100	–	–	100	Department of Health
Government Communication and Information System	50	–	–	50	Main budget
Total allocated	**6 000**	**3 000**	–	**9 000**	
Additional potential funding				**9 000**	Contingency reserve and emergency allocations

Source: National Treasury

Beyond the pandemic: lifting barriers to growth

South Africa faces severe economic challenges. Real GDP per person has been falling since 2013/14, meaning that the average South African is becoming poorer, despite high and rising fiscal deficits. Private and public investments are lower than at any time since 2005, having declined to 12.5 per cent and 5.4 per cent of GDP, respectively, in 2019.

Figure 1.3 Capital investment as a share of GDP



Source: Reserve Bank

The 2021 Budget boosts infrastructure spending. Government will partner with the private sector, multilateral development banks and development finance institutions to augment its skills, expertise and funding. The Infrastructure Fund will enhance collaboration and attract private-sector investment. Government is providing initial support of R18 billion over the medium-term expenditure framework (MTEF) period. The fund has begun work on three projects in student housing, digital infrastructure and water infrastructure. But fiscal resources are not enough: bold reforms are needed to lift private-sector investment.

Confidence and investment remain low. The focus of economic policy, therefore, is to remove structural constraints that obstruct faster growth. These constraints include the high cost of doing business in South Africa, low levels of competitiveness and a weak public-sector balance sheet. Correcting these problems can unlock large-scale investment by the private sector, which will be the primary source of growth and job creation, with the public sector playing an enabling role.

The economic recovery plan emphasises reforms on a broad scale rather than a narrow focus on government spending programmes. These reforms will raise potential output, make growth more inclusive and reduce fossil fuel dependence by promoting the green economy.

Returning the public finances to sustainability

South Africa provided one of the largest fiscal responses to the pandemic among developing countries. As a result, consolidated government spending has reached a record 41.7 per cent of GDP, compared with 29.6 per cent in 2008/09. To support households, businesses and the public health sector, the consolidated budget deficit widened from 5.7 per cent in 2019/20 to an estimated 14 per cent in 2020/21.

While a temporary increase in spending was necessary to combat the spread and impact of COVID-19, the medium-term policy stance is focused on repairing the public finances. The 2020 MTBPS noted that, over the past decade, increased government spending has failed to promote growth. Since 2008, real spending growth has averaged 4.1 per cent annually, well above annual real GDP growth of 1.5 per cent. Despite high levels of expenditure, supported by increased debt accumulation, growth has not recovered to pre-2008 levels.

The fiscal position, which was already weak before the current crisis, has deteriorated sharply, requiring urgent steps to avoid a debt spiral. For several years, increasing debt-service costs have exceeded nominal GDP growth – a trend expected to continue over the medium term. If this course is not reversed, the economy will not be able to generate sufficient revenue for the state to service debt. Were that to occur, government would lose the ability to control debt and debt-service costs, as investors conclude that lending rates do not adequately compensate them for risk, leading to greater currency volatility and a protracted capital flow reversal.

Gross loan debt is expected to increase from R3.95 trillion, or 80.3 per cent of GDP, in 2020/21 to R5.23 trillion, or 87.3 per cent of GDP, by 2023/24. Debt-service costs will rise from R232.9 billion in 2020/21 to R338.6 billion in 2023/24. These costs, which were already the fastest-rising item of spending, now consume 19.2 per cent of tax revenue. Funds that could be spent on economic and social priorities are being redirected to pay local and overseas bondholders. Over the next three years, annual debt-service payments exceed government spending on most functions, including health, economic services, and peace and security.

Update on fiscal consolidation measures

Narrowing the budget deficit and stabilising the debt-to-GDP ratio requires continued restraint in expenditure growth. These efforts remain on course:

- Compared with the 2020 Budget, main budget non-interest expenditure will be reduced by R264.9 billion, or 4.6 per cent of GDP, over the MTEF period. Most of these adjustments are to the wage bill. Excluding compensation reductions, consolidated non-interest expenditure grows by an annual average of 0.4 per cent in real terms.
- Tax revenue estimates for 2020/21 are R213.2 billion below the 2020 Budget estimate, but R99.6 billion above the 2020 MTBPS estimate. Revenue growth is expected to slow over the medium term. To support the economy, no additional tax measures are included in the MTEF period, and tax increases proposed earlier will be withdrawn.
- The fiscal framework reduces growth in the wage bill and the share of spending on wages, while sustaining real spending increases on capital payments, specifically for buildings and other fixed structures.
- The consolidated budget deficit, which reaches 14 per cent of GDP in 2020/21, narrows to 6.3 per cent by 2023/24.

Government is projected to achieve a primary surplus in 2024/25 – meaning that total revenue will exceed non-interest expenditure – and stabilise the debt ratio at 88.9 per cent of GDP in the following year.

Wage bill restraint

Public-service compensation absorbed 41 per cent of government revenues in 2019/20 and 47 per cent of revenue in 2020/21. Allowing the wage bill to continue rising in line with recent trends is not sustainable. It would require a substantial reduction in funding for capital investment, and critical public goods and services.

In December 2020, following government's decision to not implement a wage increase in 2020/21, the Labour Appeal Court reaffirmed the National Treasury's constitutional role in safeguarding the public finances. In this regard, the approach to future wage negotiations will align with the fiscal position and prevailing economic conditions. As outlined in Chapter 3, the 2021 Budget proposes a significant moderation in spending on the consolidated wage bill, which grows by an average of 1.2 per cent over the medium term.

Risks to the fiscal outlook

Over the medium term, the risks are significant:

- The fiscal framework assumes compensation budget ceilings are maintained. A departure from this assumption in the forthcoming wage agreement will be unaffordable and compromise debt stabilisation.
- The financial positions of public entities and local government remain weak as a consequence of poor financial management.
- Medium-term debt redemptions of state-owned companies total R182.8 billion. Without rapid improvements in financial management and the resolution of longstanding policy disputes – including the user-pay principle – they will continue to put pressure on public finances.

Government has been working to address these risks with the broader public service and social partners – including forums with trade unions and the private sector, the Presidency, the Budget Council and the Budget Forum. These efforts are underpinned by a fiscal policy stance that aims to reduce fiscal risks while supporting growth. A longer-term fiscal risk statement appears annually in the MTBPS.

Budget reforms for greater efficiency

South Africa does not get good value for money in public spending. Waste and inefficiency reduce developmental impact, and become a glaring problem in the context of limited state resources.

In April 2020 government launched a series of spending reviews, 30 of which have been conducted to date. They have highlighted significant restructuring opportunities – including merging or closing entities to reduce duplication of functions – and noted massive inefficiencies in some infrastructure programmes. The reviews have revealed the limits of incremental budgeting, especially where technology has the potential to transform service delivery. And they have observed cases where guaranteed budget increments create perverse incentives to enter into contracts that have high unit costs for the delivery of certain services.

These reviews will help improve the efficiency of spending as part of adopting zero-based budgeting principles. During 2021/22, the Department of Public Enterprises and the National Treasury will be the first departments to pilot a new budgeting methodology, with the intention of producing significantly re-costed budgets from 2022/23.

Summary of the 2021 Budget

Economic outlook

The National Treasury projects real economic growth of 3.3 per cent this year, from a low base of -7.2 per cent in 2020. Growth in the outer two years of the forecast averages 1.9 per cent. Household consumption is expected to rebound in 2021/22, but investment is expected to decline for the third consecutive year as a result of persistent electricity interruptions, low confidence and low capital spending by public corporations. A recovery in global growth should support moderate improvements in exports. The commencement of the African Continental Free Trade Area bodes well for the trade outlook.

Table 1.1 Macroeconomic outlook – summary

Real percentage growth	2020 Estimate	2021	2022 Forecast	2023
Household consumption	-5.9	2.9	2.4	2.0
Gross fixed-capital formation	-18.4	-2.4	3.9	3.9
Exports	-10.9	5.7	3.0	2.8
Imports	-16.5	6.3	4.6	2.5
Real GDP growth	**-7.2**	**3.3**	**2.2**	**1.6**
Consumer price index (CPI) inflation	3.3	3.9	4.2	4.4
Current account balance (% of GDP)	1.7	-0.1	-1.0	-1.4

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

In recent months, faster revenue growth has provided government with the space to support the economy and the health sector, while narrowing the consolidated budget deficit more rapidly than projected in October 2020. The consolidated budget deficit is projected to narrow from 14 per cent of GDP in 2020/21 to 6.3 per cent of GDP in 2023/24. Gross debt is projected to stabilise at a lower level of 88.9 per cent of GDP in 2025/26.

Table 1.2 Consolidated government fiscal framework

R billion/percentage of GDP	2020/21 Revised estimate	2021/22	2022/23	2023/24
		Medium-term estimates		
Revenue	**1 362.7**	**1 520.4**	**1 635.4**	**1 717.2**
	27.7%	*28.4%*	*28.9%*	*28.6%*
Expenditure	**2 052.5**	**2 020.4**	**2 049.5**	**2 095.1**
	41.7%	*37.7%*	*36.2%*	*34.9%*
Budget balance	**-689.8**	**-500.0**	**-414.1**	**-377.9**
	-14.0%	*-9.3%*	*-7.3%*	*-6.3%*

Source: National Treasury

Revenue trends and tax proposals

Gross tax revenue for 2020/21 is expected to be R213.2 billion lower than projections in the 2020 Budget. However, due to a recovery in consumption and wages in recent months, and mining sector tax receipts, 2020/21 revenue collections are expected to be R99.6 billion higher than estimated in the 2020 MTBPS. As a result, government will not introduce measures to increase tax revenue in this Budget, and previously announced increases amounting to R40 billion over the next four years will be withdrawn. The main tax proposals include an above-inflation increase in personal income tax brackets and rebates, and an 8 per cent increase in alcohol and tobacco excise duties.

Table 1.3 Impact of tax proposals on 2021/22 revenue[1]

R million		Effect on tax proposals
Gross tax revenue (before tax proposals)		**1 365 124**
Budget 2021/22 proposals		**–**
Direct taxes		**-2 200**
Personal income tax		
Increasing brackets by more than inflation	-2 200	
Revenue if no adjustment is made	11 200	
Higher-than-inflation increase in brackets and rebates	*-13 400*	
Indirect taxes		
Taxes on international trade and transactions		**2 200**
Introduction of export tax on scrap metal	400	
Specific excise duties		
Increase in excise duties on alcohol	1 100	
Increase in excise duties on tobacco	700	
Gross tax revenue (after tax proposals)		**1 365 124**

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

Medium-term spending plans

Consolidated expenditure over the 2021 MTEF period is projected to be R6.16 trillion. In line with pro-poor government policies, R987.1 billion or 56.8 per cent of the allocations in 2021/22 go to social services in learning and culture, health and social development. Improved economic growth and revenue projections in recent months have provided space to meet urgent pandemic-related spending pressures, such as procuring vaccines, and continued social and economic relief.

Table 1.4 Consolidated government expenditure by function

R billion	2020/21 Revised estimate	2021/22 Budget estimate	Average growth 2020/21 – 2023/24
Learning and culture	387.2	402.9	2.4%
Health	247.0	248.8	-0.3%
Social development	413.3	335.3	-7.7%
Community development	211.5	218.8	4.4%
Economic development	191.9	207.5	4.2%
Peace and security	218.6	208.6	-0.8%
General public services	62.5	68.4	3.4%
Payments for financial assets	87.6	48.2	
Allocated expenditure	**1 819.6**	**1 738.6**	
Debt-service costs	232.9	269.7	13.3%
Contingency reserve	–	12.0	
Consolidated expenditure[1]	**2 052.5**	**2 020.4**	**0.7%**

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 2021 MTEF period, after budgeting for debt-service costs, the contingency reserve and provisional allocations, 48.7 per cent of nationally raised funds are allocated to national government, 41.9 per cent to provinces and 9.4 per cent to local government. Because reductions to the public-service wage bill affect only national and provincial government, local government's share of revenue has risen in relative terms.

Table 1.5 Division of revenue

R billion	2020/21	2021/22	2022/23	2023/24
National allocations	804.5	763.3	736.3	739.0
Provincial allocations	628.3	639.5	643.3	646.8
Equitable share	*520.7*	*523.7*	*524.1*	*525.3*
Conditional grants	*107.6*	*115.8*	*119.3*	*121.5*
Local government allocations	138.5	138.1	146.1	148.4
Provisional allocations not assigned to votes	–	11.6	32.1	33.2
Total allocations	**1 571.3**	**1 552.5**	**1 557.8**	**1 567.5**
Percentage shares				
National	*51.2%*	*49.5%*	*48.3%*	*48.2%*
Provincial	*40.0%*	*41.5%*	*42.2%*	*42.2%*
Local government	*8.8%*	*9.0%*	*9.6%*	*9.7%*

Source: National Treasury

Government debt and contingent liabilities

In 2020/21, government's gross borrowing requirement increased from R432.7 billion to R670.3 billion, or from 8 to 13.6 per cent of GDP. Gross loan debt is expected to increase from R3.95 trillion, or 80.3 per cent of GDP, in 2020/21 to R5.23 trillion, or 87.3 per cent of GDP, by 2023/24. Over the same period, net loan debt – gross loan debt less cash balances – will increase from R3.66 trillion, or 74.3 per cent of GDP, to

R5.09 trillion, or 84.9 per cent of GDP. Contingent liabilities are projected to reach R1.11 trillion by 2020/21.

Better-than-expected revenue collection since the 2020 MTBPS projections increased government's cash balances. Over the medium term, this cash will be used to reduce the borrowing requirement and, consequently, debt issuance. Cash balances are expected to decline over the next three years.

Table 1.6 Projected state debt and debt-service costs

R billion/percentage of GDP	2020/21	2021/22	2022/23	2023/24
Gross loan debt	**3 949.7**	**4 382.8**	**4 819.9**	**5 234.5**
	80.3%	*81.9%*	*85.1%*	*87.3%*
Debt-service costs	**232.9**	**269.7**	**308.0**	**338.6**
	4.7%	*5.0%*	*5.4%*	*5.6%*

Source: National Treasury

Financial position of public-sector institutions

The COVID-19 pandemic disrupted the plans of state-owned companies, curtailing revenue growth and the collection of arrears while many operational costs remained inflexible. Many state-owned companies that were already in financial distress are at risk of defaulting on their debts. The Land Bank, which defaulted on its debt in April 2020, will receive R7 billion in recapitalisation over the medium term to put it on a stable and sustainable development path. The net asset value of development finance institutions fell by 27 per cent to R100.3 billion in 2019/20, mostly due to losses at the Industrial Development Corporation and the Land Bank.

Table 1.7 Combined financial position of public institutions

R billion/net asset value	2017/18	2018/19	2019/20[1]
State-owned companies	362.1	342.0	353.0
Development finance institutions	132.6	137.8	100.3
Social security funds	-27.0	-79.6	-147.6
Other public entities[2]	719.0	724.7	793.3

1. Due to the COVID-19 pandemic, many entities have not released audited financial statements, therefore unaudited financials or last quarter reports were used for 2019/20

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 2021 *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 are available at www.treasury.gov.za.