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2023 MTBPS

STAYING THE COURSE FOR GROWTH AND SOUND PUBLIC FINANCES

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

CHAPTER 1

STAYING THE COURSE FOR GROWTH AND SOUND PUBLIC FINANCES

In brief

- Over the medium term, government will support the economy, stabilise the public finances and protect the social wage.
- The fiscal strategy aims to continue rebuilding the public finances by narrowing the budget deficit and stabilising debt. Government remains on course to stabilise debt in 2025/26, but at a higher level than previously projected.
- Government must reduce debt-service costs to ensure national development. As a percentage of GDP, gross loan debt increased by 47.2 percentage points between 2008/09 and 2022/23, and new debt is more expensive. Rising debt-service costs now absorb a larger share of the budget than basic education, social protection or health.
- Reconfiguration of the state will commence over the medium term. The 2024 Budget will propose measures to reconfigure government programmes based on the outcome of previous spending reviews.
- Reforms are under way to improve energy security and rail transport efficiency. Private investment in renewable power is gathering pace and the separation of Eskom into three entities is under way. A significant improvement in electricity generation is expected over the medium term.

INTRODUCTION

The 2023 *Medium Term Budget Policy Statement* (MTBPS) strikes a careful balance between supporting a growth-enhancing agenda and stabilising the public finances, while maintaining support for the most vulnerable. Over the next three years, government will focus on raising GDP growth by improving the provision of electricity and logistics, enhancing the delivery of infrastructure and restructuring the state to be efficient and fit-for-purpose. Fiscal policy continues to support this approach by stabilising debt and debt-service costs.

Government faces difficult choices. The central problem is low economic growth. Frequent power cuts make it hard for firms to do business, while deteriorating rail freight and slow port operations mean fewer goods are transported to markets here and abroad. At the global level, slower growth in China, elevated inflation, higher interest rates and geopolitical tensions suggest a weaker outlook for domestic economic growth and tax revenues.

South Africa has become more vulnerable to external shocks, which makes major reforms critical and unavoidable. At present, capital investment is too low; too many government activities are inefficient, overlapping and non-critical; and the economy does not generate sufficient revenue to service government debt over the long term. These are the key shortcomings that government proposes to address over the next three years.

Over the medium term there are important opportunities for deeper reforms. The 2024 *Budget Review* will propose to scale down outdated and unproductive programmes and entities. A new mechanism will be created to crowd in financing from the private sector and international finance institutions for large infrastructure projects. And government will propose new fiscal anchors to ensure a sustainable long-term path for the public finances.

The medium-term fiscal framework includes a combination of small revenue increases, spending revisions and increased borrowing. Government will support social protection and wage bill costs for critical functions and keep the fiscal deficit within a reasonable range, while maintaining the progressive character of the tax system. Debt as a percentage of GDP will still stabilise in 2025/26 and a rising primary budget surplus – where revenue exceeds non-interest expenditure – is projected over the next three years.

RAISING ECONOMIC GROWTH OVER THE MEDIUM TERM

GDP growth is projected to slow from 1.9 per cent in 2022 to 0.8 per cent in 2023. Since the 2023 Budget, the economic growth outlook has weakened in line with changes in the world economy, and continued energy and logistics constraints. At the same time, concerns over the country's fiscal position and its growth outlook have increased the risk premium – the additional return investors require to compensate for country-specific risk – attached to South African bonds. This makes it more expensive for government to borrow in line with its spending plans.

Economic activity remains severely limited by continued shortages of electricity, deteriorating freight rail performance and slow port operations. Government is addressing these constraints through reforms outlined in Chapter 2. Energy reforms have mainly focused on making it easier for private companies and households to generate their own electricity through renewable technologies, such as the purchase of solar panels. Power plants previously affected by unplanned maintenance or breakdowns are starting to return to operation. Equally important is the continuing unbundling of Eskom and revised regulations that will de-monopolise the power grid. Fiscal policy has also played its part through Eskom debt relief announced in the 2023 Budget.

The Eskom debt-relief arrangement contains strict conditions. If Eskom does not meet these conditions, the loan will not be converted into equity at the end of the financial year. In addition, the Minister of Finance may reduce the amount of debt relief available to Eskom going forward. Government has also decided to convert the loan from interest-free to interest-bearing to better reflect the cost of this arrangement. Amendments to the Eskom Debt Relief Act (2023) will be tabled to provide for the interest condition outlined above, and to empower the Minister to reduce amounts from future allocations.

While debate continues over the role of macroeconomic policy settings in achieving higher economic performance, evidence from 2008/09 to 2019/20 – before the onset of COVID-19 – shows that higher public spending and persistent budget deficits failed to bolster economic growth in South Africa. This poor multiplier effect is related to the accumulation of debt financing, bailouts of state-owned enterprises and the funding of ineffective programmes. The increase in debt stock also makes South Africa more vulnerable to changes in global conditions. Any changes affecting borrowing costs – including increases in global interest rates – have a relatively greater impact on debt-service costs.

Under these conditions, fiscal policy can best support growth by maintaining a disciplined approach that mitigates borrowing costs and risks, thereby promoting investment. At the same time, this fiscal stance will reorient government spending in ways that enhance growth while continuing to support developmental goals. One example is the effort discussed later in this chapter to improve infrastructure delivery, which will support growth and employment.

Table 1.1 Macroeconomic projections

	2022	2023	2024	2025	2026
Calendar year	Actual	Estimate	Forecast		
Percentage change unless otherwise indicated					
Household consumption	2.5	0.8	1.4	1.5	1.7
Gross fixed-capital formation	4.8	6.2	3.6	4.6	3.4
Real GDP growth	**1.9**	**0.8**	**1.0**	**1.6**	**1.8**
GDP at current prices (R billion)	**6 628.6**	**6 947.3**	**7 321.4**	**7 786.8**	**8 288.7**
CPI inflation	6.9	6.0	4.9	4.6	4.5
Current account balance (% of GDP)	-0.5	-2.4	-3.0	-3.0	-3.1

Across all tables in the Medium Term Budget Policy Statement, 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: Reserve Bank and National Treasury

FISCAL POLICY

Government's medium-term fiscal policy remains unchanged: achieve fiscal sustainability, support economic growth and reduce fiscal and economic risks.

Since the 2023 Budget, several fiscal risks have materialised. Corporate tax collections – primarily mining sector revenue – underperformed and the revenue outlook weakened. The 2023 public-service wage agreement increased the cost of compensation of employees. And, as discussed above, borrowing costs increased, pushing up the costs of servicing government debt. In this context, government will continue to take a sound and balanced approach to fiscal policy. The proposed fiscal framework for the medium term includes targeted spending revisions that contain overall expenditure while directing resources to core functions. Additional allocations will cover wage increases for employees in labour-intensive sectors and support social protection. Deeper reforms to improve the efficiency and effectiveness of spending will complement these changes.

In line with this stance, over the next three years government will borrow an average of R553.7 billion per year. This borrowing will be used for three purposes: first, to finance the gap between what government spends and the revenues it collects; second, to refinance the redemption of maturing debt; and third, to finance the Eskom debt-relief arrangement. From the current year and over the medium term, a significant increase in maturing debt requires a large increase in debt redemptions, as shown in Chapter 3.

The consolidated budget deficit is projected to reach 4.9 per cent in 2023/24, narrowing to 3.6 per cent by 2026/27. Gross loan debt will stabilise at 77.7 per cent of GDP in 2025/26, relative to 73.6 per cent of GDP in the same year projected in the 2023 Budget.

Table 1.2 Consolidated government fiscal framework

R billion/percentage of GDP	2022/23	2023/24	2024/25	2025/26	2026/27
	Outcome	Revised	Medium-term estimates		
Revenue	**1 898.2**	**1 915.5**	**2 012.6**	**2 139.3**	**2 286.5**
	28.2%	*27.3%*	*27.0%*	*27.1%*	*27.2%*
Expenditure	**2 145.2**	**2 262.0**	**2 352.5**	**2 473.3**	**2 588.6**
	31.9%	*32.3%*	*31.6%*	*31.3%*	*30.8%*
Budget balance	**-247.0**	**-346.5**	**-339.9**	**-334.0**	**-302.0**
	-3.7%	*-4.9%*	*-4.6%*	*-4.2%*	*-3.6%*
Total gross loan debt	**4 765.4**	**5 238.0**	**5 641.3**	**6 133.4**	**6 524.9**
	70.9%	*74.7%*	*75.8%*	*77.7%*	*77.5%*

Source: National Treasury

Government debt dynamics

Although many countries are contending with rising debt levels in the wake of the pandemic, over the past 15 years South Africa has had one of the largest increases in government debt as a share of GDP. This debt accumulation has led to a rapid increase in debt-service costs, which now consume more than 20 per cent of main budget revenue. For every R5 collected in revenue, government pays R1 to lenders instead of funding education, policing, health and other critical services.

Figure 1.1 Change in gross debt as a share of GDP, 2008–2022

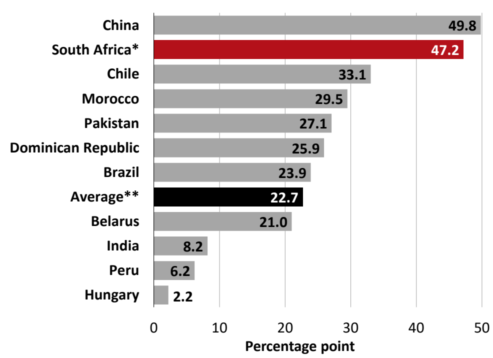
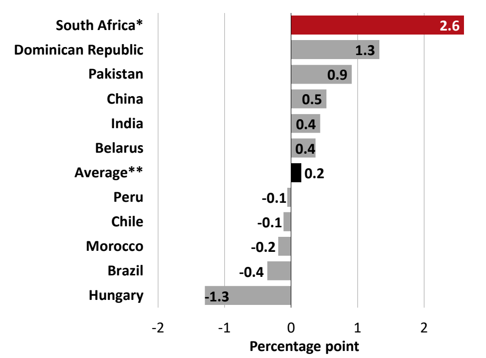


Figure 1.2 Change in debt-service costs as a share of GDP, 2008–2022

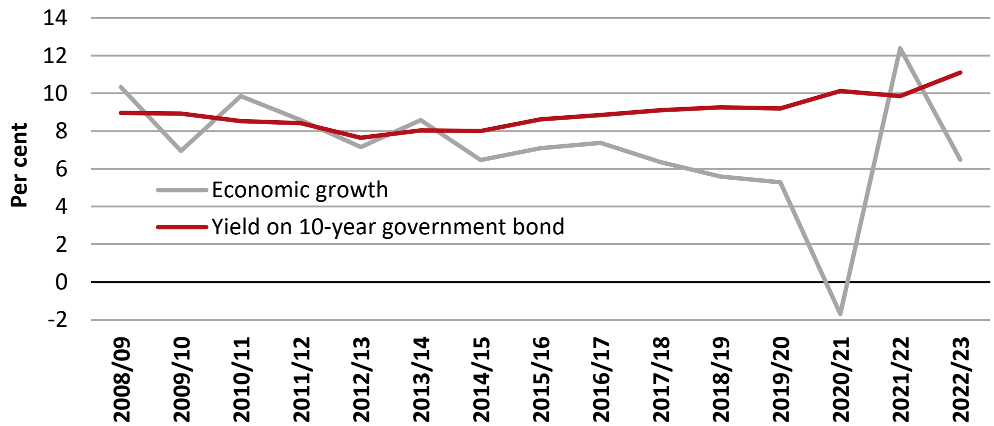


**National Treasury data*
***Excludes South Africa*
Source: National Treasury and IMF World Economic Outlook (October 2023)

As the stock of debt grows, any change affecting the cost of borrowing is magnified. Debt-service costs are now estimated to reach R385.9 billion in 2024/25 and R455.9 billion in 2026/27. Borrowing costs have risen across the yield curve, meaning that regardless of the maturity profile of loans and bonds, investors are demanding a premium to compensate them for the risks of investing in South Africa. Since 2013/14, South Africa's interest on debt has exceeded the rate of economic growth, implying that the economy is not able to generate enough revenue to pay the additional interest costs, resulting in the crowding out of service delivery expenditure.

The scale and duration of South Africa's debt accumulation, alongside the slow rate of economic growth, means that a primary budget surplus is needed to stabilise debt as a percentage of GDP and arrest the escalation in interest costs. The current estimate of the primary surplus required to stabilise debt is 1.3 per cent of GDP.

Figure 1.3 Nominal economic growth and bond yields



Source: National Treasury and Reserve Bank

EXPENDITURE PRIORITIES

Table 1.3 Consolidated government expenditure

R billion	2023/24 Revised	2024/25 Medium-term estimates	2025/26	2026/27	Average annual growth 2023/24 – 2026/27
Learning and culture	464.9	474.2	492.1	515.4	3.5%
Health	264.5	268.4	277.6	290.0	3.1%
Social development	369.7	387.5	385.1	398.8	2.6%
Community development	251.9	265.6	278.4	287.5	4.5%
Economic development	239.6	254.7	281.7	287.4	6.2%
Peace and security	234.9	234.9	246.0	256.6	3.0%
General public services	77.6	72.9	75.3	78.3	0.3%
Payments for financial assets	3.9	3.4	3.9	4.3	
Total expenditure by function	**1 907.1**	**1 961.7**	**2 040.2**	**2 118.2**	**3.6%**
Debt-service costs	354.5	385.9	425.5	455.9	8.7%
Contingency reserve	0.4	5.0	7.6	14.5	
Total expenditure	**2 262.0**	**2 352.5**	**2 473.3**	**2 588.6**	**4.6%**

Source: National Treasury

Over the next two years, main budget non-interest expenditure will decrease by R85 billion compared with 2023 Budget projections. Targeted revisions to spending include additional allocations to labour-intensive sectors to support implementation of the 2023 public-service wage agreement.

ADDRESSING KEY CHALLENGES

Infrastructure delivery

Investment in infrastructure is central to promoting economic growth and job creation. Government seeks to shift the quantity and quality of delivery by significantly increasing the extent to which the private sector is involved in funding infrastructure and providing technical expertise. Government will also widen the scope for concessional borrowing – that is, where interest rates are lower than average market rates.

The 2024 Budget will provide details on a new mechanism through which private-sector investors and multilateral institutions can co-invest with government for selected infrastructure projects. Government is also exploring the creation of alternative financing instruments for priority projects.

As announced in the 2023 Budget, the National Treasury has made progress on reviewing the framework for public-private partnerships. This process has recently been completed with concrete recommendations. The 2024 Budget will outline amendments to Treasury Regulations and key elements of municipal legislation.

Reconfiguration of the state

Over the last three years the National Treasury has conducted a series of spending reviews. In many cases, these reviews have highlighted deficiencies in policy choices and programme design, scale and cost. They have also revealed shortcomings in planning and implementation, which result in overlapping mandates and functions, and duplication of effort. Government considers these inefficiencies to place a further drag on the economy.

In the 2023 State of the Nation Address, the President announced plans to review and reconfigure the structure and size of the state. In this regard, a joint plan to rationalise government departments, entities and programmes over the next three years is being prepared. The following criteria will be used to determine whether a department or entity should be closed or merged:

- The performance and size of the entity or department, especially if it is no longer fulfilling its mandate or does not have capacity to fulfil its mandate.
- The ability of a larger department to absorb the function(s) of a small department.
- The duplication and overlap of functions across departments and entities.
- The clarity and execution of the legislative mandate.

High-level recommendations on programme and entity closures are being formulated by the Presidency, the National Treasury, the Department of Public Service and Administration and the Department of Planning, Monitoring and Evaluation. A dedicated technical team, consisting of the appropriate legal, financial and human resource expertise, has been created to facilitate implementation.

The public-service wage bill

The 2023 public-service wage agreement included higher-than-budgeted remuneration increases. Significant trade-offs and claw-back mechanisms are being implemented to mitigate the impact of these higher costs on the fiscal framework and to contain the budget for compensation of employees.

Government has issued a directive to national and provincial departments to implement control measures for creating and filling vacant posts, including restrictions on recruitment for less-critical posts. Government is assessing further controls on personnel budgets, including by providing incentives for early retirement.

STRENGTHENING FISCAL CREDIBILITY

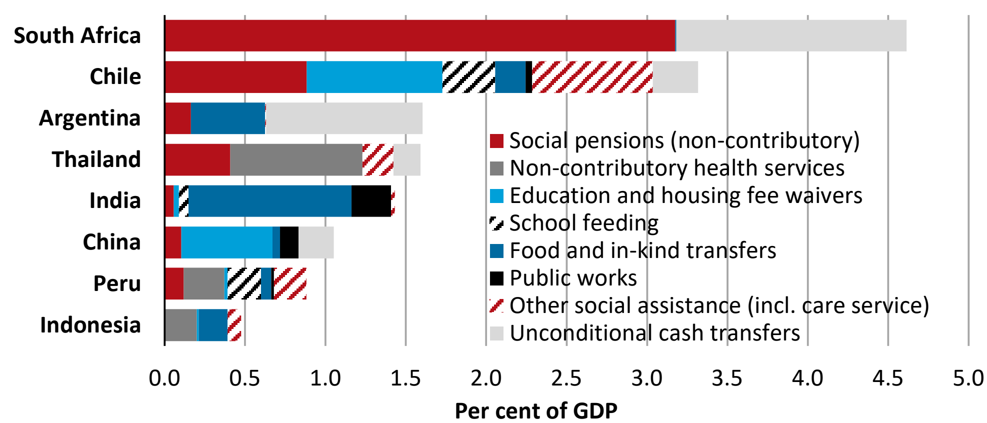
In 2012, government introduced a ceiling on non-interest expenditure to anchor fiscal policy. However, budget deficits and debt have continued to grow, in part because the ceiling was not binding. The target of reducing and stabilising debt has been persistently shifted out, largely because of lower-than-expected economic and revenue growth, and large spending pressures such as state-owned company bailouts and compensation costs. As a result, main budget expenditure has remained relatively high at over 29 per cent of GDP over the past two years.

This has led government to consider additional rules to provide an anchor for fiscal sustainability. Further details will be provided in the 2024 Budget.

SOCIAL PROTECTION AND PUBLIC EMPLOYMENT

Over the 2024 medium-term expenditure framework (MTEF) period, 61 per cent of consolidated non-interest spending goes to the social wage — combined public spending on health, education, housing, social protection, transport, employment and local amenities. Of this amount, R945.9 billion will be spent on social protection transfers, including the *old age grant*, the *child support grant*, the *disability grant* and the *COVID-19 social relief of distress grant*. South Africa's social protection expenditure programme, measured as a percentage of GDP, is one of the largest among developing countries.

Figure 1.4 Social assistance spending*



**Estimates are sourced from the World Bank and therefore not directly comparable to the National Treasury's figures. Calculated using data for the most recent available year(s) between 2015 and 2020*
Source: World Bank ASPIRE dataset

The 2023 Budget indicated that the *COVID-19 social relief of distress grant* was only funded until March 2024. The grant was introduced to support low-income individuals affected by the lockdowns during the COVID-19 pandemic. No policy decisions have yet been made on the grant and no funding solution has been agreed to. For this reason, the 2023 Budget reiterated that any extension of the grant, or any replacement thereof, needs to be funded by a new revenue source or reprioritisation of other spending items. Since then, fiscal space has declined markedly, reducing the scope for an extension without additional financing. Government proposes that the fiscal framework make provision for funding for the grant for 2024/25. Beyond this, a comprehensive review of the entire social grant system by the Department of Social Development and the National Treasury is required.

Apart from social protection spending, government maintains a comprehensive public employment programme, including the Expanded Public Works Programme and its associated components, such as the Community Works Programme. The MTBPS proposes that government should coordinate its approach to employment support. In this regard, significant portions of the Expanded Public Works Programme and the Community Works Programme will be repurposed into the presidential employment initiative.

CONCLUSION

South Africa urgently needs higher economic growth. The country's national development fortunes rest largely on lifting energy and logistics constraints and executing reforms that increase investment and reduce vulnerabilities arising from fiscal imbalances. Over the 2024 MTEF period, government will focus on increasing infrastructure investment, reconfiguring the operations of the state to ensure greater efficiency, and maintaining a prudent fiscal stance that stabilises debt and debt-service costs.