2020 Pre-budget Brief

PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

Parliamentary Budget Office

The Parliamentary Budget Office (PBO) has been established in terms of the Money Bills Amendment Procedure and Related Matters Act (Act 9 of 2009). The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money Bills. The PBO supports the implementation of the Act by undertaking research and analysis for the Finance and Appropriations Committees.

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Purpose

The purpose of the pre-budget analysis report is to assist members with their deliberations and approval of the fiscal framework and revenue proposals. It further aims to assist members in determining the consistency of the changes to the division of revenue with the fiscal framework, taking into account the service delivery obligations and priorities of all affected national departments, provincial government departments and local governments.

Introduction

The South African budget process is governed by legislation. The fiscal policy and budget priorities which inform the final budget process, was presented to Parliament in October 2019. Subsequent to the tabling of the final budget proposals in Parliament, the Budget must be enacted into law.

The Parliamentary Budget Office has been established to assist the Committees of Finance and Appropriations with the implementation of the requirements of the Money Bills Amendment Procedure and Related Matters Act, which includes, amongst others, to ensure:

- An appropriate balance between revenue, expenditure and borrowing
- Reasonable debt levels and debt interest cost
- That the cost of recurrent spending is not deferred to future generations
- Adequate provisioning for spending on infrastructure development, overall capital spending and maintenance

The Finance and Appropriations Committees are further required to:

- Consider the short, medium and long -term implications of the fiscal framework, on economic growth and the development of the country
- Take into account economic and public finance factors including extra-budgetary funds, and contingent liabilities

This report provides Members with strategic information relating to the allocation of nationally raised funds. It further provides the macroeconomic background to the fiscal framework, the proposed changes to the fiscal framework, and the debt outlook for the country. Changes to revenue and expenditure are discussed.

Strategic direction for the budget

The State of the Nation Address (SONA) identified priorities for government action to grow the economy and to reduce unemployment. The priorities focus on the economy, crime prevention, skills development and the expansion of sectors with proven potential for job creation, in particular the:

- Fixing of commuter rail, to provide, a safe, reliable and affordable service.
- Building of new TVET college campuses, a new University of Science and Innovation in Ekurhuleni and addressing the accommodation challenges on campuses.
- Combating crimes of economic disruption emanating from construction and other businesses, the policing of tourist attraction areas, strengthening Anti-Gang Units and

establishing a Crime Detection University in Hammanskraal are all initiatives to improve the quality of crime prevention and detection.

- Developing new and innovative ways to support youth entrepreneurship and self-employment.
- Noting the success made by the automotive master plan, and indicating the progress made in finalising and implementing master plans in clothing and textile, poultry, sugar and steel industries.

The President acknowledged the fact that for over a decade, South Africans have had to contend with the effects of a constrained energy supply. Government is committed to take several measures to rapidly and significantly increase generation capacity outside of Eskom.

Other initiatives announced by the President is the establishment of a sovereign wealth fund as a means to preserve and grow the national endowment of our nation, giving practical meaning to the injunction that the people shall share in the country's wealth. The President also indicated that they are proceeding with the establishment of a state bank as part of the effort to extend access to financial services to all South Africans. The Minister of Finance will provide details on these in his Budget Speech.

Integrated planning and budgeting

Budgeting is merely the resourcing of strategic plans. Plans and budgets should be integrated in order to improve operational effectiveness rather than solely for compliance reasons. Funding should; therefore, be allocated to the priorities articulated in a department's strategy and plans. Figure 1 shows the elements of the planning and budgeting cycle.

Figure 1: Planning and budgeting cycle

The 2020 medium term expenditure framework (MTEF) marks the beginning of a new 5-year planning and budgeting cycle. Critical factors to consider at this stage of the new 5-year cycle are:

- The alignment of resources with policy intent
- To ensure suitable budget programmes
- To enable the implementation of the NDP through departmental strategic and annual performance plans
- The Medium Term Budget Policy Statement (approved in 2019) provided the funding priorities for the formulation of the 2020 budget
- The 2020 SONA provided priorities for budgets over the MTEF and longer
- Strict oversight over all the elements critical for efficient and effective use of funds

Roles and responsibilities are allocated to the following institutions:

- DPME and Offices of Premiers in provinces for:

    - Guidance
    - Assessment
    - M&E

- National and Provincial Treasuries for:
    - Formats
    - Alignment of budget with priorities
    - Programme structures

- DPSA to:
    - Monitor service delivery improvement

- National and Provincial Departments of Cooperative Governance for:
    - Alignment of IDPs with national and provincial priorities
    - Monitor performance

- National Departments responsible for concurrent functions for:
    - Sector plans
    - Coordinate the collection of performance information
    - Standardised programme structures and performance indicators

- Institutions/departments with oversight responsibilities of Public Entities to:
    - Provide policy direction and support
    - Assess alignment to government priorities and mandate of the department

Introduction of the 2020 Budget

On Budget day the Minister of Finance will introduce the National Budget, the Division of Revenue Bill, the Appropriation Bill and several tax proposals. The National budget consists of the:

- Budget Review which includes a summary of the:
    - Economic environment on which the budget is based
    - Fiscal policy
    - Fiscal framework
    - Revenue trends and tax proposals
    - Consolidated spending plans
    - Division of revenue and spending by provinces and municipalities
    - Government debt and contingent liabilities
    - Financial position of public-sector institutions

- The Estimates of National Expenditure (ENE) contains:

Detailed information about the allocations set out in the Appropriation Bill, for the current financial year, proposed spending plans for the full three-year (MTEF) period.

ENE is compiled using data and information provided by national departments and their respective entities. Information on how government institutions have spent their budgets in previous years is included.

Explanations are provided of how institutions intend to use their allocations over the medium term to achieve their goals, and the outputs and outcomes their spending is expected to achieve.

Tables depict non-financial performance indicators and targets, departmental receipts, and detailed expenditure trends and estimates by programme, sub-programme and economic classification for each department and for selected entities. Brief explanatory narratives set out the institution's purpose (and that of its programmes), mandate, programme level objectives and descriptions of sub-programmes. A more in-depth narrative analyses the institution's expected expenditure over the MTEF period.

A summary table is included at the end of each chapter for votes in which there is significant spending on infrastructure.

- The Division of Revenue Bill (DORA) provides for the allocation of funds between national, provincial and local government as required by the Constitution
- The Appropriations Bill sets out the proposed amounts to be appropriated from the National Revenue Fund for the first year of the medium-term expenditure framework (MTEF) period per vote, programme and economic classification.

Subsequent to the tabling of the budget documents the relevant committees:

- Adopt or amend the fiscal framework, revenue proposals and possible expenditure items to be appropriated during the year
- Pass the Division of Revenue Bill
- Pass the Appropriation Bill
- Pass the revenue Bills
- Monitor the implementation of the priorities and budgets

Macroeconomic background to the budget

The global economy in 2020

There is widespread agreement that the level of global economic growth will remain low in 2020. The most recent estimates for global growth in 2020 from international organisation suggest small improvements in growth:

- World Bank's January 2020 Global Economic Prospects (GEP), 2.5 per cent in 2020 up from 2.4per cent in 2019
- IMF's World Economic Outlook January 2020, 3.3 per cent in 2020 up 2.9 per cent in 2019
- UNCTAD's World Economic Prospects for January 2020, 2.5 per cent in 2020 and 2.3 per cent in 2019

It is important to note that all these estimates for 2020 global economic growth were published in January 2020 and did not take into account the potentially large impact of the spread of Covid-19 Coronavirus. The virus is expected to have a large impact on the Chinese economy, which has one of the largest levels of manufacturing output in the world. As a result, global value chains have been affected. Further, the extent to which the virus will spread and how long it will take before the infections are brought under control is still unknown. This uncertainty puts downward pressure on economic activity and is expected to further decrease global levels of aggregate demand.

The World Bank's January 2020 GEP also raises concern about high levels of global debt, particularly high levels of debt in emerging and developing countries. The GEP says there has been four waves of global debt accumulation over the past 50 years. The first 3 waves are associated with financial crises in many emerging and developing countries. The GEP says that the fourth wave started in 2010. According to the GEP, "… the increase in debt in these economies has already been larger, faster, and more broad based than in any of the previous three waves."

As we start 2020 it is clear that there are many risks to economic activity and growth in an increasingly integrated global economy. These risks include:

- Global debt accumulation and growing risks of financial instability and crises
- Increasing climate change events, e.g. flooding and fires
- Global Epidemics, such as the Covid-19 coronavirus
- Poor performance of key economies – China, India, Europe etc.
- High & rising levels of unemployment, inequality & instability
- War and conflict events increasing

The South African Macroeconomic situation

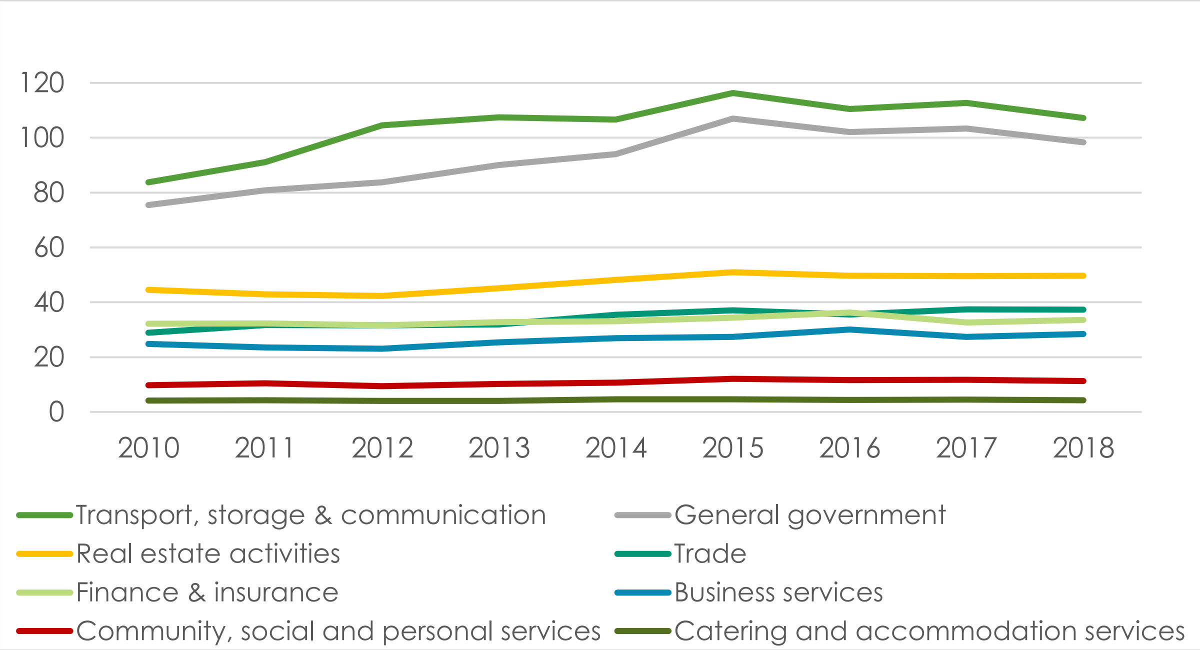
The level of aggregate demand in South Africa, as in the global economy, has been low over the past few years. However, the problems in the South African economy are deeper than periodically low levels of demand because of the business cycle or even slow, lacklustre recovery after the global financial crisis of 2008. The problems in South Africa relate to the industrial structure of the economy and the poorly developed manufacturing and related productive services sectors. The South African economy has also suffered over a long period from mass unemployment, extraordinary levels of inequality, widespread poverty and poor levels of investment. In fact, South Africa's level of inequality and unemployment are amongst the highest in the world.

These massive problems cannot be dealt with only through microeconomic interventions to increase the operations of economic sectors and raise the competitiveness of the economy. In addition to supply-side interventions and reforms, South Africa requires demand-side macroeconomic solutions. Macroeconomic policies that boost demand to support investment and employment could improve the effectiveness of structural interventions. Further, the envisaged continued poor economic performance of the economy and serious external risks require implementation of an immediate macroeconomic countercyclical stimulus rather than continued fiscal consolidation. Government debt to GDP levels will continue to climb unless there is a macroeconomic boost to GDP.

Investment

Over the past few years, overall fixed investment growth in South Africa has been negative, and contributed towards the factors putting downward pressure on GDP growth. The contribution of the tertiary sector, which is made up of the services subsectors, to total investment is much larger than other sectors. Total Investment growth from 2010 to 2015 was driven by the tertiary sector. However, services investment declined from 2015 to 2018. As a result, total investment declined from 2015 to 2018.

Figure 2: Services gross fixed capital formation (investment) in 2010 R'billion



Source: Quantec

It is important to note that the growth in services investment from 2010 to 2015 was limited to two only two subsectors: Transport, storage & Communication and General Government services. Investment in both these services subsectors has declined since 2015. As a result, total services investment declined from 2015 to 2018. Investment in general government services is an important contributor to total investment and GDP. General government services investment was more than a quarter of total services investment in 2018.

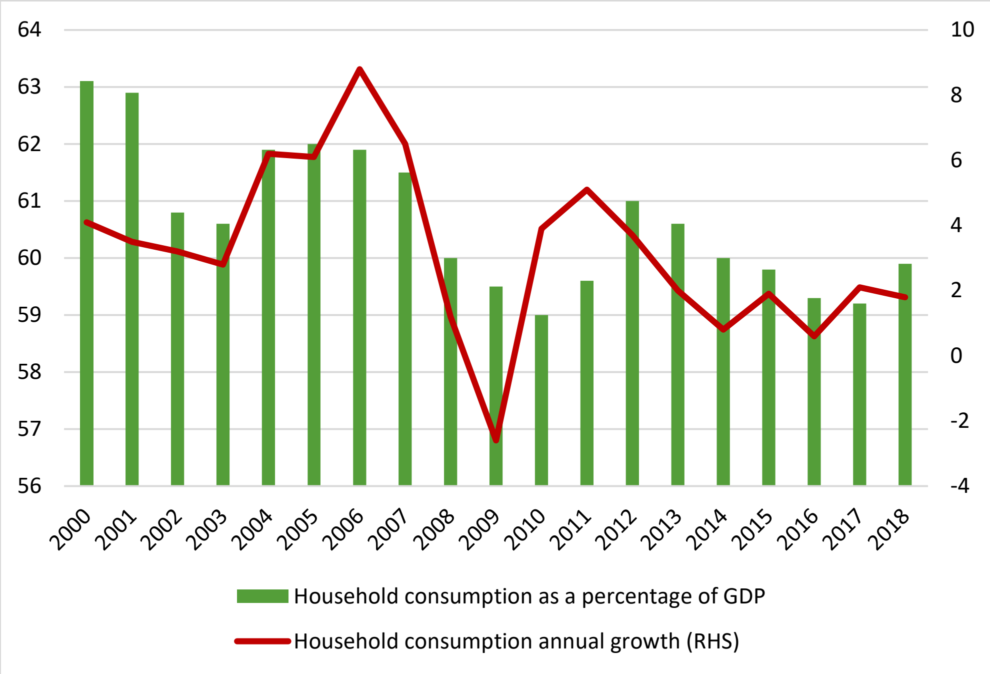
Measures to increase general government investment in services should support economic growth directly by boosting the amount of investment in the economy. This growth in general government services investment will also have indirect effects that boost GDP growth. More investment in general government services is generally helpful and supportive to the economic activities of households and firms and so boost demand. In this manner they can help to 'crowd in' higher levels of private sector investment

Household consumption and debt

Household consumption is an important contributor to the overall level of domestic demand for goods and services in the economy. While real levels of household consumption have increased, its contribution to GDP has remained around 60 per cent over the past decade.

Observing changes in household consumption and household debt over time gives a sense of the financial health of households and their expected contribution to aggregate demand and GDP growth.

Figure 3: Trend in Household consumption in constant 2010 prices

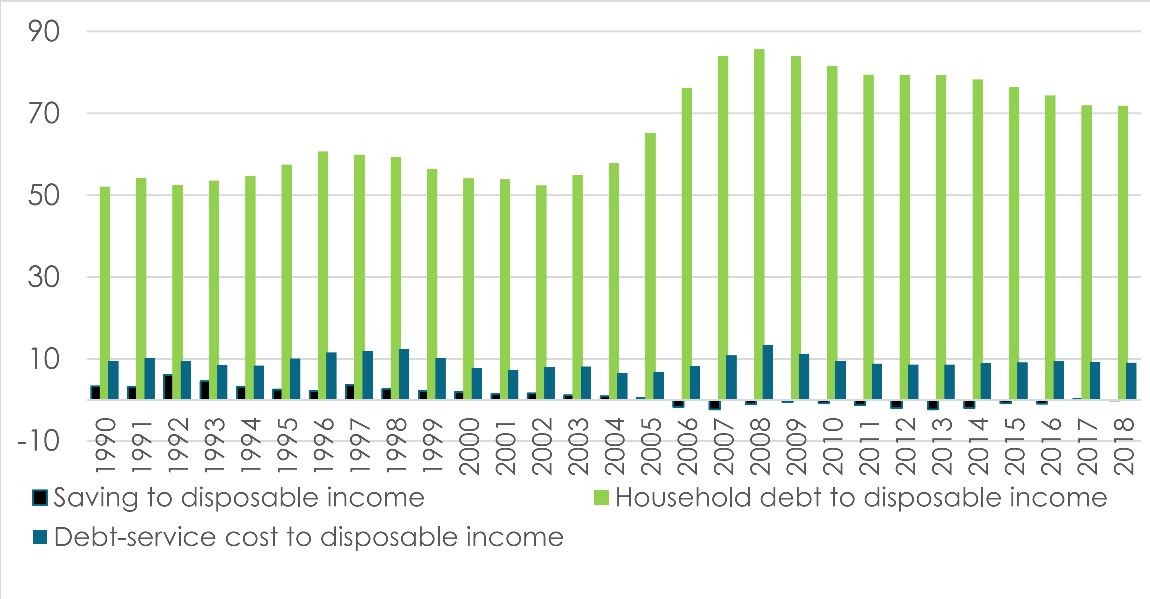


Source: South African Reserve Bank

Households that took on high levels of debt before the 2008 global financial crisis would take a long time paying off that debt. They would have to curb their consumption to pay off their debt for that period. In particular, while household debt to disposable income has come down since 2014, debt-service costs have remained the same between 2014 and 2018. In other words, on average South African households have reduced their amount of debt relative to their disposable incomes but they are unable to spend more due to the average annual debt service cost as a share of disposable income has not declined for households. Another implication of the relatively high level of debt service costs, as shown in figure 3, is that the average household has been unable to save.

Given the high levels of poverty and unemployment in South Africa, government efforts to improve grants, food security and service delivery to poorer households could raise aggregate demand and bolster economic growth.

Figure 4: Household debt, debt service and savings as percentages of household disposable income

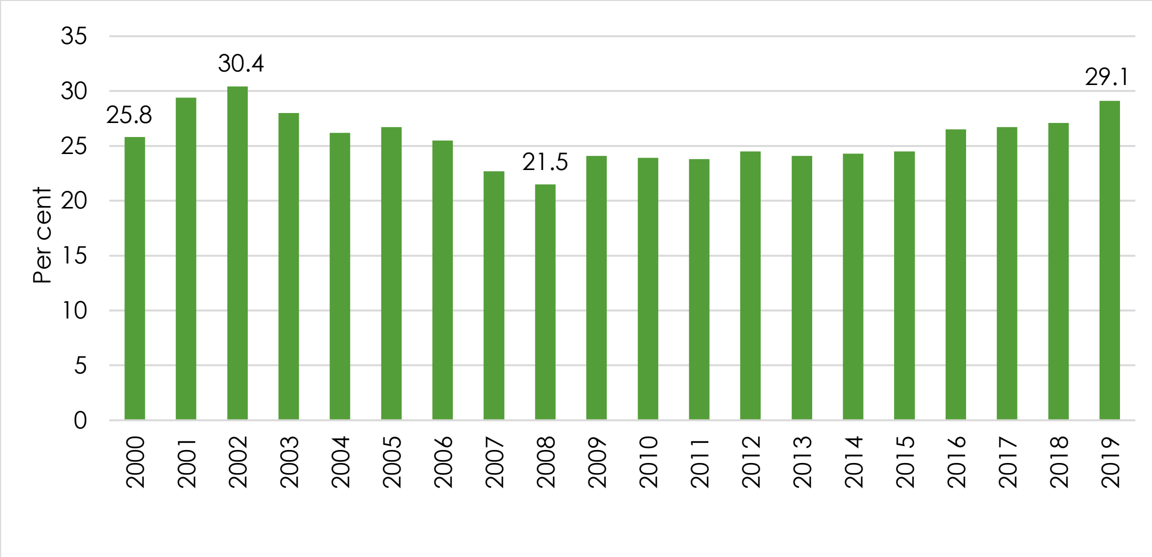


Source: South African Reserve Bank

Unemployment

South Africa suffers from structural unemployment that requires sectoral/microeconomic policy actions by government. These actions should work to allay destruction of existing jobs and to promote sectoral growth in employment over the longer term. However, the structural unemployment in South Africa is mass unemployment that cannot be solved by sectoral interventions alone, but has to be addressed through macroeconomic policies. These macroeconomic policies should aim to increase aggregate demand in the economy through fiscal policies, such as direct and indirect transfers and also efforts to redistribute income and wealth towards those affected by mass, structural unemployment. Sectoral interventions require time to work and it is likely that unemployment could increase during the initial phases of implementing these actions. Macroeconomic interventions are urgent and have to take into account the current negative effects of current mass unemployment on households and the social fabric of communities. The fiscal multipliers associated with government spending and investment to alleviate the effects of unemployment should be relatively high. In fact, the potential positive impact of aggregate demand boosting macroeconomic stimuli should improve the success of sectoral interventions. Figure 4 shows the trend in South Africa's official unemployment rate between 2000 and 2019.

Figure 5: Trend in South Africa's Official Unemployment Rate between 2000 and 2019



Source: Stats SA

The second quarter Quarterly Labour Force Survey (QLFS), shows that the country's official unemployment rate reached 29 per cent. In the third quarter of 2019 it had increased by 0.1 per cent to 29.1 per cent, and remained at this level to the end of 2019. Using the broad definition of unemployment that includes discouraged work seekers, the unemployment rate has increased to 38.4 per cent, down by 1 per cent as compared to the third quarter. The number of discouraged work-seekers increased by 62 000, while the number of people who were not economically active for reasons other than discouragement increased by 45 000 between the third and the fourth quarters of 2019, resulting in a net increase of 107 000 in the not economically active population.

By the end of 2019 more job losses were reported by StatsSA on third quarter labour force trends in their Quarterly Employment Statistics. They reported that 28 000 jobs had been shed between July and September 2019. In particular, 11 000 full-time jobs and 17 000 part-time jobs had been lost during the quarter. The quarterly decline in total employment was driven by major losses in construction (-12 000); manufacturing (-12 000); community services (-11 000); business services (-9 000); and transport (-1 000). Employment levels in the mining and electricity industries remained the same by the end of September. The only industry to record a quarterly increase was trade, up by an additional 17 000 jobs. By the end of the first quarter of 2019 jobs had increased by 22 000 in the formal, non-agricultural sector and in the second quarter it reflected a net quarterly decrease of 2 000 jobs. This puts the total number of jobs lost between the first quarter and third quarter of 2019 at 8 000.

Mid-2019, 20 companies had already reported plans to retrench workers as a result of plans to restructure, sell off and/or close down business units. Announcements of retrenchments had been made by industry stalwarts, such as Tongaat-Hulett (5 000 jobs), Sibanye-Stillwater (3 450 jobs), Multi-choice (2 000 jobs), IBM Global (2 000 jobs), and Standard Bank (1200 jobs), to name a few. Many other big businesses (such as Group five and PPC cement) had not disclosed the estimated number of jobs to be lost through their intended restructuring.

2020 has kicked off with news that Edgars with close its flagship store in Rosebank. This comes after its parent company Edcon signalled its intentions to scrap approximately 150 stores last year. The closures will more than likely result in retrenchments. A similar story is taking place at Massmart, which has indicated that it will close 34 Dion Wired and Masscash stores. Up to 1400 people could be affected via retrenchments. Telkom plans to retrench more than 3000 workers. It announced it was planning to restructure its business, claiming that market conditions, regulatory uncertainty and the competitive environment had made it difficult for the company to thrive. Telkom had already shed more than 2,000 permanent jobs or 12.5 percent of its workforce, the group said in a financial statement for the year ended March 2019. Sibanye Gold also cut jobs at its Marikana mines as part of restructuring plans and Glencore issued a statement that there could be a possible reduction in its employees at its Rustenburg ferrochrome smelter. Cash-strapped South African Airways (SAA) ended the year with reports that it would begin a restructuring process that could see over 900 jobs at risk.

If realised, these job losses will add to an official unemployment rate that would indicate a third of the active South African labour force is unemployed. This could further dampen aggregate demand and consumption spending. South Africa's unemployment rate has remained high, largely due to insufficient economic growth.

Inequality

South Africa is consistently ranked as one of the most unequal countries in the world. The National Development Plan (NDP) prioritises the reduction of inequality as a key objective. One of the NDP targets is to reduce income inequality (measured by the Gini coefficient) from 0.70 to 0.60 by 2030.

Table 1: Inequality measures based on per capita expenditure

Year	Gini Coefficient	Palma ratio			
		Bottom 40%	Middle 50%	Top 10%	Ratio
2006	0.67	6.6%	36.2%	57.2%	8.6
2009	0.65	6.5%	40.2%	53.3%	8.1
2011	0.65	6.8%	39.9%	53.3%	7.9
2015	0.65	6.6%	40.8%	52.6%	7.9

Source: StatsSA "Inequality in South Africa"

The Gini coefficient ranges from 0 to 1, where 0 indicates perfect equality (all individuals have the same income) and 1 indicates perfect inequality (where one person has all the income and the rest have none). The Palma ratio is defined as the ratio of national income/expenditure shares of the top 10 per cent of the population relative to the bottom 40 per cent.

The national Gini coefficient dropped from 0.67 in 2006 to 0.65 in 2009, while it remained the same between 2009 and 2015. The Palma ratio which is based on per capita expenditure decreased from 8.6 in 2006 to 7.9 in 2015, suggesting a small decline in inequality. The Palma ratio also increased in the share of expenditure going to the middle 50 cent per of the population, resulting in a small decline in the share of expenditure for the top 10 per cent, while the share of the bottom 40 per cent remained relatively the same.

According to the "Inequality in South Africa" report released by Stats SA the bottom 60 per cent of households depend more on social grants than income from the labour market. Since 2006, individuals from the bottom deciles received more income from social grants than they do from participating in the labour market. Individuals in the top deciles appeared to participate more in the labour-market and received income from labour market activities. The report further states that labour market income was the largest contributor to income inequality relative to other income sources. Social grants and remittances have played a crucial role in reducing the income inequality gap between the bottom and top deciles over the years in South Africa.

Salaries (64.8 per cent) and grants (45.2 per cent) were the most common sources of income reported by households in 2018 [General Household Survey (GHS) Report]. The percentage of individuals that received social grants increased from 12.8 per cent in 2003 to 31 per cent in 2018. Also, according to the GHS, the percentage of households that received at least one social grant increased from 30.8 per cent in 2003 to 44.3 per cent in 2018.

In the 2019 Budget Review, the number of social grant beneficiaries is expected to grow by about 2 per cent every year. This means that over the medium term the number of social grant beneficiaries is expected to increase from 17.9 million to 18. 6 million by 2021/22.

Government's social protection system is intended to reduce poverty and inequality through the issuance of social grants and the provision of social welfare services to vulnerable groups. Social grants continue to be adjusted in line with inflation projections in order to maintain their real value, however the size of the grants have generally been inadequate given the level of poverty and unemployment in the economy. Further, these grants do not cover a large share of the poor and unemployed.

Revised growth outlook

South Africa's growth outlook has been consistently downwardly-revised over the last twelve months by all major forecasters. Following two quarterly contractions in 2019 (first and third quarters respectively), the economy is expected to record its weakest annual growth in a decade in 2019. On a year-to-date basis, the economy grew by a mere 0.4 per cent over the first three quarters of 2019. The economy is expected to grow slower than projected at the 2019 Budget Review and the 2019 MTBPS. We expect government to also downwardly-revise its real GDP growth outlook for the medium term.

Table 2: Growth Domestic Product outlook

GDP growth outlook - calender year*	2019	2020	2021	2022
National Treasury - Budget 2019	1.5%	1.7%	2.1%	-
National Treasury - MTBPS 2019	0.5%	1.2%	1.6%	1.7%
South African Reserve Bank - January 2019	1.7%	2.0%	2.2%	-
South African Reserve Bank - September 2019	0.6%	1.5%	1.8%	-
South African Reserve Bank - January 2020	0.4%	1.2%	1.6%	1.9%
Bureau for Economic Research - 1Q2019	1.5%	2.0%	2.4%	-
Bureau for Economic Research - 3Q2019	0.2%	1.1%	-	-
Bureau for Economic Research - 1Q2020	-	0.7%	1.6%	1.6%
IMF - World Economic Outlook - January 2019	1.4%	1.7%	-	-
IMF - World Economic Outlook - October 2019	0.7%	1.1%	1.4%	1.8%
IMF - World Economic Outlook - January 2020	0.4%	0.8%	1.0%	
Reuters Polls (median) - January 2019	1.5%	1.9%	2.0%	-
Reuters Polls (median) - August 2019	0.6%	1.3%	1.7%	-
Reuters Polls (median) - January 2020	0.3%	0.9%	1.4%	1.4%

*Growth projections correspond to publication date and not forecast date

Figure 6: Downward-revision to real GDP growth outlook over the medium-term

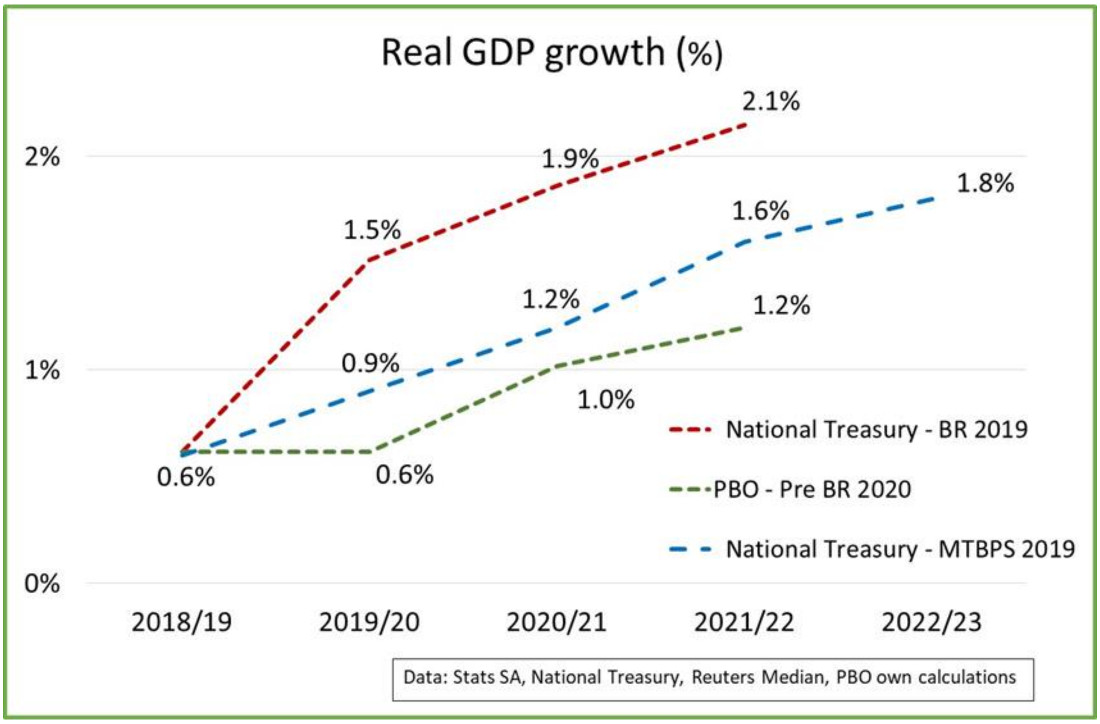
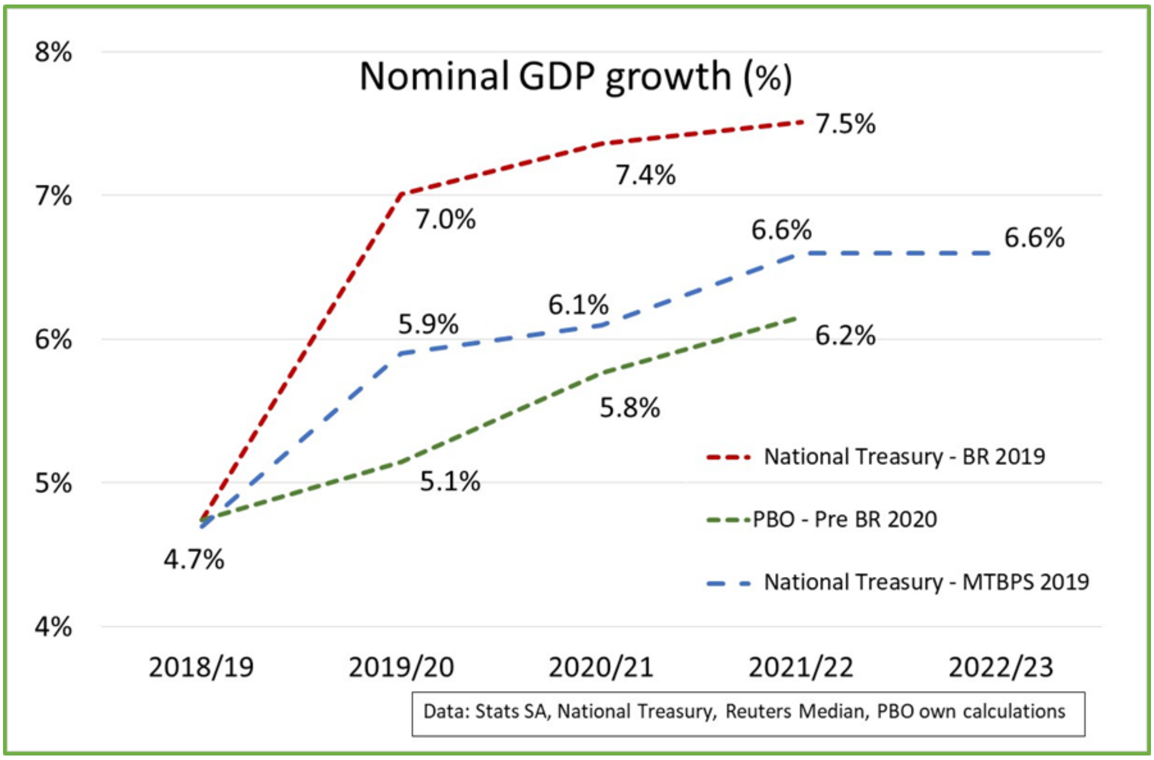


Figure 7: Downward-revision to nominal GDP growth outlook over the medium-term



Revisions to the fiscal framework

In the October 2019 MTBPS government presented a large increase in the projected budget deficit for the current fiscal year and over the medium term compared with the 2019 Budget Review. The increase in the projected budget deficits was due to a large downward-revision to real GDP growth, GDP inflation, revenue, and increases in expenditure.

The PBO's revised fiscal framework for 2019/20 and over the medium term reflects its most recent nominal GDP and revenue projections, and government's revised expenditure estimate from the 2019 MTBPS. The PBO expects no change in the budget deficit as a share of GDP over the current fiscal year (2019/20) and a slight improvement by 2021/22 compared with the projections from the 2019 MTPS. It should be emphasised that these projections are base-line projections and do not reflect any future revenue and/or expenditure measures that may be taken by government.

Table 3: Current Fiscal Framework

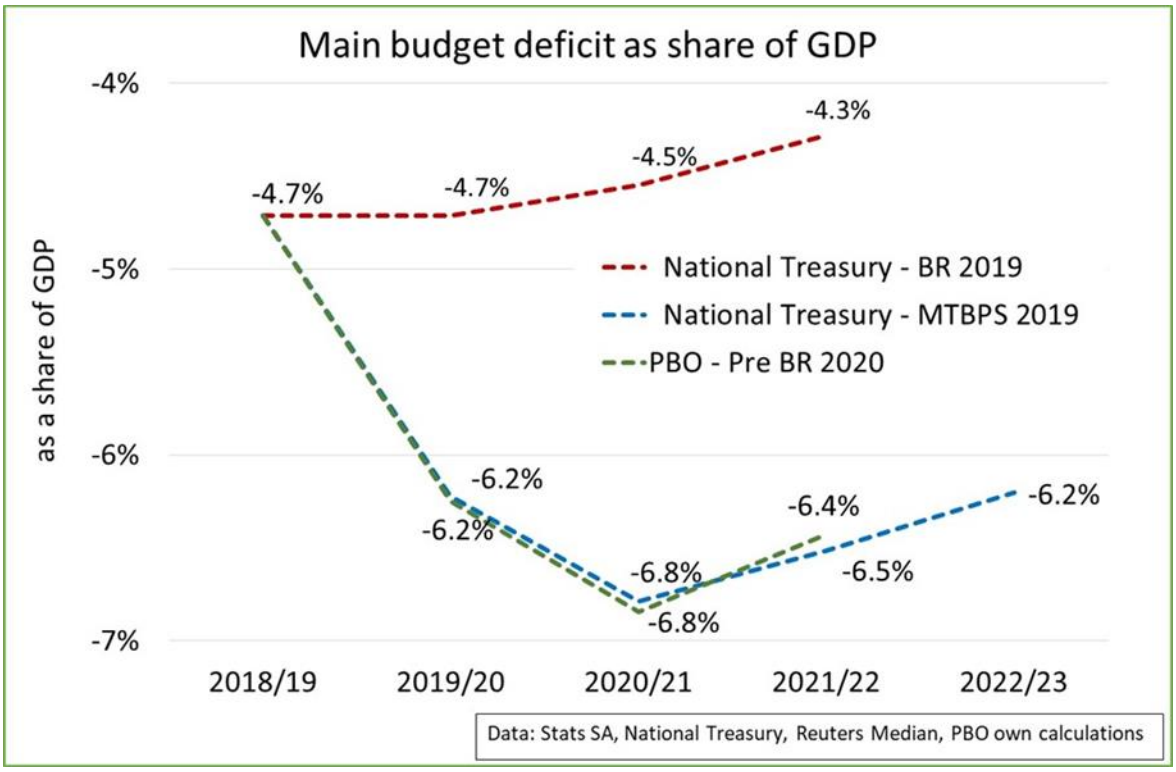
R billion/percentage of GDP	2016/17	2017/18	2018/19	2019/20	2019/20 year-to-date	2020/21	2021/22	2022/23
		Outcome		Revised			Medium-term estimates	
Main budget revenue	**1 137.9**	**1 196.4**	**1 274.7**	**1 359.1**	**967.0**	**1 425.9**	**1 525.6**	**1 627.9**
	25.7%	*25.5%*	*25.9%*	*26.1%*		*25.8%*	*25.9%*	*25.9%*
Main budget expenditure	**1 305.5**	**1 405.0**	**1 506.7**	**1 683.4**	**1 216.8**	**1 801.2**	**1 909.5**	**2 017.7**
	29.5%	*29.9%*	*30.6%*	*32.3%*		*32.6%*	*32.4%*	*32.1%*
Non-interest expenditure	1 159.0	1 242.3	1 324.9	1 479.6	1 089.3	1 568.5	1 644.9	1 718.6
	26.2%	*26.4%*	*26.9%*	*28.4%*		*28.4%*	*27.9%*	*27.4%*
Debt-service costs	146.5	162.6	181.8	203.7	*127.5*	232.8	264.6	299.1
	3.3%	*3.5%*	*3.7%*	*3.9%*		*4.2%*	*4.5%*	*4.8%*
Main budget balance	**-167.6**	**-208.6**	**-232.0**	**-324.3**	**-249.7**	**-375.3**	**-383.9**	**-389.8**
	-3.8%	*-4.4%*	*-4.7%*	*-6.2%*		*-6.8%*	*-6.5%*	*-6.2%*
Primary balance	**-21.1**	**-46.0**	**-50.1**	**-120.5**	**-122.2**	**-142.5**	**-119.3**	**-90.7**
	-0.5%	*-1.0%*	*-1.0%*	*-2.3%*		*-2.6%*	*-2.0%*	*-1.4%*

Table 4: Changes to 2019/2019 Fiscal Framework

R million	**NT Budget Review 2019**		**NT MTBPS 2019**	**PBO Pre-BR (February 2020)[1]**	**Surplus (shortfall) compared to NT MTBPS projections**		
Personal income tax	552 877	↓	527 606	533 577	5 971	↑	1.13%
Corporate income tax	229 608	↓	218 984	219 043	59	↑	0.03%
Value-added tax	360 471	↓	348 388	339 841	-8 547	↓	-2.45%
Other tax revenue	170 182	↓	165 488	167 865	2 378	↑	1.44%
Customs and excise duties	109 069	↑	109 213	110 215	1 002	↑	0.92%
Gross tax revenue	**1 422 208**	↓	**1 369 678**	**1 370 541**	**863**	↑	**0.06%**
Main budget revenue	**1 403 464**	↓	**1 359 085**	**1 359 948**	**863**	↑	**0.06%**
Main budget expenditure	**1 658 707**	↑	**1 683 352**	**1 683 352**	-		-
Main budget balance	**-255 243**	↓	**-324 267**	**-323 404**	863	↑	**-0.27%**
Main budget balance (% of GDP)	**-4.7%**	↓	**-6.2%**	**-6.2%**	0.0%		-

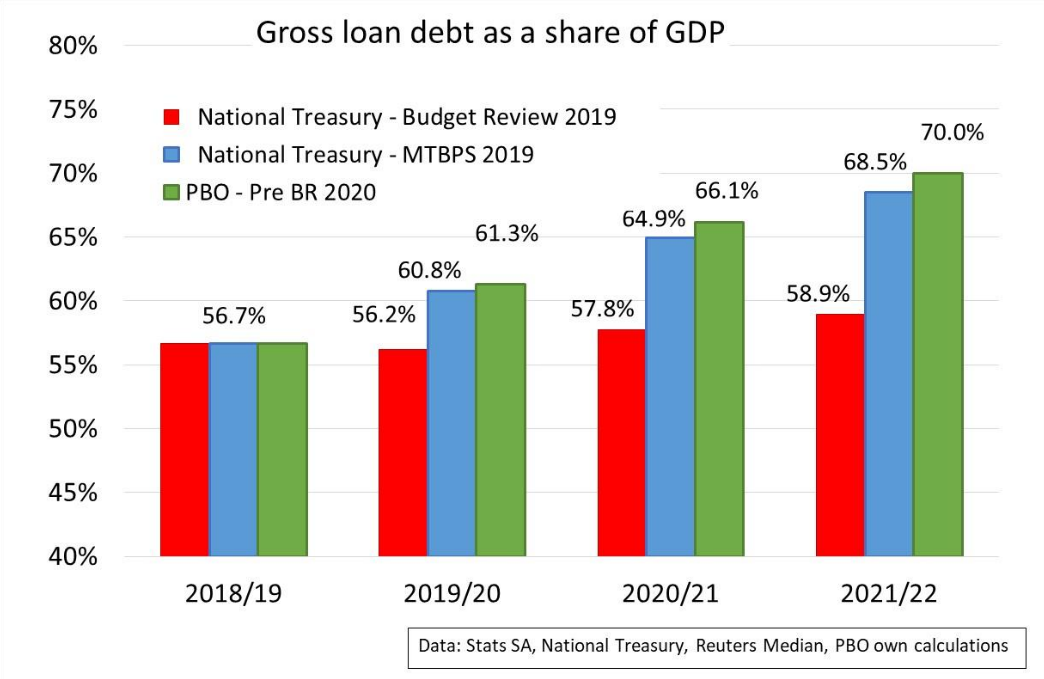
1. Projections are from PBO's in-year revenue and expenditure model. PBO uses historical monthly profiles of revenue data available in Section 32 reports to project full-year main budget outcomes. PBO's model is based on methodologies employed by other independent fiscal institutions.

Figure 8: Downward-revision to main budget balance over the medium-term



Downward revisions to nominal GDP and persistent budget deficits will result in the debt increasing as a share of GDP over the medium term. The increasing trajectory of government debt over the medium term will increase the share of main budget expenditure consumed by debt service costs, from its current level of 11.6 per cent to about 15 per cent in 2022/23.

Figure 9: Government debt to increase over the medium-term



Persistent slow economic growth and the accompanying increase in government debt to fund persistent budget deficits, as well as the increase in contingent liabilities arising from state-owned companies have contributed to concerns surrounding the sustainability and creditworthiness of South Africa's government debt.

The major credit ratings agencies have since 2012 successively downwardly-revised the outlook and ratings on South Africa's local- and foreign – currency debt. At present only Moody's rates the country's local currency debt at investment grade. Moody's is scheduled to release its review of South Africa's sovereign debt after the 2020 Budget Review. This presents a risk to the outlook for South African debt (cost and ability to borrow). As institutional investors are mandated to only hold debt that is investment grade, a downgrade by Moody's would require such institutional investors to sell-off SA debt currently held, and would preclude institutional investors from purchasing newly issued SA debt in the future (to fund future fiscal deficits as well as refinancing existing debt stock), irrespective of the attractiveness of the yields SA debt.

Whilst a credit rating downgrade by Moody's will trigger an automatic sell-off of South Africa debt by institutional investors only mandated to hold investment grade debt, the immediate negative effects on the exchange rate and bond yields is likely to be partially mitigated by fund managers tracking the World Government Bond Index having already sold off large share of their SA government bonds ahead of the likely downgrade by Moody's.

In a context of sustained excess global liquidity and low yields in many advanced economies, South African government debt still presents an attractive investment option. South Africa is likely to continue to be able to issue new debt and roll-over existing debt in the context of a downgrade by Moody's, albeit at elevated borrowing costs.

Revenue collection and policy trends

The 2019 revised estimated gross tax revenue collection for 2019/20 of R1.37 trillion is R52.5 billion less than the 2019 Budget estimates. By the end of Q3 of 2019/20, R979 billion (71.5 per cent) had been collected. This outcome is a 1.22 per cent increase in collections when compared to the similar period in 2018/19, when it was 70.29 per cent. At the end of quarter 3, Personal Income Tax (PIT), Corporate Income Tax (CIT) and the general fuel levy experienced higher collection rates than other tax instruments (2.16 per cent, 3.73 per cent and 2.92 per cent respectively). However, Value Added Tax (VAT), Custom Duties and Dividends Withholding collection rates as at the end of Q3 of 2019/20 declined by 2.97, 13.34 and 8.8 per cents respectively compared to the same period in 2018/19.

Table 6: Status of tax revenue collection as at 31 December 2019

R million	2018/19	2019/20		
	Collection as %	Revised Estimate	Collection: Apr-Dec 19	Collection as %
PIT	68.82%	527,606	374,499	71.0%
VAT	73.78%	348,388	246,700	70.8%
CIT	70.18%	218,984	61,843	73.9%
Fuel Levy	72.41%	78,354	59,022	75.3%
Dividend withholding	76.18%	32,012	21,587	67.4%
Custom Duties	72.84%	58,365	34,732	59.5%
Specific Excise Duties	69.02%	46,511	31,771	68.3%
Skill Development Levy	74.14%	18,574	13,459	72.5%
Ad-valorem	73.51%	4,337	3,243	74.8%
Other	59.76%	36,547	32,594	89.2%
Gross Tax Revenue	**70.29%**	**1,369,678**	**979,450**	**71.5%**

Source: NT, SARS and PBO

Tax developments since 2019

Refinement of the Special Economic Zone (SEZ) definition

The special economic zone act is intended to boost economic growth through investment in designated geographical areas including through a tax regime including a reduced tax rate and other tax incentives. The tax act was not explicit in stating the qualifying criteria for businesses to make use of the SEZ tax regime. The amendment aligns the tax act with the SEZ Act. The change is retrospectively applied from 1 March 2019.

The Employment Tax Incentive (ETI)

Alignment of ETI Act with the Special Economic Zone provisions

The ETI tax incentive is only available to employers for qualifying employees between the ages of 18 and 29 years. Employers can claim the ETI incentive regardless of the age of the employee for employees employed by a business operating in a designated SEZ area. The SEZ Act has specific requirements for a business to qualify for the SEZ regime, which the ETI Act does not currently contain. The amendment aligns the ETI Act with the SEZ Act. The change will have applied retrospectively from 1 January 2019.

Alignment of ETI Act with the National Minimum Wage Act

The aim of ETI is to reduce the cost of hiring qualifying employees through sharing of employment costs between qualifying employers and the government. The mechanism used for the government's contribution is a reduction of PAYE payable by qualifying employers. The amount by which the employer's PAYE liability is reduced is determined by a formula dependent on the salary paid to the qualifying employee. The employer can only qualify for the ETI incentive if the salary paid to the employee complies with the wage regulating measures applicable to that employer or at least R2 000 per month. The implementation of the National Minimum Wage Act in 2018, which stipulated a national minimum wage of R20 per hour or R3 500 per month, resulted in misalignment between the two Acts. The 2019 amendment aligns the ETI Act with the National Minimum Wage Act. The higher amount between the wage regulating measures applicable to that employer and the national minimum wage will be used as qualifying criteria. The minimum R2 000 stipulation will however remain in the ETI Act for employers that are exempt from the national minimum wage act. The change was retrospectively applied from 1 August 2019.

Deduction for investments in Venture Capital Companies

When the VCC tax incentive was introduced in 2008, it contained strict rules, including a limitation of the deduction to R750 000 per tax year and a maximum of R2 250 000 during the lifetime of an investor. Because of these limitations, the uptake of the incentive did not gain traction until 2015 when gradual amendments were made to the regime. The changes included the removal of the cap, resulting in a 100 per cent allowable deduction from the income of a taxpayer on expenditure actually incurred in acquiring any venture capital shares. Due to the apparent abuse of the incentive, the amendment reintroduces limits in annual deductions on VCC investments at R2.5million for natural persons and R5million for corporates. The change is retrospectively applied from 21 July 2019.

Expat Tax -Comes into effect on 01 March 2020

Government introduced taxation law amendment on -section 10(1)(0)(ii)) [Limitation of Foreign Employment Income Exemption] in the 2017 Budget. According to government, the amendment is meant to ensure that the principles of taxing residents on their worldwide income and equity and progressivity are maintained in the tax system.

Over the years it became apparent that there are South Africa tax residents earning income from foreign employer where such incomes are either untaxed or lower taxes were imposed. As a result, income for those tax residents from low or non-taxed jurisdiction were left out of tax calculation in the South African tax liabilities, or led to double non-taxation. Double non-taxation is an unintended policy outcome, and has undermined the principle of equity and progressive tax system.

The 2017 amendments, coming into effect from the 01 March 2020, are intended to ensure that the principles of residence tax and equity and progressivity are maintained, and that double non-taxation is limited. This will be achieved by requiring South African tax residents' income (including non-monetary benefits like housing allowances, car allowances and other benefits) earned from foreign employer be included in the tax liability (in South Africa) calculation subject to R1million foreign income exemption. Tax residents earning foreign income would still be protected by double taxation treaties to avoid double taxation. The amendments are expected to raise additional personal income tax revenue from the 2020/21 tax year, however there could be compliance costs leading to lower tax generated.

Expenditure trends

Table 3 shows the effect of the 2019 adjustments on the spending trends as at the end 31 December 2019. The spending trend in Communication and Public Enterprises shows that the additional funds provided for transfers to public entities had not been transferred by the end of December 2019. In other departments where budgets were adjusted downwards during the adjustments budget process, spending is still below the notional benchmark of 75 per cent for the first nine months of the financial year.

Table 7: National expenditure as at end 31 December 2019

R thousand		Adjustments	% spent on main budget	% spent on adjusted budget
3	Communications	3 197 000	72.3%	**23.9%**
4	Cooperative Governance and Traditional Affairs	(371 233)	66.3%	**66.6%**
5	Home Affairs	1 188 000	81.9%	**71.7%**
9	Public Enterprises	12 938 000	60.7%	**46.9%**
11	Public Works	98 057	73.2%	**72.3%**
16	Health	(265 527)	72.9%	**73.3%**
19	Defence and Military Veterans	375 140	72.9%	**72.4%**
23	Police	(768 047)	71.8%	**72.4%**
24	Agriculture, Forestry and Fisheries	(52 800)	75.2%	**75.8%**
25	Economic Development	(55 750)	73.7%	**77.9%**
26	Energy	(256 464)	77.8%	**80.6%**
27	Environmental Affairs	(46 000)	63.3%	**63.7%**
28	Labour	(1 934)	68.9%	**69.0%**
30	Science and Technology	(4 793)	78.8%	**78.9%**
31	Small Business Development	(300 000)	72.5%	**82.0%**
34	Trade and Industry	25 700	61.4%	**61.3%**
35	Transport	10 954	75.0%	**75.0%**
36	Water and Sanitation	26 927	59.2%	**59.1%**
37	Arts and Culture	(45 400)	68.8%	**69.5%**
38	Human Settlements	(17 252)	62.1%	**62.1%**
39	Rural Development and Land Reform	(117 294)	67.8%	**68.6%**
Total appropriation by vote		14 868 725	72.9%	**71.7%**

Source: National Treasury

Conclusion

Planning for the 2020 medium term expenditure framework (MTEF) marks the beginning of a new 5-year planning and budgeting cycle. This is a critical factor in the planning cycle for the alignment of resources with policy intent. Different institutions including the Parliament of the Republic of South Africa have roles to play in the integrated planning and budgeting processes in government.

In addition to oversight over the mechanisms available for integrated planning and budgeting, South Africa faces serious economic challenges, which require policy and funding decisions supportive of economic growth, job creation and reducing poverty and inequality.