2019 MTBPS analysis

05 November 2019

Parliamentary Budget Office

PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

Outline

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- Changes to consolidated expenditure by function in R'billion
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The Parliamentary Budget Office (PBO)

- The Parliamentary Budget Office (PBO) was established in terms of Section 15 of the Money Bills and Related Matters Act 2009 as amended in 2018;
- The PBO assists MPs with the implementation of the Money Bills and Related Matters Act; in particular the Finance and Appropriations Committees of both Houses of Parliament as well as other Committees subject to availability;
- The PBO offers independent and objective advice and analysis to the Finance and Appropriations Committees in both Houses of Parliament on money bills and other bills presented by the Executive; and any other documentation or reports with fiscal implications.

Roles of Committees: Medium Term Budget Policy Statement

Finance Committees	Appropriations Committees
Current year revised fiscal framework and the proposed fiscal frameworks for the next three financial years: a. Chapter on Economic Overview b. Chapter on Fiscal Policy	Spending priorities of national government for the next three financial years
Explanation of the macro-economic and fiscal policy position, the macro-economic projections and the assumptions underpinning the fiscal framework: a. Chapter on Economic Overview b. Chapter on Fiscal Policy c. Also take into account: - Fiscal Risk Statement	Proposed division of revenue between the spheres of government for the next three financial years
	Proposed substantial adjustments to conditional grant allocations to provinces and municipalities, if any
	Review of actual spending by each national department and each provincial government between 1 April and 30 September of the financial year in which the statement is tabled

Strategic direction for the MTBPS

Strategic direction for the MTBPS

- The 2017 MTBPS was based on the NDP, 2014-2019 MTSF and the Mandate Paper
  - The aim of the Mandate Paper was to strengthen the alignment of the national budget and the NDP
- The 2018 MTBPS made no mention of the Mandate Paper, prioritisation was based on the President's Economic Stimulus and Recovery Plan
  - Progress on this plan includes:
    - Tourism: withdrawal of the requirement for unabridged birth certificates for foreign minors.
    - The electronic visa platform to be piloted in November 2019
    - Cabinet approved a revised Integrated Resources Plan for energy
    - Final telecommunications policy directive for spectrum licensing was released in July 2019

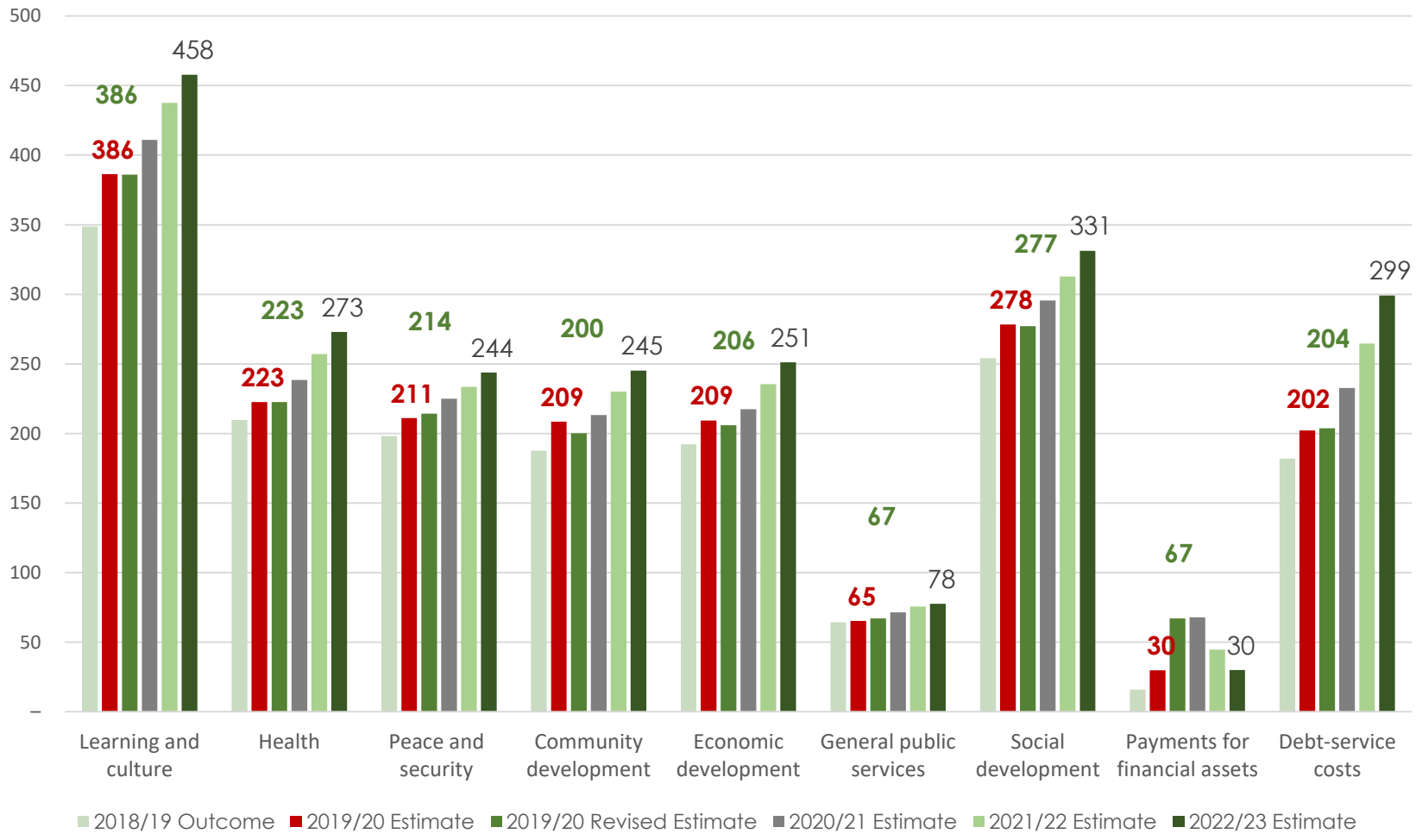
Strategic direction for the MTBPS (cont.)

- The 2019 MTBPS makes no mention of the Mandate Paper and
- The 2019-2024 MTSF for the second phase of the implementation of the NDP has also not been published
  - What is the position of the Mandate Paper?
- The 2019 MTBPS is based on the State of the Nation Address, which identified seven priorities

Strategic direction for spending Priorities

Seven priorities (SONA – June 2019)	Budget Function group	Reprioritisation to
Economic transformation and job creation	• Economic development	• Improve trade in agricultural exports • Strengthen the Industrial Parks Revitalisation Programme • A new operational model to improve its support to small and medium-sized enterprises.
Education, skills and health	• Learning and Culture • Health	• Improve early grade reading and mathematics • Develop a student funding framework • The Student Housing Infrastructure Programme • Improve the efficiency of service delivery in health • Rolling out the health patient registration system • Reprioritised funds to establish an NHI Office.
Consolidating the social wage through reliable and quality basic services	• Social development	• ECD grant integrated into equitable share
Spatial integration, human settlements and local government	• Community development	• Increase free basic services • Transfers to the Passenger Rail Agency of South Africa to fund rail modernisation
Social cohesion and safe communities	• Learning and Culture • Peace and security	• Implement the Integrated Criminal Justice Strategy
A capable, ethical and developmental state; and A better Africa and World	• General public services	• Additional funds for SARS, AGSA and StatsSA

Changes to consolidated expenditure by function in R'billion



Macroeconomic overview and fiscal policy

Sectoral interventions, the MTBPS and NT's policy document

- The MTBPS offers little in terms of macroeconomic analysis and solutions to current economic downturn
- Instead, the MTBPS points to solutions outside of the fiscal sphere that may not improve macroeconomic performance during MTEF
- The government seems to overlook its potential role in driving economic growth in economy through the budget
- The solution globally is to use both monetary and fiscal policy while in South Africa we have hardly used either of these macroeconomic solutions

Sectoral interventions, the MTBPS and NT's policy document

- Even successful implementation of programmes for the ambitious sectoral goals should have a small impact on investment, employment, economic growth, revenue collection and the debt ratio over the MTEF
- But successfully achieving the sectoral interventions will be hard. Experience with the NDP provides an indication:
  - The President said in the June 2019 SONA that insufficient progress on the NDP goals were made in the last MTSF,
  - The PBO's research showed problems of integration, alignment, coordination, and M&E of NDP activities within government
- Demand constrained, poor global economic and a low growth domestic economy, hampered by fiscal consolidation, reduces chances of success, and
- Constrains the potential impact of sectoral interventions.

Potential constraints to achieving NT's sectoral goals - business

- International integration and corporate restructuring may constrain achievement of the sectoral goals
- The SA economy is concentrated and dominated by large corporations
- They have a history of using predatory behavior to limit competition
- They have restructured and internationalised and often treat their SA subsidiaries as just assets in larger international portfolios.
- Further, outsized influence of financial institutions on allocation of finance prioritises short-term high returns not long-term productive, fixed investments
- Integrated financial markets exposes SA to contagion and systemic risks and increase macroeconomic instability

Potential constraints to achieving NT's sectoral goals - society

- Extreme levels of inequality continue to manifest along racial categories and reinforce the dysfunction of apartheid spatial outcomes
- These inequalities affect all aspects of consensus-making within and across political parties and other stakeholders
- E.g., big business and unions are two powerful interest groups that have very different visions for the economy, labour markets and workplaces
- Continued distrust and ideological divide across stakeholders and interest groups may work against agreement on:
  - Regulation and ownership of network industries,
  - Competition and industrial policies,
  - Labour market regulation, and
  - Privatisation and public private partnerships (PPPs)
- Further, limited growth in government economic cluster expenditure constrains already inadequately funded network and industrial policies
- Low levels of industrial development financing may further seriously constrain sectoral interventions

Where will growth come from – public sector

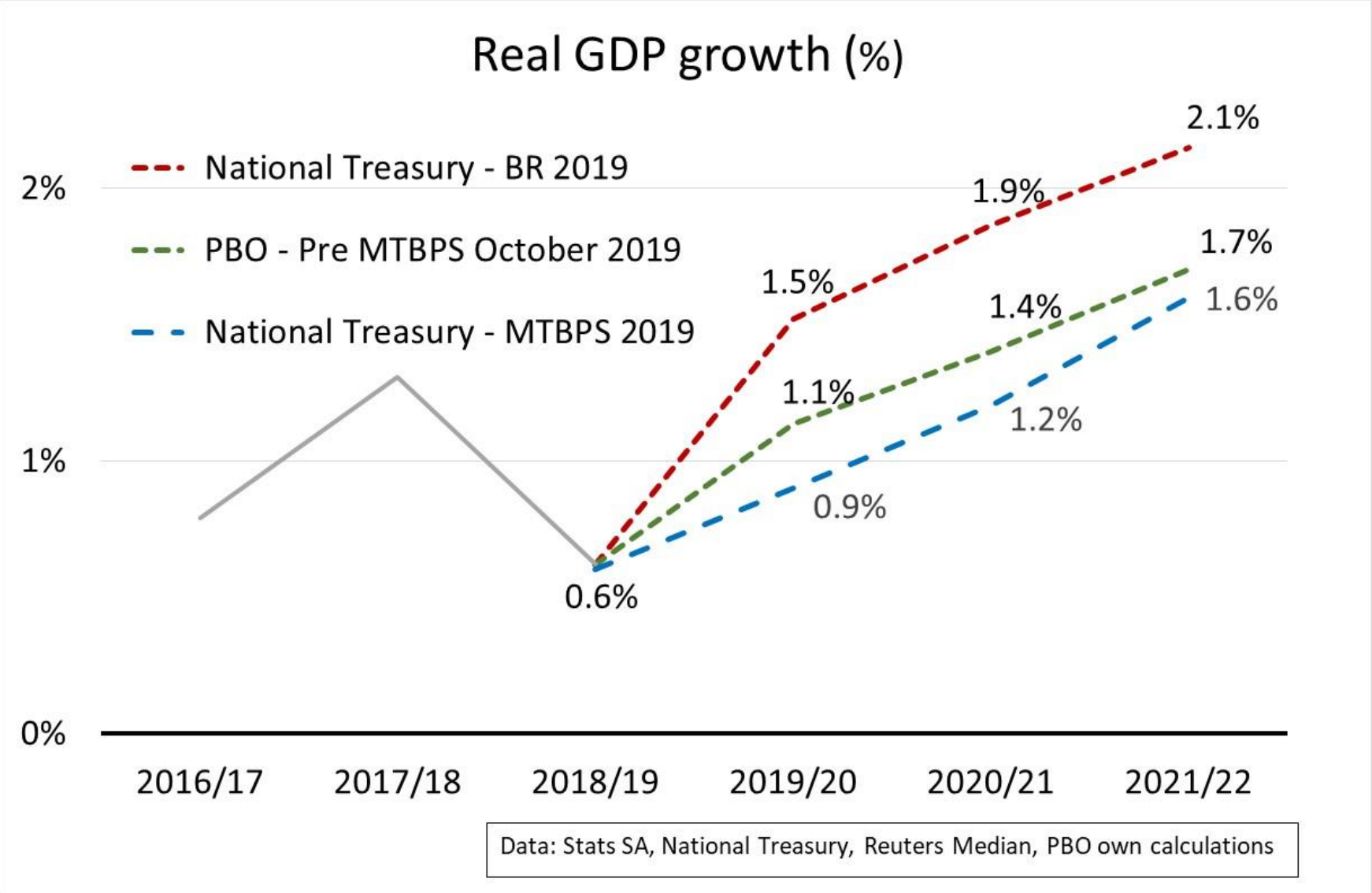
- Government does not have direct influence over private spending by households and investments by enterprises
- Through the budget, government can make choices about government's direct contribution to GDP
- With increased expenditure government can spur more private sector consumption and investment and set off positive multipliers
- The outlook for contribution to GDP from the private sector, in the forms of household consumption and private investment, means that additional public consumption and investment will be needed to lift GDP in the medium term. In 2018:
  - The public sector contribution to GDP was 26.7%
  - The private sector contribution was 60% from households and 12.5% from enterprises investment (amounting to 72.5%).
- Household consumption and private investment is not expected to increase significantly over the MTEF
- An increase in government consumption and investment should add extra percentage points to GDP and support multiplier effects

Where will growth come from – private investment and household consumption

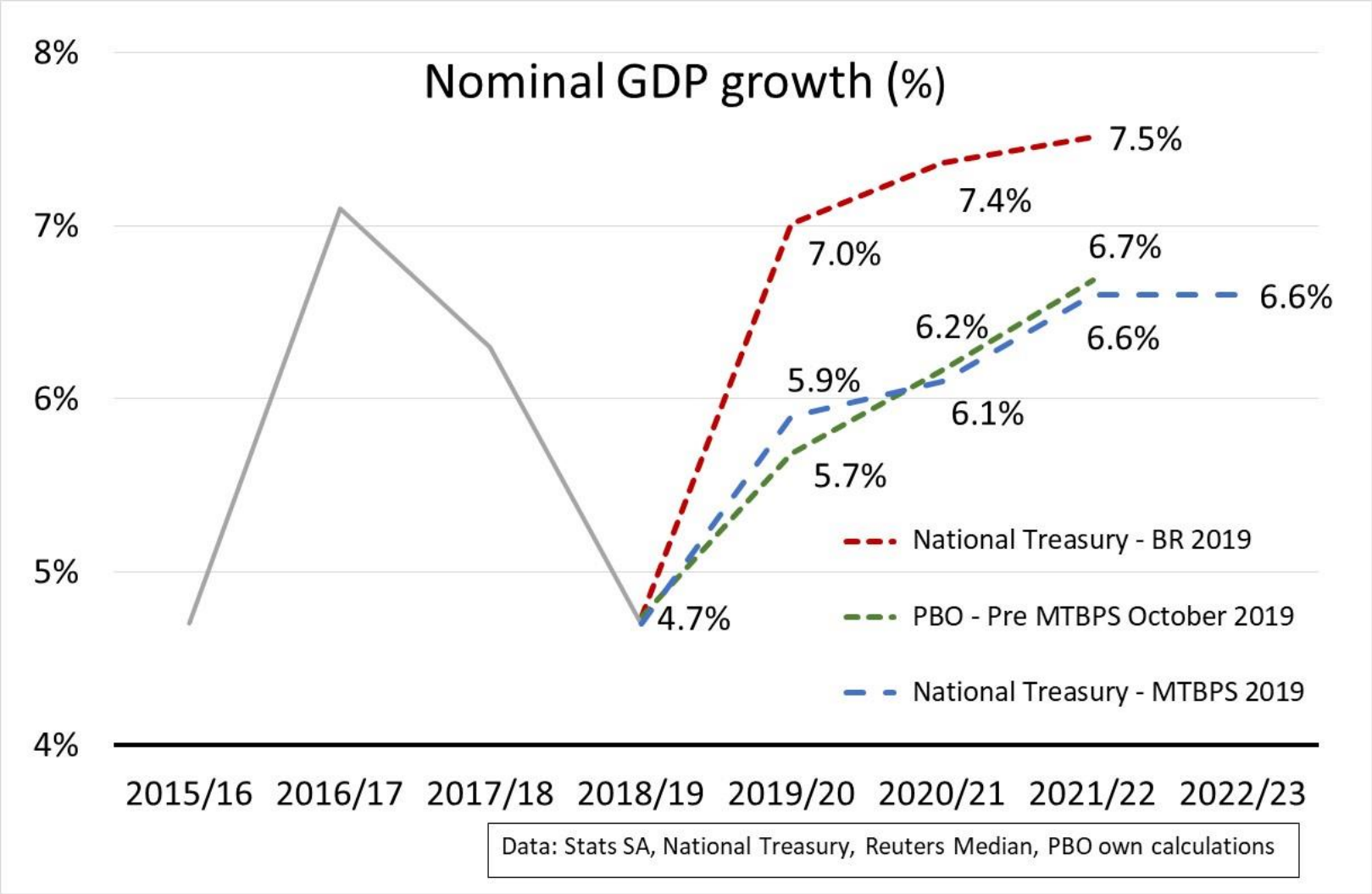
- Household consumption will remain constrained over the medium term due to:
  - Social protection expenditure increased slightly but there has been large gaps in coverage, high dependency ratios and increasing unemployment
  - Average compensation increases of the employed have not been adequate to substantially lift household demand
- Poor investment performance over the past few years was due to
  - Misallocation of finance before the global financial crisis,
  - Continued high level of household debt and continued speculation in financial markets , and
  - The decline in demand by households and the effect on private investment
- Low levels of global demand and trade and poor domestic demand will continue to put downward pressure on private investment levels

Revised Growth, Fiscal Framework and Debt Outlook

Downwardly revised growth outlook



Worsening nominal GDP outlook



Changes to 2019/20 Fiscal Framework

R million	NT Budget Review 2019	PBO Pre-MTBPS 2019[1,2]	NT MTBPS 2019
Personal income tax	552,877	538,625	527,606
Corporate income tax	229,608	220,507	218,984
VAT	360,471	349,071	348,388
Other tax revenue	279,252	265,513	274,700
Gross tax revenue	**1,422,208**	**1,373,715**	**1,369,678**
Non-tax revenue[3]	31,537	32,880	39,686
SACU payments	(50,280)	(48,289)	(50,280)
Main budget revenue	**1,403,464**	**1,358,306**	**1,359,084**
Main budget expenditure	**1,658,707**	**1,680,232**	**1,683,352**
Main budget balance	**(255,243)**	**(321,926)**	**(324,268)**
Main budget balance (% of GDP)	**-4.7%**	**-6.2%**	**-6.2%**
Gross loan debt (% of GDP)	**56.2%**	**58.8%**	**60.8%**
Net loan debt (% of GDP)	**50.3%**	**50.7%**	**56.1%**
Tax buoyancy[4]	**1.31**	**1.18**	**1.08**

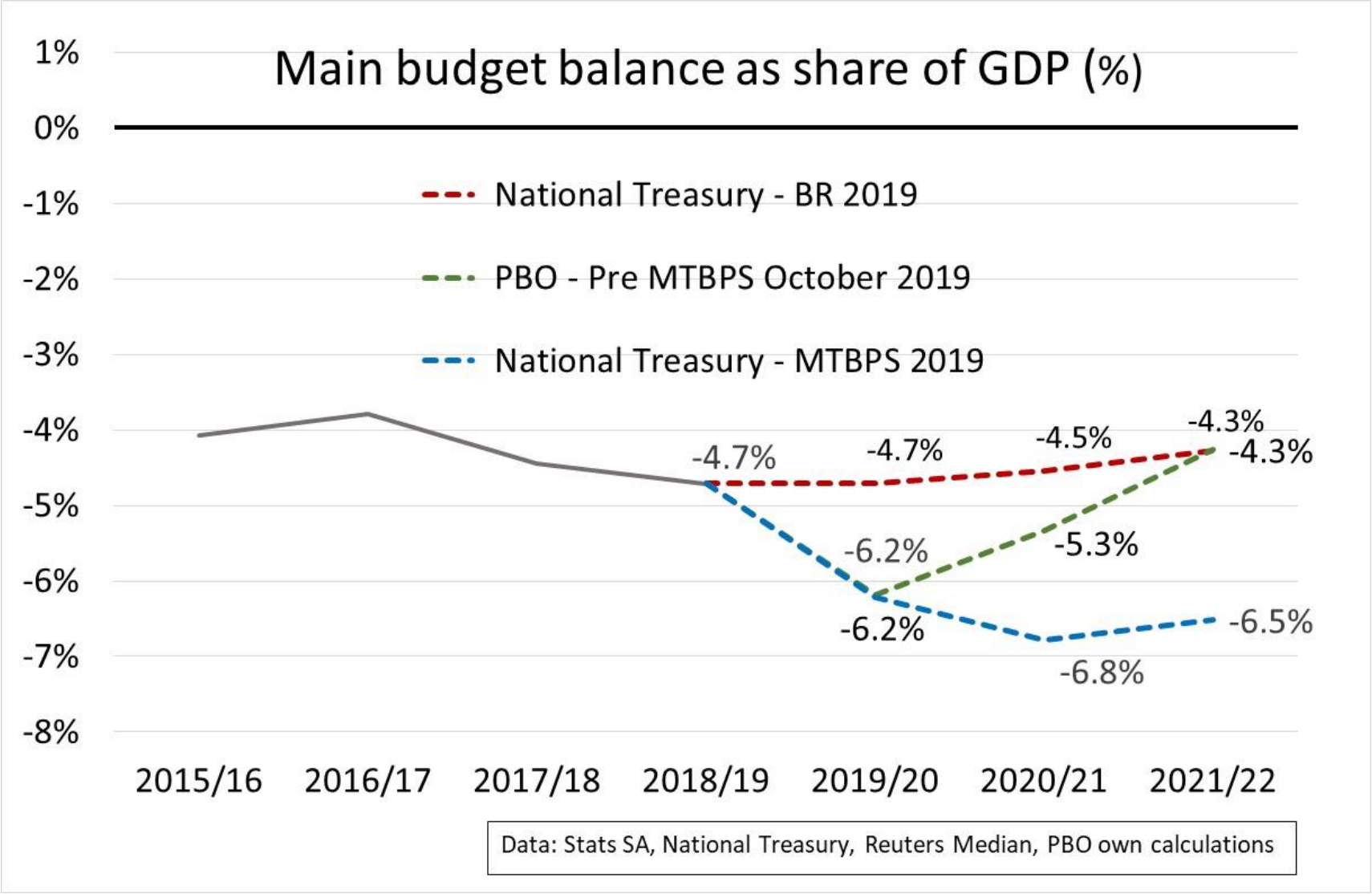
Main Budget Framework

R billion/percentage of GDP	2016/17	2017/18	2018/19	2019/20 Estimates	2019/20 Revised Estimates	2020/21	2021/22	2022/23
Main budget revenue	**1 137.9**	**1 196.4**	**1 274.7**	**1 403.5**	**1 359.1**	**1 425.9**	**1 525.6**	**1 627.9**
	25.7%	*25.5%*	*25.9%*		*26.1%*	*25.8%*	*25.9%*	*25.9%*
Expenditure								
Expenditure ceiling	1 142.0	1 225.5	1 307.2	1 430.6	1 404.7	1 493.0	1 591.3	1 673.6
Baseline allocations	*1 142.0*	*1 225.5*	*1 307.2*	*1 430.6*	*1 404.7*	*1 487.0*	*1 585.3*	*1 667.6*
Contingency reserve	–	–	–	*13.0*	–	*6.0*	*6.0*	*6.0*
Other non-interest expenditure	17.0	16.9	17.6	19.2	74.9	75.4	53.6	45.0
of which:								
Eskom financial support					49.0	56.0	33.0	23.0
Provisional allocations not assigned to votes					25.9	19.4	20.6	22.0
Non-interest expenditure	**1 159.0**	**1 242.3**	**1 324.9**	**1 456.5**	**1 479.6**	**1 568.5**	**1 644.9**	**1 718.6**
Debt-service costs	146.5	162.6	181.8	202.2	203.7	232.8	264.6	299.1
Main budget expenditure	**1 305.5**	**1 405.0**	**1 506.7**	**1 658.7**	**1 683.4**	**1 801.2**	**1 909.5**	**2 017.7**
	29.5%	*29.9%*	*30.6%*	*30.6%*	*32.3%*	*32.6%*	*32.4%*	*32.1%*
Main budget balance	**-167.6**	**-208.6**	**-232.0**	**-255.2**	**-324.3**	**-375.3**	**-383.9**	**-389.8**
	-3.8%	*-4.4%*	*-4.7%*	*-4.7%*	*-6.2%*	*-6.8%*	*-6.5%*	*-6.2%*
Primary balance	**-21.1**	**-46.0**	**-50.1**	**-53.0**	**-120.5**	**-142.5**	**-119.3**	**-90.7**
	-0.5%	*-1.0%*	*-1.0%*	*-1.0%*	*-2.3%*	*-2.6%*	*-2.0%*	*-1.4%*

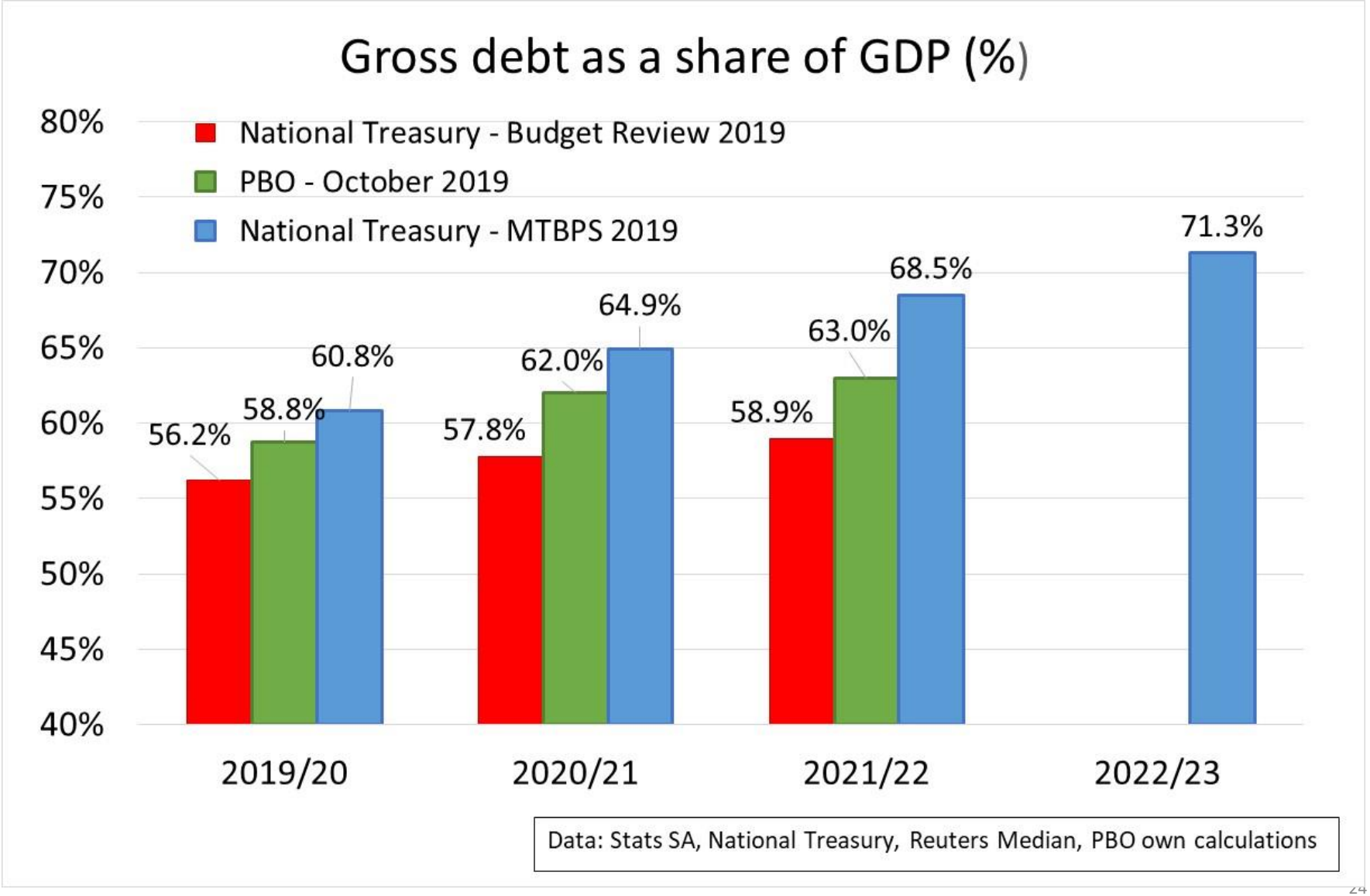
Tax collection considerations

- Tax revenue budgets have required downward adjustments in the MTBPS since 2014/15.
- R52.5 billion is the estimated under collection for 2019/20.
- The MTBPS calls for additional measures amounting to R150 billion over the MTEF.
- Some policy proposals in the MTBPS may worsen tax revenue collection if implemented, for example reduction of the public sector wage bill and impact on PIT and VAT.
- Some possible sources for additional revenue –
  - Taxation of electronic cigarettes and tobacco heating products
  - Re-assessment of the VAT zero rated basket
  - Expansion of fuel levy scope
  - Expansion of wealth tax
  - Improved design and scope of tax incentives

Further fiscal slippage



Higher debt outlook



Expenditure discussion

Consolidated expenditure by economic classification

R billion	2018/19 Outcome	2019/20 Revised	2020/21 Medium-term estimates	2021/22	2022/23	Average annual growth 2019/20 – 2022/23
Current payments	**1 006.6**	**1 093.8**	**1 181.0**	**1 275.6**	**1 363.9**	**7.6%**
Compensation of employees	584.7	630.7	675.2	717.6	758.5	6.3%
Goods and services	233.4	252.2	264.3	284.9	297.3	5.6%
of which: debt-service costs	*181.8*	*203.7*	*232.8*	*264.6*	*299.1*	*13.7%*
Transfers and subsidies	**548.8**	**593.0**	**626.3**	**665.5**	**700.3**	**5.7%**
Payments for capital assets	**81.5**	**90.1**	**97.6**	**105.8**	**114.7**	**8.4%**
Buildings and other capital assets	65.3	70.1	75.1	82.6	89.6	8.5%
Machinery and equipment	16.2	20.0	22.5	23.3	25.1	7.8%
Payments for financial assets	**15.9**	**67.1**	**67.9**	**44.6**	**30.0**	**–**
Total	**1 652.8**	**1 844.1**	**1 972.7**	**2 091.5**	**2 208.9**	**6.2%**

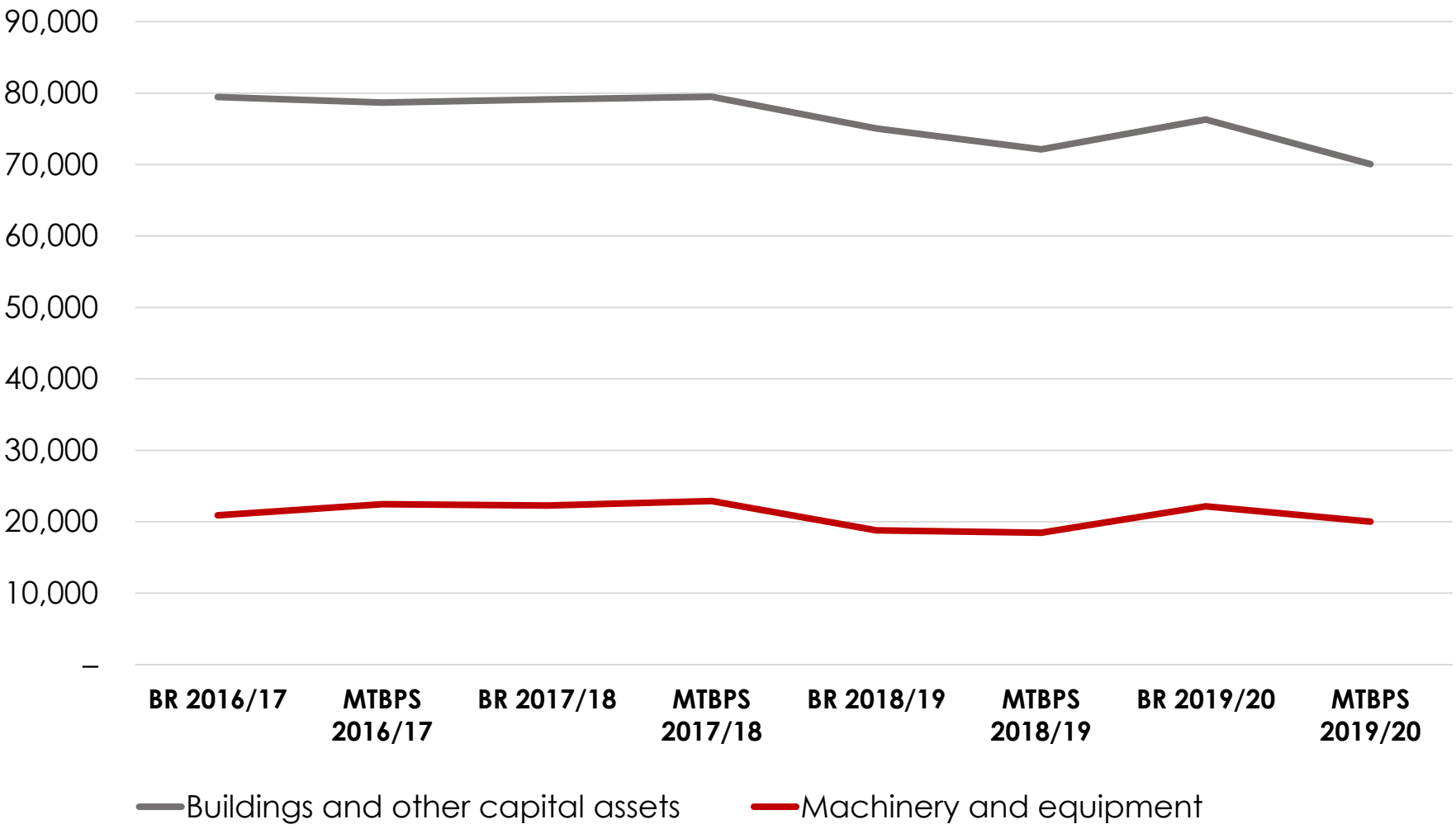
Overview of the compensation of state employees

- In 2018/19 spending on compensation of state employee accounted for 35.4% of consolidated expenditure, of which 37% of compensation spending occurred at national level and 61% at provincial level.
- After adjusting for inflation, average remuneration in the public service rose 66 per cent between 2006/07 and 2018/19. Much of this increase was concentrated in 2009/10 and 2010/11. Where the fastest rise in wages was recorded in high-skill professions, including medical doctors, teachers and lawyers, where occupation-specific dispensations were introduced.
- Average public sector remuneration is higher in part because a larger proportion of public servants have tertiary qualifications.
- Within more specialised groups, including middle and senior managers, remuneration is higher and the distribution is larger. In total however these groups make up about 6 per cent of the public service.

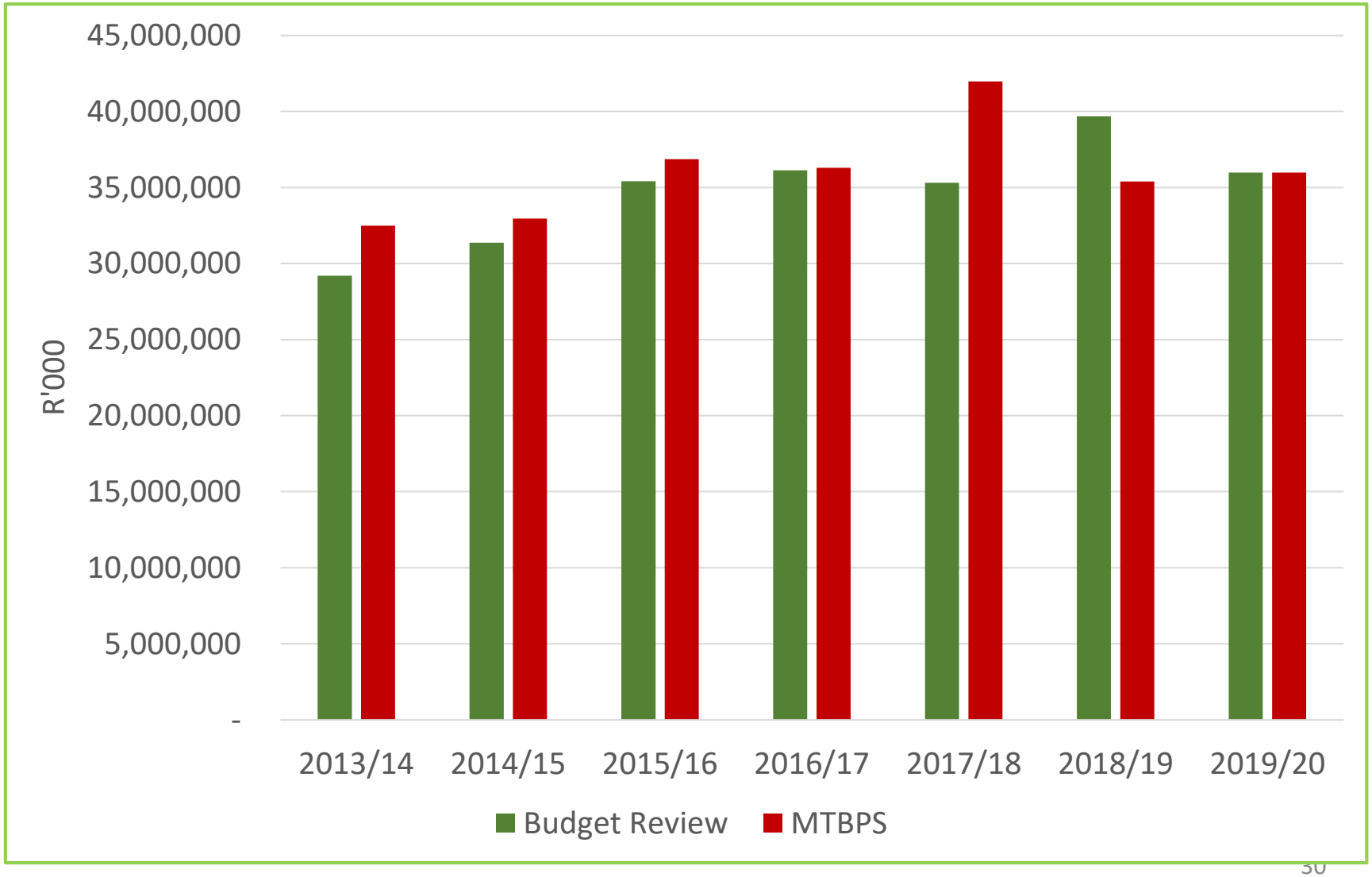
Analysis of the compensation of state employees

- Are we willing to "thin" out the public sector, only for the sake of reducing expenditure, without having a look at the possible impact this may have on service delivery, the attraction of highly-skilled professionals into the public sector and the overall unemployment rate?
- Public sector workers account for a relatively larger segment of the Income Tax base in South Africa, both because they comprise a larger share of the workforce and because their earnings tend to be higher than their counterparts in the private sector. Consequently, the South African tax base is potentially more sensitive to public sector pay policy decisions.
- In times of public spending growth, it is generally recognized that positions in the public sector tend to offer greater job security than in the private sector, yielding a steady stream of Income Tax payable to the Treasury. However, in times of austerity, the tendency to impose policies directly aimed at reducing the public sector workforce size or capping pay can have a disproportionate effect on the South African tax base.

Decline in payment for capital assets budget in R'million



Provincial capital budget and actual outcomes, 2013/14 – 2019/20



Key issues for oversight on Infrastructure Expenditure

National/Provincial Government- Also based on AGSA reports and government findings	Local Government - Based on AGSA report- Infrastructure Spending Concerns
Government Infrastructure Expenditure has been in decline over the years, making way for fiscal consolidation;	Due to lack of capacity, infrastructure projects are delayed beyond their planned completion dates;
However, 2018 Economic Stimulus Package included Infrastructure spending as measure to boost economic growth and service delivery;	Failure to have a properly monitor and supervise mechanisms at metros infrastructure projects has led to poor quality of some completed projects;
To consider service delivery implications of reduced spending on infrastructure projects, including maintenance of infrastructure directly link to service delivery;	Tendency to replace contractors in the middle of infrastructure projects, this has resulted in significantly increased costs;
Inefficiencies in the value chain of infrastructure delivery starting from planning, procurement and implementation- e.g. EC;	Some Infrastructure planning documentations plans lacks indicators and targets to measure performance or success of projects
Infrastructure service delivery models are not always backed by a scientific investigation into infrastructure capacitation across all spheres of government;	Failure to compliance with SCM processes in appointing contractors and service providers, resulting in the expenditure irregular expenditure
Some of the specific examples of challenges related to infrastructure spending: Underspending on accelerated school infrastructure delivery initiative and education infrastructure grant There has been failure to realise value in capital and infrastructure payments, e.g: • PRASA lost R2.2 billion, • Human Settlement (FS) overpay suppliers by R 32 million, • Basic Education paying for lower than required standard in project. • Water and sanitation delayed payments for water infrastructure projects; • Spending on ICT infrastructure that never get used;	In many infrastructure projects at some metros, payments are often made without evidence for reported work in progress or work done; There are also inaccuracies in reporting of completed projects valuations;

Proposed changes to the Provincial Equitable Share

R million	2019/20	2020/21 Budet	2020/21 MTBPS	2020/21 Change	2021/22 Budget	2021/22 MTBPS	2021/22 Change	2022/23
Eastern Cape	68 824	72 744	71 747	-996	76 293	75 656	-637	78 841
Free State	28 187	30 338	30 157	-181	32 411	32 046	-366	33 657
Gauteng	102 448	111 636	112 640	1 004	120 700	121 685	985	129 908
KwaZulu-Natal	106 014	113 370	111 960	-1 410	120 324	118 302	-2 022	123 544
Limpopo	58 965	62 986	62 619	-368	66 779	66 564	-215	69 935
Mpumalanga	41 428	44 475	44 310	-165	47 389	47 215	-175	49 724
Northern	13 424	14 388	14 356	-33	15 309	15 278	-31	16 068
North West	34 973	37 694	37 722	28	40 325	40 361	36	42 682
Western Cape	51 291	55 278	55 464	187	59 115	59 552	437	63 194
Total	**505 554**	**542 909**	**540 975**	**-1 934**	**578 645**	**576 658**	**-1 987**	**607 554**

In-year adjustments

Summary of the 2019/20 Adjusted Appropriations

Total budget estimates increases by R14 868.7 million

- Allocations announced in the 2019 Budget speech R16 777.8 million
- Roll-overs R344.9 million
- Self-financing expenditure R1 655.3 million
- Declared unspent funds of R3 909.3 million

Direct charges increases by R1 517.9 million:

- Debt-service costs R1 522.9 million
- National Revenue Fund payments R224.2 million
- Members' remuneration R73.0 million
- Skills levy and sector education and training authorities were reduced by R182.2 million
- Magistrates' salaries were reduced by R120 million

The total increase of R24. 7 billion (including the R26 billion to Eskom) from R1 658.7 billion to R1 683.4 billion are offset against the provisional allocations and contingency reserve set aside in the 2019 Budget

Conclusions

- The 2019-2024 MTSF for the second phase of the implementation of the NDP has not been published
- The 2019 MTBPS is based on the June 2019 SONA
- The 2019 MTBPS does not offer solutions within the fiscal framework to address poor growth prospect during the MTEF
- The successful implementation of the sectoral initiatives, as suggested by the National Treasury *Growth Agenda* will be difficult to achieve in the current global economic climate
- Business and societal challenges as well as constrained government spending will hamper the contribution of these sectoral initiatives to economic growth
- Private household and firm contribution to growth is expected to remain low
- Therefore, government can make a direct contribution to growth through increasing expenditure
- The growth outlook has been revised downward

Conclusions

- Government has downwardly revised revenue estimates
- In addition, increased expenditure on SOCs resulted in a main budget deficit larger than estimated in the 2019 Budget
- Debt to GDP is estimated to increase
- Government revenue expected to underperform by R52.5 billion, and is estimated to be R150 billion less over the 2020 MTEF
- Government is considering additional measures for further taxes
- Expenditure ceiling has been downwardly revised over the medium term, by
  R28.4 billion; this excludes allocation to Eskom;
- Government proposes to reduce the wage bill: this discussion should take into account the potential impact on service deliver and other issues matters like tax revenue;
- Infrastructure spending has been declining over time in part due to fiscal consolidation.