Rationality of the budget cuts in government and its impact on service delivery

PORTFOLIO COMMITTEE ON PUBLIC SERVICE AND ADMINISTRATION

National Treasury | **30 May 2018**

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National Treasury
REPUBLIC OF SOUTH AFRICA

Contents

Context

- Budgeting is a political exercise that starts with political choices about priorities and ends with political choices about which programmes and projects get funded
- Government's priorities are reflected in the MTSF and NDP and embodied in the Budget
- The budget process involves numerous role-players that interact at various stages of the Budget. These include:
  - National Assembly
  - National Council of Provinces
  - Provincial Legislatures
  - Portfolio Committees, Finance Committees, Appropriations Committees
  - Cabinet and Extended Cabinet
  - Financial and Fiscal Commission (FFC); provincial government - the Budget Council
  - Minister's Committee on the Budget (MINCOMBUD)
  - MINCOMBUD Technical Committee (MTEC)
  - Departments and entities
- The National Treasury manages the annual process of engagement between all these role-players to ensure that a budget is presented to Parliament

Context (continued)

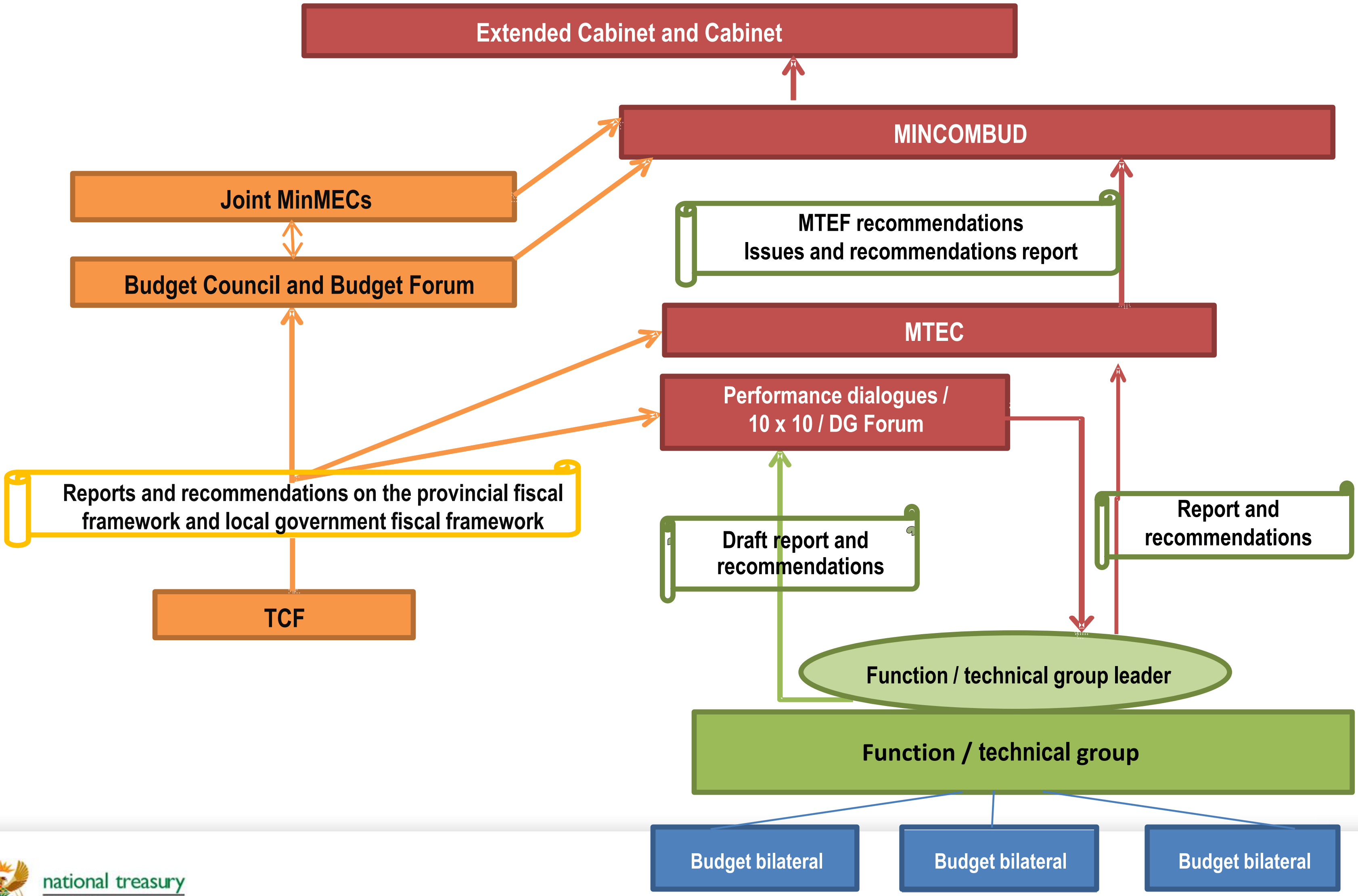
- The budget process is initiated through extensive discussions that take place between the National Treasury, the Department's of Planning Monitoring and Evaluation, Cooperative Governance and Public Service and Administration and line departments, particularly those with concurrent responsibilities shared with sub-national governments. The outcome of such discussions are then referred to MTEC for consideration.

- MTEC is comprised of the Directors-General of the National Treasury (chairperson of MTEC), Planning, Monitoring and Evaluation, Cooperative Governance and Public Service and Administration. The Committee is tasked with making recommendations to MINCOMBUD regarding budget allocations in the medium term expenditure framework. Such recommendations take into account government priorities, funding available, alternative sources of funding and the division of revenue amongst the three spheres of government.

- The recommended Division of Revenue between national, provincial and local government takes into account discussions in Cabinet, at MINCOMBUD, at MTEC, as well as at the Technical Committee on Finance (TCF), Budget Council and Budget Forum meetings which take place during the course of the year.

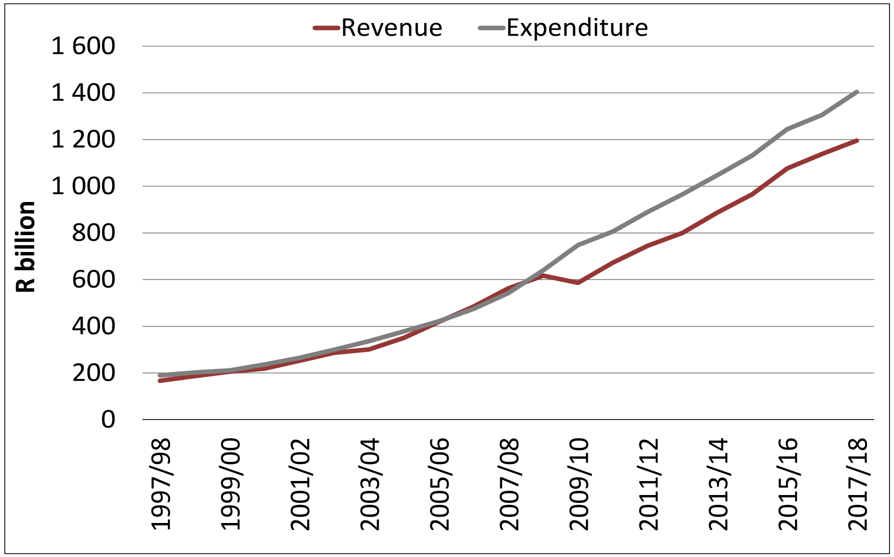
- Cabinet then considers and approves the recommended budgetary decisions put forward by the various committees, which includes the Fiscal Framework, Division of Revenue and the proposed departmental appropriations.

Context (continued): Technical and political structures

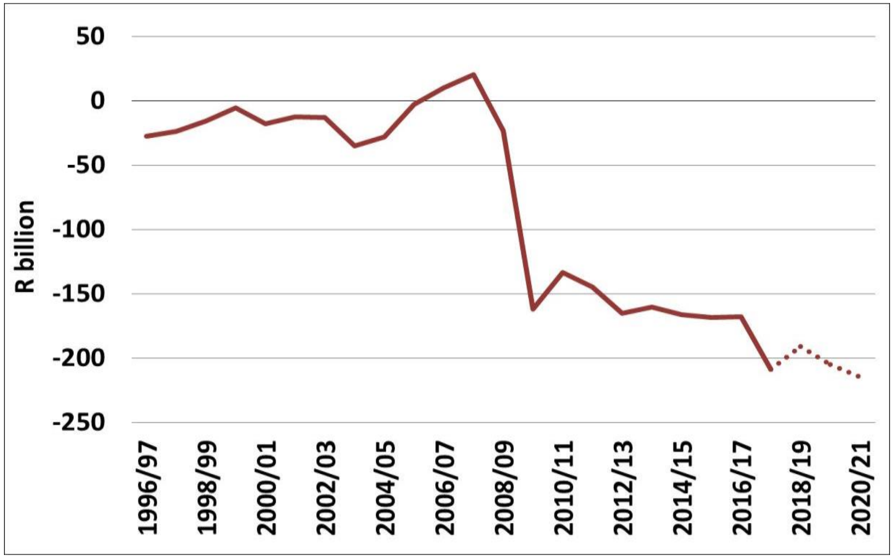


Fiscal framework – key fiscal trends

Main budget revenue and expenditure

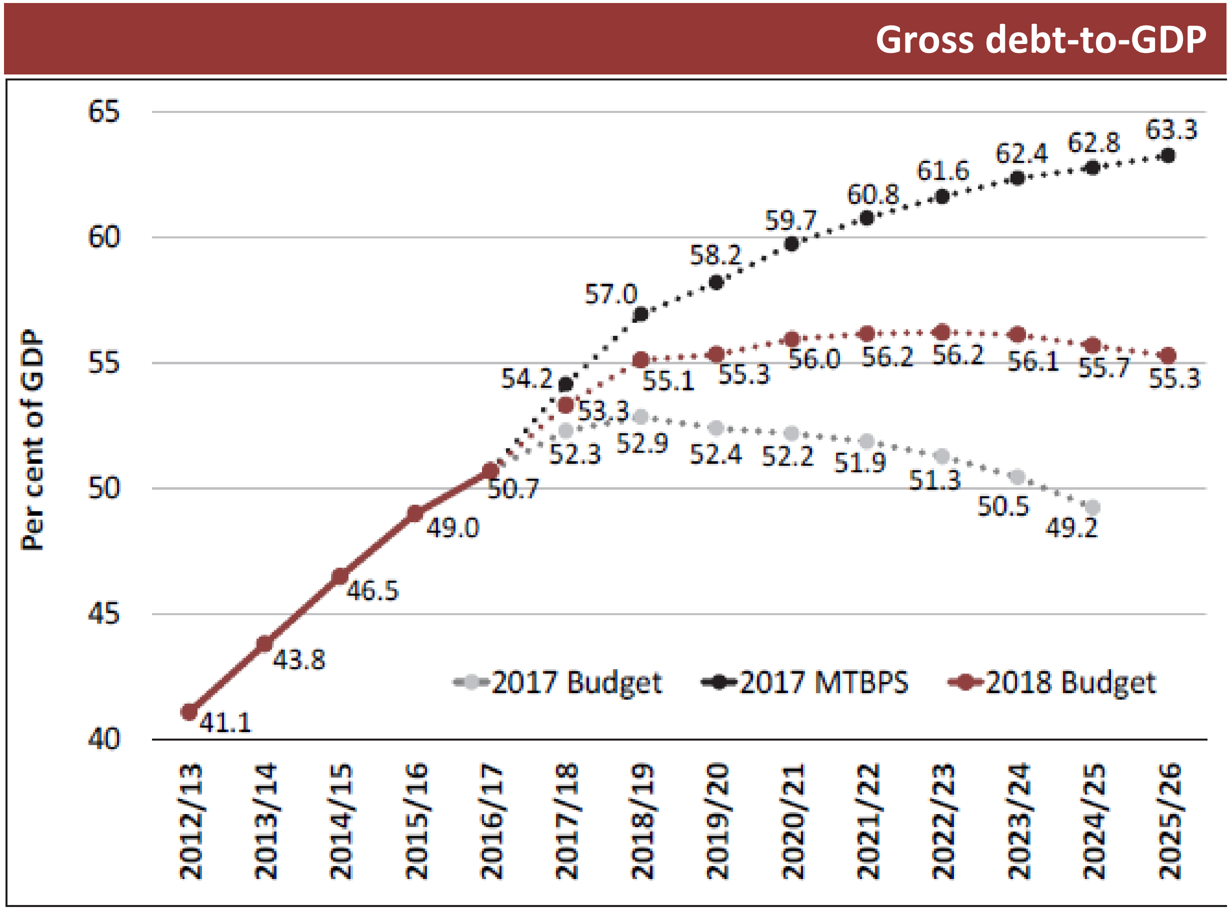


Main budget deficit



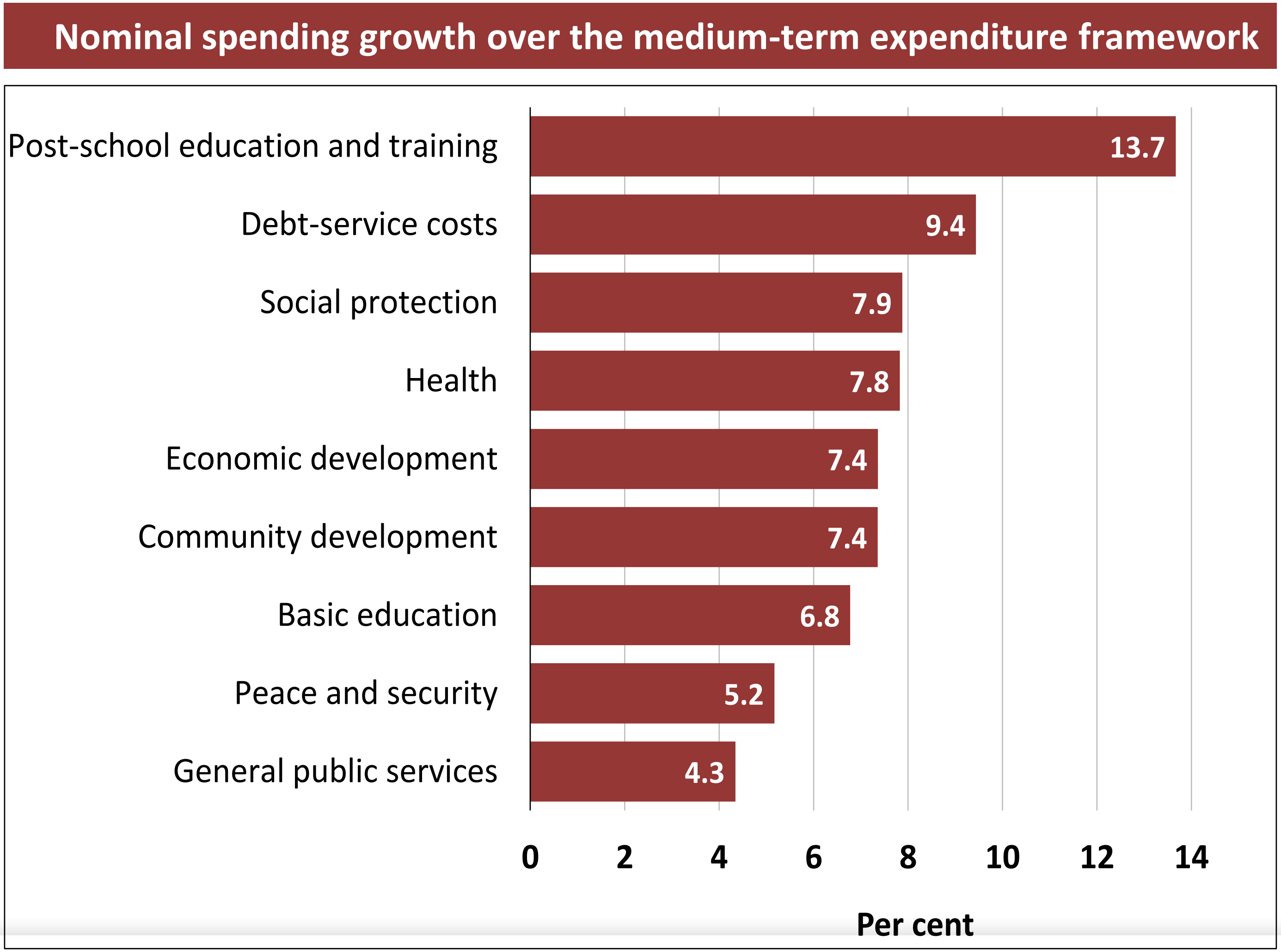
- Over the past decade, South African fiscal policy has focused on closing the gap between revenue and expenditure that emerged after the financial crisis in 2009/10
- The persistence of the gap reflects both policy decisions (e.g. high wage settlements) and declining growth (i.e. revenue shortfalls)
- Despite years of spending reductions and tax increases, government expects to borrow around R200 billion per year over the MTEF
- Borrowings add to gross national debt, which is now projected to reach R3.3 trillion by 2020/21

Debt-to-GDP ratio stabilises over the coming decade



Source: National Treasury

Fiscal framework – debt-service costs are the second fastest growing area of spending



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Complex factors shaped fiscal choices in the 2018 Budget

- In light of the economic slowdown in early 2017, the MTBPS revised the 2017/18 revenue estimate down by R50.8 billion, resulting in reduced revenue projections over the MTEF.

- Risks at several state-owned companies materialised, resulting in government transfers totalling R13.7 billion in 2017/18.

- Revenue + Borrowing = Expenditure
  - The deteriorating outlook triggered credit rating downgrades in April and Nov 2017.
  - Taking no fiscal action and allowing and increase in borrowing would have led to a further ratings downgrade, raising future borrowing and debt-service costs.

- In November, in response to the deteriorating fiscal outlook, a Cabinet subcommittee identified medium-term spending cuts amounting to R85 billion.

- In December, the then-President announced fully-subsidised higher education and training for poor and working-class students.

- As increasing debt was not an option, the fiscal measures required to balance the fiscal framework over the 2018 MTEF could only be found from a combination of large-scale spending reallocations and tax increases.

Budget 2018 proposed major spending reprioritisation over the medium term

- Total spending measures for 2018/19 to 2020/21 include:
  - R85 billion in reductions to departmental baselines
  - Funding for fully-subsidised higher education and training, which amounts to additional spending of R57 billion
  - An additional R10 billion for the contingency reserve over three years
  - A provisional allocation R6 billion in 2018/19 for drought management and public infrastructure
  - Allocations of R4.2 billion for national health insurance funded through adjustments to the medical tax credit, R490 million to establish the Tirisano Construction Fund Trust and R1 billion for the 2021 Census
  - An additional amount of R2.6 billion to enable an above-inflation increase to social grants to partially offset the impact of the VAT increase on the poor.
- These spending adjustments result in the expenditure ceiling being marginally revised down by R5.8 billion over 2018/19 to 2020/21.
- The revenue measures amounted to R36 billion in 2018/19 of which R22,9 billion is estimated to come from the 1 per cent increase in the rate of VAT

The technical exercise

- The National Treasury (NT) and the department of Planning, Monitoring and Evaluation (DPME) were asked to conduct the technical exercise and present proposals to the committee of Ministers, after which the proposals were presented to Cabinet for approval

- To achieve the required amount of budget reductions of R85,7 billion over the MTEF (R26,4 billion in 2018/19, R28,8 billion in 2019/20 and R30,5 billion in 2020/21), different options were considered.

- **Option 1:** An across the board cut (covering all 3 spheres of government) was suggested by NT and DPME.
  - This would have implied nearly a 2,5 percentage reduction to ALL programmes
  - The NT and DPME rejected the approach as that would have included the reduction in the budgets of key programmes like social grants, the HIV and Aids Grant as well as the Local Government Equitable Share
  - Hence, this option was not considered

The technical exercise (2)

- **Option 2:** A different methodology was then proposed so that any reductions would minimise the negative impact on service delivery.
- The following programmes / items were excluded from budget reductions:
  - Programmes focusing on delivery to the poor:
    - Social Grants
    - Local Government Equitable Share, to protect the provision of free basic services
    - Key programmes in Education (like the School Nutrition Programme) and Health (like HIV and Aids Grant)
  - Compensation of employees, as reductions of R25 billion (R10 billion in 2017/18 and R15 billion in 2018/19) had already been instituted in the 2016 Budget
  - Direct charges (like judges salaries), transfers to international organisations and payments for financial assets (like contributions to the New Development Bank (NDB)) were excluded, as these are legal obligations that cannot be reduced

The technical exercise (3)

Given that programmes were excluded from reductions implied that those that were included would need to have their budgets reduced by more than the 2.5 per cent

In identifying programmes to be reduced, the NT and DPME focus was on large programmes and grants, where such programmes had been underspending in previous financial years or where implementation of capital programmes could be postponed:

- Large programmes with budgets of more than R1 billion in 2018/19 – a general reduction of 5 per cent was applied, excluding Conditional Grants, Provincial and Local Government Equitable Shares and Public Entity Transfers
- Administration – an across the board 2 per cent reduction on programme administration for all national and provincial departments
- Public entity cuts – a 5 per cent reduction on transfer to all entities receiving more than R300 million in 2018/19. The research councils, health entities and the Water Trading Entity were excluded from the cuts. In some instances, the cuts were increased to more than the proposed 5 per cent like for the Special Defence Account and the South African National Roads Agency Limited
- Conditional Grants – a 5 per cent reduction on most provincial and local infrastructure conditional grants. In a number of instances, cuts of more than 5 per cent were introduced for slow spending grants like the Human Settlements Development Grant and the Municipal Infrastructure Grant

The impact

- In the national sphere, accounting officers who had more detailed knowledge of the programmes of their departments suggested changes to the initially proposed budget reductions. For example in the Department of Transport, the original budget reduction was meant to be on the Public Transport Operations Grant but was changed to increase the reduction on the Provincial Roads Maintenance Grant.

- For some programme reductions there is no immediate impact as the programme had been underspending for many years and the reduction brought the spending in line with departmental capacity to spend. Examples include:

  – The Department of Telecommunications and Postal Services had allocations for SA Connect for 3 years, with zero spending against the programme

  – The School Infrastructure Backlogs Indirect Grant in the department of Basic Education has been underspending since it's inception in 2011/12

- Public entity transfers were reduced for entities that have surpluses or have capital projects that can be rescheduled, like SARS, Special Defence Account, SANRAL, while in other entities the reductions aim at improving efficiency through general cuts to the baselines

Summary of how reductions were applied to the Division of Revenue (DoR)

Baseline reductions by sphere of government, before funding fee-free higher education and training

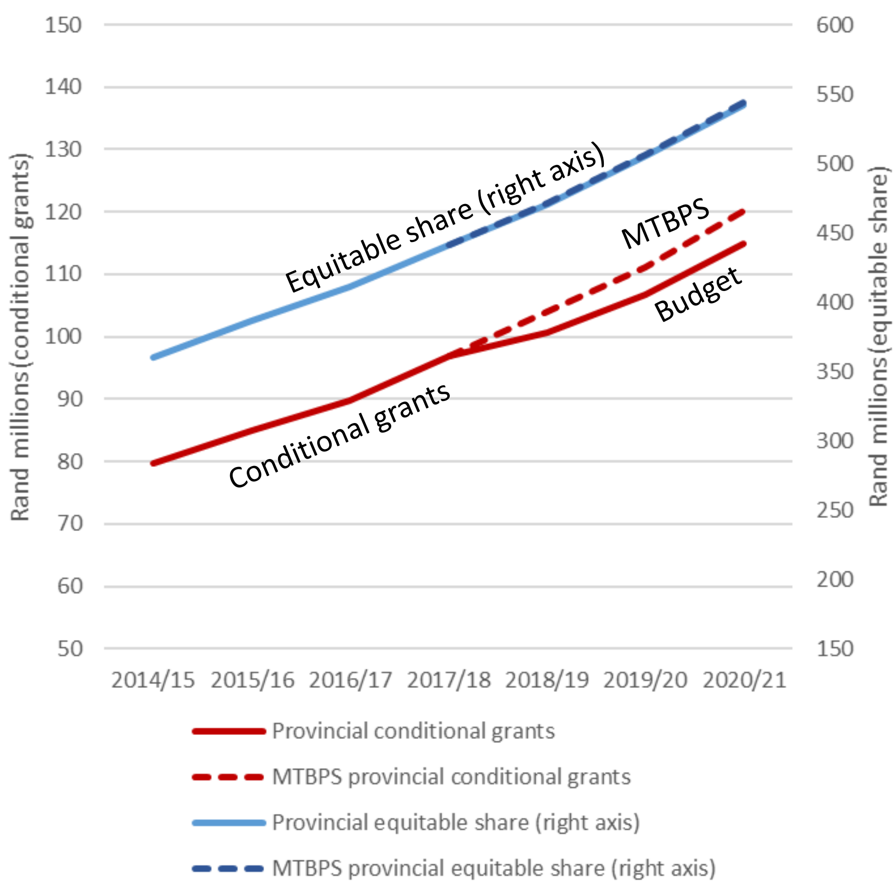
R million	2018/19	2019/20	2020/21	MTEF total	% of baseline
National government	**-18 048**	**-17 221**	**-18 177**	**-53 446**	**-2.1%**
Goods and services	-5 165	-5 525	-5 834	-16 523	-7.6%
Transfers to public entities	-10 402	-9 393	-9 917	-29 712	-7.7%
Other national spending items[1]	-2 481	-2 304	-2 427	-7 211	-1.1%
Provincial government	**-5 182**	**-6 387**	**-6 797**	**-18 366**	**-1.0%**
Provincial equitable share	-1 437	-1 584	-1 684	-4 705	-0.3%
Provincial conditional grants	-3 745	-4 803	-5 113	-13 661	-0.9%
Local government	**-3 152**	**-5 212**	**-5 499**	**-13 863**	**-3.5%**
Local government conditional grants	-3 152	-5 212	-5 499	-13 863	-9.3%
Total baseline reductions	**-26 382**	**-28 820**	**-30 473**	**-85 676**	**-1.8%**

1. Transfers to private enterprises and households, as well as capital items

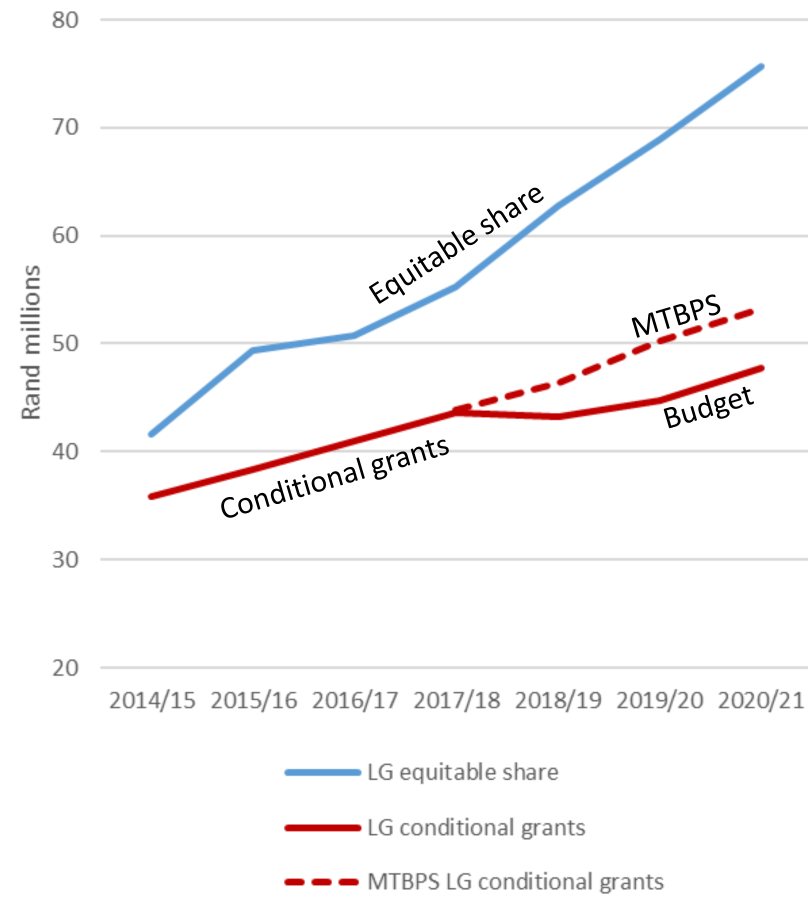
- R85 billion over 3 years reduced from expenditure announced in the MTBPS
  - R18.4 billion from provincial transfers and R13.9 billion from local government
  - This is before funding for free-fee higher education and training is added to the budget (for national)
- Reductions as a percentage of total allocations is small: provinces = -1% and LG = -3.5% (before accounting for LG own revenues)

Perspective on the scale of reductions to intergovernmental transfers

Provincial transfers



Local government transfers



- Biggest impact of reductions is on conditional grants
- Over the MTEF conditional grants still grow (but from a lower base than previously planned)

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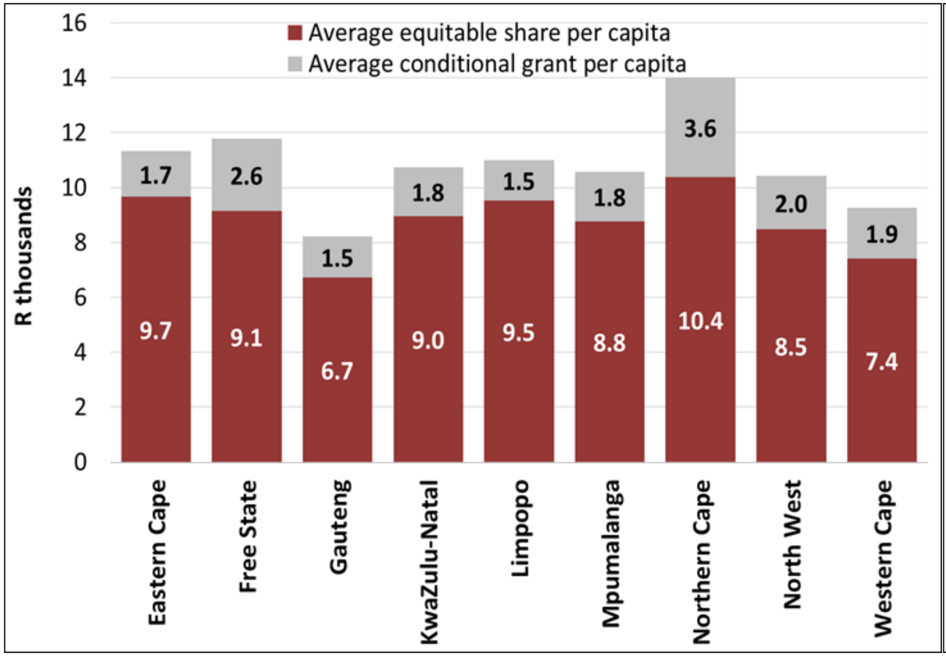
Which DoR transfers were reduced, and which were not?

- Main impact of reductions was on infrastructure grants – will result in some delays to rollout of planned projects
- Smaller reductions to provincial equitable share and current grants

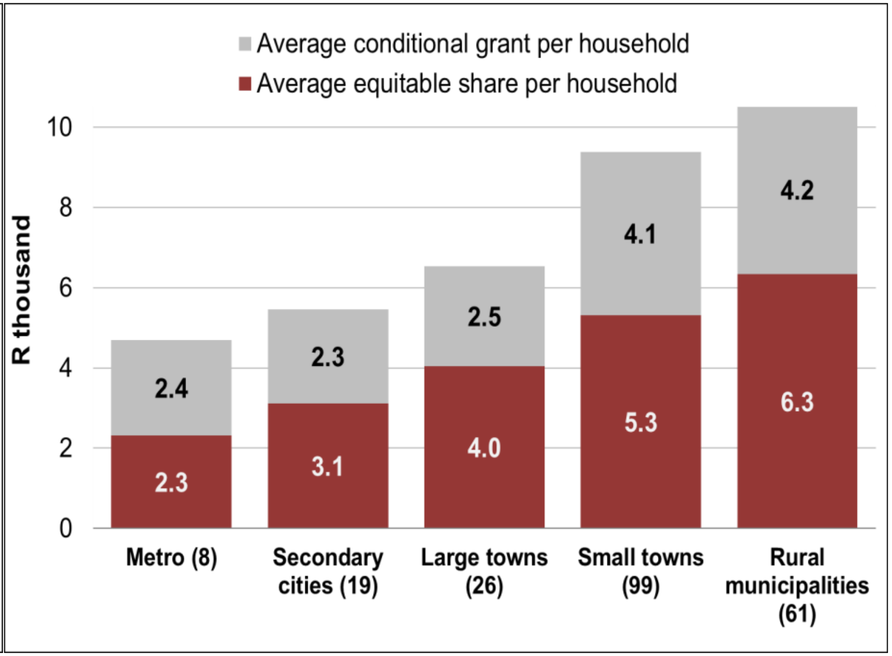
Reduced	Not reduced
Provincial equitable share – reduction of 0.3%, provinces expected to reduce goods and services	Local government equitable share – fully funded to provide free basic services for 9.8 million households
Education Infrastructure Grant and School Infrastructure Backlogs Grant	National School Nutrition Programme Grant – provides meals to 9 million poor learners
Human Settlements Development Grant	Comprehensive HIV, Aids and TB Grant
Smaller provincial grants, including for libraries and the EPWP	Public Transport Operations Grant – funds bus subsidies for commuters
Municipal Infrastructure Grant, Urban Settlements Development Grant, Public Transport Network Grant, Integrated National Electrification Grant	Learners with Profound Intellectual Disabilities Grant - to preserve access for intellectually challenged scholars
Water and sanitation specific grants – reduced by smaller proportions than other grants	Human Papillomavirus vaccine grant reduces the incidence of cervical cancer in women
Other local government grants including Financial Management Grant, EPWP etc.	Some local government grants including the Energy Efficiency Demand Side Management Grant

The DoR remains highly redistributive in favour of rural areas

Provincial transfers per capita, 2018/19



Local government transfers per household, 2018/19



- South Africa's tax base is concentrated in urban areas
- However, the allocations through the Division of Revenue transfer higher per capita/per household amounts to rural areas
  - Allocations to rural municipalities of R10 500 per HH is more than twice as much as to metros (R4 700), due to metros' higher own revenue raising abilities
- This indicates a division of revenue that is highly responsive to rural development even after reductions to some grants

Detailed information

- The details of the budget reductions can be found in the budget documents on the website www.treasury.gov.za
  - 2018 Estimates of National Expenditure pages vi to xv gives the list of all the budget reductions and additions by functional group
  - Details of the service delivery impact for each of the 40 National Votes are provided in their individual chapters of the 2018 Estimates of National Expenditure
  - For the 9 provinces details of their budget reductions can be found in the individual provincial Estimates of Revenue and Expenditure published on the National Treasury website

Thank you

South Africa has been ***RANKED FIRST***, alongside New Zealand, on the 2017 Open Budget Index. The survey evaluates **115 countries** on the **transparency** of their budgets, across a range of measures.

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