1

2023 BUDGET REVIEW

NAVIGATING AN UNEVEN ECONOMIC RECOVERY

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

CHAPTER 1

NAVIGATING AN UNEVEN ECONOMIC RECOVERY

In brief

- South Africa is prioritising stable and clear policies that promote economic growth and fiscal health in the midst of an uncertain outlook.
- The economy is estimated to have grown by an upwardly revised 2.5 per cent in 2022. However, the growth rate for 2023 is revised downward to 0.9 per cent.
- The 2023 Budget proposes a major debt-relief arrangement for Eskom to address its persistently weak financial position and enable it to conduct the necessary investment and maintenance.
- Fiscal consolidation measures have positioned the public finances to absorb a portion of Eskom debt, maintain support for the economy and the most vulnerable, and make budget additions to fight crime and corruption.
- The fiscal strategy ensures that the social wage is protected and fiscal balance is restored without resorting to unsustainable borrowing and damaging tax increases. A primary surplus is achieved in 2022/23 and the consolidated deficit is projected to narrow at a faster rate than previously estimated, to 3.2 per cent of GDP in 2025/26.

OVERVIEW

Government is navigating difficult domestic and global economic conditions with stable, balanced and clear policies that support faster growth and address emerging fiscal risks. The fiscal consolidation strategy proposed in the 2020 *Medium Term Budget Policy Statement* (MTBPS) has enabled government to stabilise the public finances in the context of several shocks and a highly uncertain economic outlook. While maintaining this prudent stance, government will continue to protect the social wage, invest in infrastructure and strengthen the criminal justice system, without resorting to tax rate increases that could harm economic growth.

Prolonged and debilitating power failures, a weaker performance among the world's largest economies and persistently higher inflation are expected to reduce South Africa's GDP growth from 2.5 per cent in 2022 to 0.9 per cent in 2023. Meanwhile, the fiscal position has improved. A primary surplus will be achieved in 2022/23 and is projected to reach 1.7 per cent of GDP in 2025/26, while the consolidated deficit is set to narrow from 4.2 per cent of GDP to 3.2 per cent in 2025/26.

A central proposal of the 2023 Budget, which will carry through over the medium-term expenditure framework (MTEF) period, is to provide substantial debt relief to Eskom. This arrangement, subject to strict conditions, will relieve extreme pressure on the utility's balance sheet. The debt relief will support a broader industry restructuring. Establishing a competitive electricity market will enable South Africa to ensure a stable, uninterrupted power supply as it transitions to a clean energy future. The arrangement, which will enable Eskom to pay down its debt and interest obligations over the next three years, will increase government's borrowing requirement.

POLICIES FOR AN UNCERTAIN ECONOMIC OUTLOOK

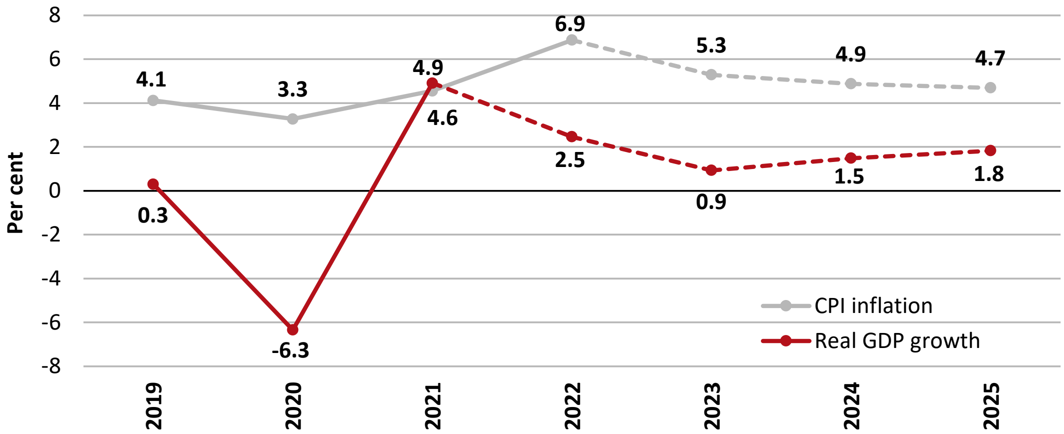
The post-pandemic period has been characterised by an uneven recovery. In 2021, the economy grew by 4.9 per cent after accounting for inflation. The 2022 growth estimate has been revised upwards to 2.5 per cent from 1.9 per cent at the time of the 2022 MTBPS. However, projected economic growth for 2023 has been revised downwards to the lowest level since 2020.

Countervailing factors have made it difficult to assess the economic outlook:

- Prolonged power failures and poor operational performance of transport industries continue to hamper operations and investment in manufacturing, mining and agriculture.
- Global inflation reached 8.8 per cent in 2022. A concerted effort by central banks to combat inflation has led to the strengthening of the US dollar, higher borrowing and debt-service costs for government and other borrowers, lower investment and consumer demand, and lower growth.
- The reopening of China's economy, and the consequent pick-up in global trade and demand, may counteract downside factors weighing on the global outlook.

GDP is expected to grow by 0.9 per cent in real terms in 2023, compared with an estimate of 1.4 per cent at the time of the MTBPS, recovering slowly to 1.8 per cent in 2025. This rate of economic expansion is well below the pace required to generate significant employment growth and support national development.

Figure 1.1 Real GDP growth and CPI inflation



Source: National Treasury and Statistics South Africa

Macroeconomic stability, structural reforms and state capability

Three policies support the economic growth agenda. The first is ensuring a clear and stable macroeconomic framework; the second is implementing reforms in key areas of the economy, particularly energy and transport; and the third is improving state capability.

The 2023 Budget reduces the consolidated budget deficit to 3.2 per cent of GDP in 2025/26 – its lowest level since 2017/18 – and maintains fiscal buffers through a contingency reserve, an unallocated reserve and a rising primary budget surplus. In this way, policy settings prevent the build-up of systemic risks to the financial system and broader economy, protecting the value of savings and building confidence for investors.

As outlined in Chapter 2, the economic reform agenda is making progress. Over the last year, additional steps have been taken to liberalise the electricity sector and encourage private investment. Power generation regulations have been relaxed, with businesses and municipalities given greater freedom to generate power and implement greener solutions. Eskom debt relief will reduce financial pressure on the utility, enabling it to conduct necessary maintenance. Government is pursuing greater competition in transport and logistics through third-party access to the freight rail sector.

Over the next three years, additions to expenditure are designed to ease conditions for economic activity and cushion poor households from the effects of weak economic growth. Apart from the one-year extension of the *COVID-19 social relief of distress grant*, additional allocations prioritise education, health, safety and security, and infrastructure-related spending. The budget will boost public investment, with budgets for buildings and fixed structures growing, on average, by 18.9 per cent annually over the MTEF period.

ESKOM DEBT RELIEF

The 2023 Budget proposes large-scale debt relief for Eskom, as outlined in the box below. This arrangement will require a significant increase in public debt. Gross loan debt will rise from R4.73 trillion in 2022/23 (71.1 per cent of GDP) to R5.84 trillion (73.6 per cent of GDP) in 2025/26 and will decline thereafter. Although the stock of government debt will increase, the fiscal balance will nevertheless continue to improve over the medium term. The main budget fiscal deficit will decrease from 4.5 per cent of GDP in 2022/23 to 3.3 per cent of GDP in 2025/26.

Eskom debt-relief arrangement

Eskom's operational failures are intertwined with its untenable financial position. Since 2008/09, government has provided the utility with R263.4 billion in bailouts. These allocations have failed to stem the collapse of Eskom's balance sheet and operations. The utility imposes an enormous drain on the economy and its debt stands at an unsustainable R423 billion. Government guarantees R350 billion of this debt, which is at risk of default – a contingent liability that raises South Africa's risk premium and borrowing costs.

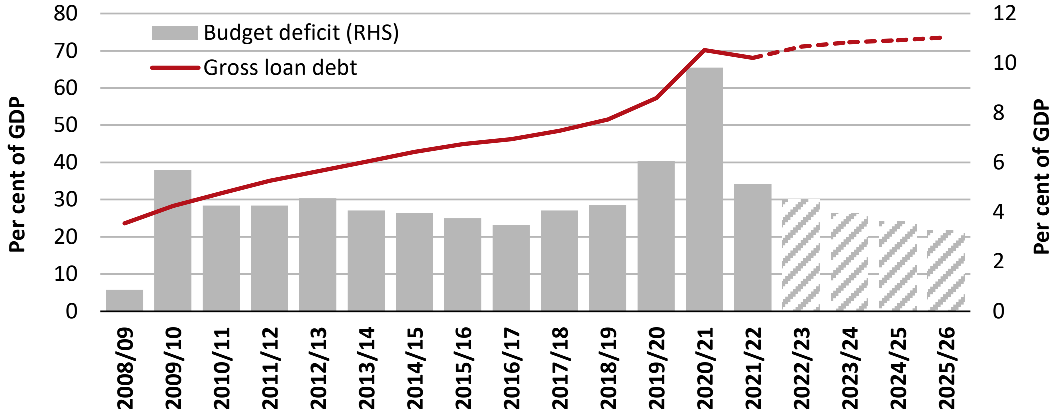
Government proposes to provide Eskom with debt relief of R254 billion (about R168 billion in capital and R86 billion in interest) over the next three years. The goal is to strengthen the utility's balance sheet, enabling it to restructure and undertake the investment and maintenance needed to support security of electricity supply. The key features of this arrangement are as follows:

- Government will provide Eskom with advances of R78 billion in 2023/24, R66 billion in 2024/25 and R40 billion in 2025/26. These advances will cover capital and interest payments as they fall due and may only be used for that purpose.
- These amounts will be financed through the R66 billion MTEF baseline provision that was in the 2022 MTBPS, and R118 billion in additional borrowing over the MTEF period ahead.
- In 2025/26, government will directly take over up to R70 billion of Eskom's loan portfolio.

This arrangement has been the subject of extensive consultation with Eskom and its stakeholders. Annexure W3 (online) reviews the provision of debt relief and spells out the strict conditions governing the arrangement. Its success rests on the implementation of key reforms that address the inadequacies of the transmission network and performance of existing power stations, which form part of the following obligatory conditions:

- Eskom, the National Treasury and the Department of Public Enterprises have agreed to design a mechanism for building new transmission infrastructure that will allow for extensive private-sector participation in the development of the transmission network.
- The National Treasury has appointed an international consortium with extensive experience in the operations of coal-fired power stations to review all plants in Eskom's coal fleet and advise on operational improvements. The review is scheduled to conclude by mid-2023. Eskom is required to implement the operational recommendations emanating from this independent assessment. This will include a determination of which plants can be resuscitated to original equipment manufacturers' standards, following which Eskom must concession all these power stations with clear targets for the electricity availability factor and operations.

Figure 1.2 Fiscal ratios over the medium term



Source: National Treasury

CONSOLIDATING THE PUBLIC FINANCES

The 2022 MTBPS outlined three fiscal objectives:

- Reduce the budget deficit and stabilise debt as a percentage of GDP.
- Support economic growth by maintaining a prudent fiscal stance, directing resources towards infrastructure, and fighting crime and corruption.
- Reduce fiscal and economic risks, including through the Eskom debt-relief arrangement.

The fiscal balance will continue to improve over the medium term, with government non-interest spending below revenue. The consolidated fiscal deficit will narrow from 4.2 per cent of GDP in 2022/23 to 3.2 per cent of GDP in 2025/26. A small primary budget surplus is achieved in 2022/23.

The budget supports economic growth through higher public infrastructure investment. Government spending on buildings and fixed structures will increase from R62 billion in 2022/23 to R104.2 billion in 2025/26. To improve municipal water infrastructure, the Budget Facility for Infrastructure has approved projects to the value of R3.7 billion, and these are ready for implementation once the 2023 Appropriations Bill is enacted.

Over the medium term, R711 billion will be made available for the peace and security function, including measures to fight corruption and financial crimes, with significant additions compared to the previous budget. The police budget is increased by R7.8 billion, while additions of R1.3 billion and R100 million are made to the budget of the National Prosecuting Authority and the Special Investigating Unit, respectively.

Higher-than-anticipated revenues are split between new spending and reducing debt. The 2023 Budget tax proposals do not increase the overall tax burden, but continue to focus on broadening the base and confronting illicit activities. The South African Revenue Service is allocated additional funding to strengthen tax administration and collection, and combat the illicit economy.

Combating financial crimes and illicit activities

Since 2003 South Africa has been a member of the Financial Action Task Force (FATF), which sets global standards to combat money laundering and the financing of terrorism across national borders.

The FATF's most recent mutual evaluation of South Africa identified a number of deficiencies in its legislative framework and implementation. Government is working to rectify these shortcomings. The enactment of legislation in 2022 – the General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act and the Protection of Constitutional Democracy Against Terrorist and Related Activities Amendment Act – addresses 15 of the 20 legislative deficiencies identified. The remaining five will be addressed through regulations and practices that do not require legislation.

Government is committed to addressing flaws in the regulatory framework, strengthening enforcement and applying strong sanctions. The 2023 Budget also allocates an additional R265.3 million to the Financial Intelligence Centre over the MTEF period to implement the recommendations of the State Capture Commission and the FATF.

At its February 2023 plenary, the FATF will pronounce on South Africa's progress and the extent to which it will face enhanced monitoring, including possible grey listing. Additional information is provided in Annexure E.

Risks to the fiscal outlook

The major fiscal risks are as follows:

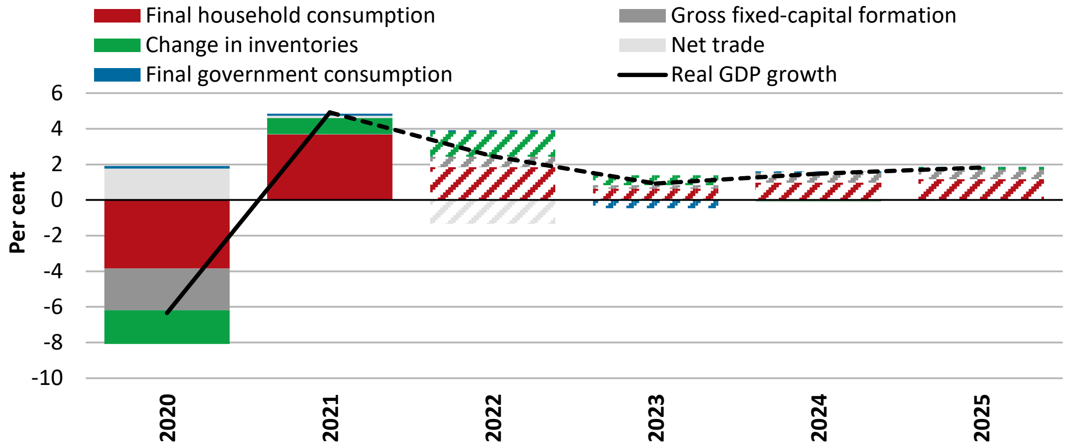
- Low or no economic growth, leading to lower tax revenues and simultaneous requests for fiscal support.
- Rising borrowing costs due to inflation and higher interest rates.
- Unaffordable public-service wage bill settlements.
- A replacement of the current *COVID-19 social relief of distress grant* with an unaffordable alternative.

SUMMARY OF THE 2023 BUDGET

Economic outlook

The economy is estimated to have grown by 2.5 per cent in real terms in 2022. However, largely as a result of intensive and persistent load-shedding, real GDP growth has been revised down to 0.9 per cent for 2023. Over the next three years, growth will average 1.4 per cent. Chapter 2 discusses the economic outlook and associated risks, provides details on government's economic growth strategy and reports on the status of previously announced reforms.

Figure 1.3 Macroeconomic outlook*



**Stacked bars indicate the contributions of each component to real GDP growth, while residual term has been omitted*
Source: National Treasury

Table 1.1 Macroeconomic outlook – summary

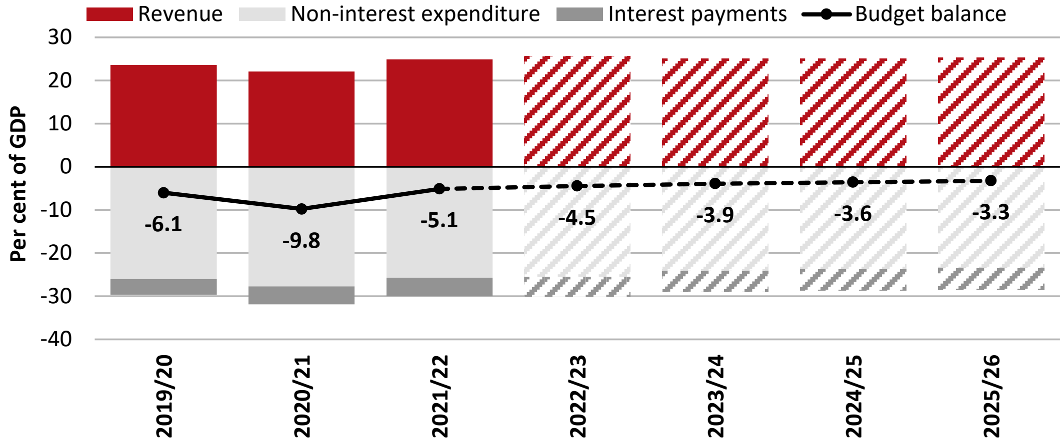
Real percentage growth	2022	2023	2024	2025
	Estimate	Forecast		
Household consumption	2.8	1.0	1.5	1.8
Gross fixed-capital formation	4.2	1.3	3.8	3.5
Exports	8.8	1.0	2.2	2.9
Imports	14.0	1.1	2.3	2.9
Real GDP growth	**2.5**	**0.9**	**1.5**	**1.8**
Consumer price index (CPI) inflation	6.9	5.3	4.9	4.7
Current account balance (% of GDP)	-0.4	-1.8	-2.0	-2.1

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, Reserve Bank and Statistics South Africa

Fiscal policy

The consolidated budget deficit is projected to continue declining over the MTEF period ahead, narrowing to 3.2 per cent in 2025/26. Gross loan debt, incorporating the Eskom debt-relief arrangement, will stabilise at 73.6 per cent of GDP in 2025/26. Debt-service costs will rise from R307.2 billion in 2022/23 to R397.1 billion in 2025/26. The continuing rise in the cost of servicing debt underscores the importance of ensuring that the gap between government spending and revenues does not expand.

Figure 1.4 Main budget fiscal outlook



Source: National Treasury

Table 1.2 Consolidated government fiscal framework

R billion/percentage of GDP	2022/23	2023/24	2024/25	2025/26
	Revised estimate	Medium-term estimates		
Revenue	**1 892.7**	**1 958.9**	**2 077.8**	**2 225.3**
	28.5%	*28.0%*	*27.9%*	*28.0%*
Expenditure	**2 168.8**	**2 242.6**	**2 359.7**	**2 477.4**
	32.6%	*32.0%*	*31.7%*	*31.2%*
Budget balance	**-276.1**	**-283.7**	**-282.0**	**-252.1**
	-4.2%	*-4.0%*	*-3.8%*	*-3.2%*

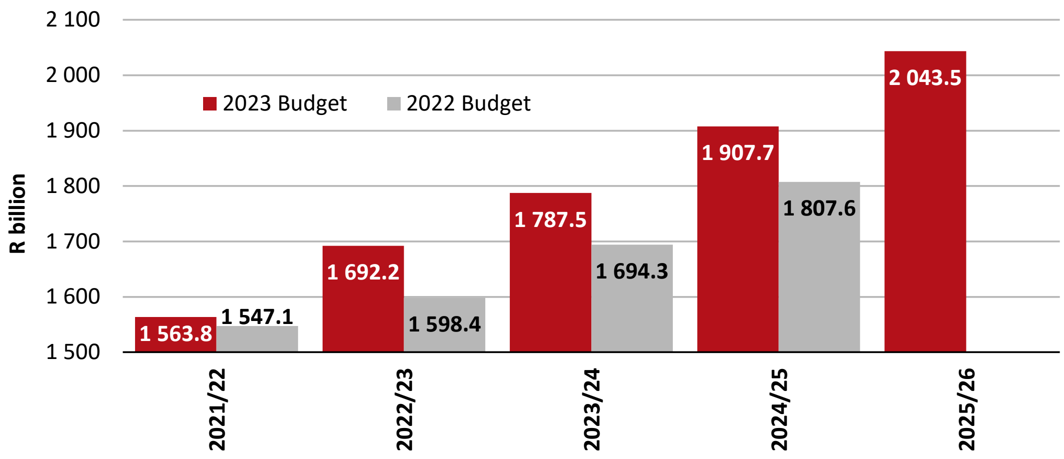
Source: National Treasury

Revenue trends and tax proposals

Gross tax revenue for 2022/23 is expected to reach R1.69 trillion – R93.7 billion higher than the 2022 Budget estimate. Tax relief totalling R13 billion supports the clean-energy transition, increases electricity supply and limits the impact of consistently high fuel prices. In addition, the budget provides inflation-related adjustments to the personal income tax tables, the retirement tax tables, and alcohol and tobacco duties.

South Africa's broad-based tax system keeps tax rates at a level consistent with promoting economic growth. Although no new tax rate increases are proposed in the 2023 Budget, new spending policies, such as a possible extension of or significant increase in the cost of expanded social protection programmes, may prompt a reconsideration.

Figure 1.5 Medium-term gross tax revenue outlook



Source: National Treasury

Table 1.3 Impact of tax proposals on 2023/24 revenue[1]

R million		Effect of tax proposals
Gross tax revenue (before tax proposals)		**1 800 456**
Budget 2023/24 proposals		**-13 000**
Direct taxes		**-9 000**
Personal income tax		
Increasing brackets by inflation	–	
Revenue if no adjustment is made	*15 700*	
Increase in brackets and rebates by inflation	*-15 700*	
Rooftop solar tax incentive for individuals	-4 000	
Corporate income tax		
Expansion of section 12B - renewable energy incentive	-5 000	
Indirect taxes		**-4 000**
Fuel levy		
Not adjusting the general fuel levy	-4 000	
Specific excise duties		
Increase in excise duties on alcohol	–	
Increase in excise duties on tobacco	–	
Gross tax revenue (after tax proposals)		**1 787 456**

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

Source: National Treasury

Medium-term spending plans

The consolidated spending budget amounts to R7.08 trillion over the next three years. A majority of this amount – R3.6 trillion – is allocated to the social wage: combined public spending on health, education, housing, social protection, transport, employment and local amenities.

Additions to baselines since the 2022 Budget amounting to R227 billion are proposed over the medium term. These increases support infrastructure, crime fighting, health and education. Debt-service costs account for an average of 17.1 per cent of main budget expenditure over the medium term.

Table 1.4 Consolidated government expenditure by function

R billion	2022/23	2023/24	Average growth
	Revised estimate	Budget estimate	2022/23 – 2025/26
Learning and culture	446.7	457.1	3.6%
Health	259.4	259.2	2.7%
Social development	357.8	378.5	-0.1%
Community development	230.0	259.7	8.0%
Economic development	221.8	237.6	7.7%
Peace and security	227.8	227.3	2.8%
General public services	71.7	73.6	2.3%
Payments for financial assets	46.3	4.1	
Allocated expenditure	**1 861.6**	**1 897.1**	**2.9%**
Debt-service costs	307.2	340.5	8.9%
Contingency reserve	–	5.0	
Consolidated expenditure[1]	**2 168.8**	**2 242.6**	**4.5%**

1. *Consisting of national and provincial government, social security funds and selected public entities. Refer to Annexure W2 on the National Treasury website for a full list of entities included*

Source: National Treasury

Division of revenue

Given the weight of the social wage in public expenditure, most budget resources are distributed to provincial and local government. Over the next three years, after budgeting for debt-service costs, the contingency and unallocated reserves and provisional allocations, 41.5 per cent of nationally raised revenue is distributed to provinces and 10 per cent is made available to local government. There is a notable increase in local government's share of nationally raised revenue, notwithstanding municipalities' considerable revenue-raising powers.

Table 1.5 Division of revenue

R billion	2022/23	2023/24	2024/25	2025/26
	Revised	Medium-term estimates		
National allocations	854.4	828.6	835.7	877.9
Provincial allocations	694.6	695.1	720.5	754.7
Equitable share	*570.9*	*567.5*	*587.5*	*614.3*
Conditional grants	*123.7*	*127.5*	*133.0*	*140.4*
Local government allocations	147.8	164.0	174.4	183.3
Provisional allocations not assigned to votes	–	1.5	3.9	4.0
Total allocations	**1 696.8**	**1 689.1**	**1 734.4**	**1 819.9**
Percentage shares				
National	*50.4%*	*49.1%*	*48.3%*	*48.3%*
Provincial	*40.9%*	*41.2%*	*41.6%*	*41.6%*
Local government	*8.7%*	*9.7%*	*10.1%*	*10.1%*

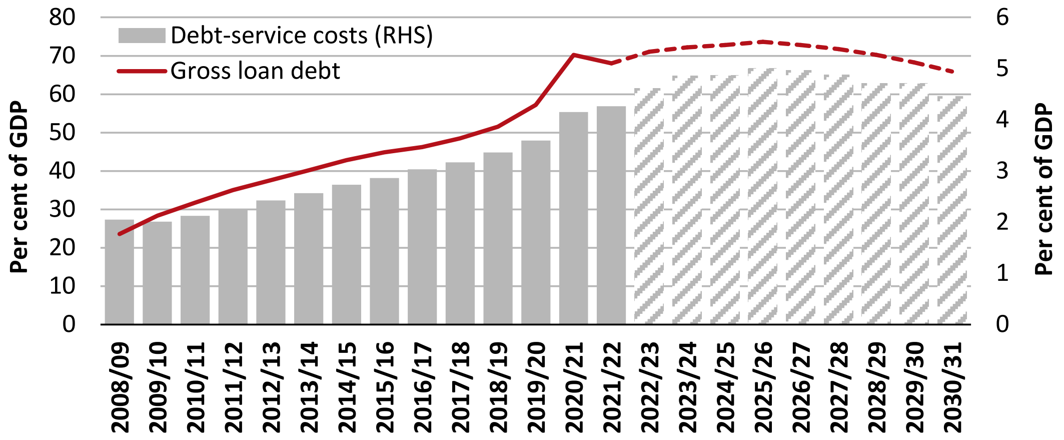
Source: National Treasury

Government debt and contingent liabilities

As a result of the Eskom debt-relief arrangement, gross loan debt is expected to increase from R4.73 trillion in 2022/23 to R5.84 trillion in 2025/26. Debt will rise as a percentage of GDP, but will stabilise at 73.6 per cent in 2025/26, before declining for the rest of the decade.

Debt-service costs will also rise, due to rising market lending rates and Eskom debt relief.

Figure 1.6 Gross loan debt and debt-service costs



Source: National Treasury

Table 1.6 Projected state debt and debt-service costs

R billion/percentage of GDP	2022/23	2023/24	2024/25	2025/26
Gross loan debt	**4 727.4**	**5 060.2**	**5 423.7**	**5 843.0**
	71.1%	*72.2%*	*72.8%*	*73.6%*
Debt-service costs	**307.2**	**340.5**	**362.8**	**397.1**
	4.6%	*4.9%*	*4.9%*	*5.0%*

Source: National Treasury

Financial position of state-owned companies

Several major state-owned companies continue to rely on government bailouts and dominate the guarantee portfolio. Government continues to monitor the financial health of public entities and manage associated risks. A new framework for managing bailouts to state-owned companies will support continued reform efforts.

Table 1.7 Combined financial position of public institutions

R billion/net asset value	2019/20[1]	2020/21[1]	2021/22
State-owned companies	352.7	376.7	417.6
Development finance institutions	98.1	127.8	161.5
Social security funds	-156.5	-210.3	-198.8
Other public entities[2]	811.2	834.3	927.5

1. Due to the COVID-19 pandemic, many entities had not released audited financial statements for the 2019/20 and 2020/21 financial year at the time of the publication and the draft financial statements were used

2. State-owned institutions without a commercial mandate and listed in either schedule 1 or 3 of the PFMA

Source: National Treasury

BUDGET DOCUMENTATION

The 2023 *Budget Review* is accompanied by several other documents and submissions to Parliament. These include:

- The Budget Speech
- The Division of Revenue Bill
- The Appropriation Bill
- The Eskom Debt Relief 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.