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Budget 2020: *A Balancing Act*

The Budget is an important policy, planning and monitoring instrument that can be used by Parliament to oversee the alignment of the proposed expenditure with Government policy priorities and more broadly alignment to the National Development Plan (NDP) goals. The Budget can also be used as an oversight tool for monitoring the implementation and achievement of priority service delivery outputs towards the realisation of the NDP goals.

This brief provides a snapshot of the Government's spending priorities for 2020, as well as risk factors to both revenue and expenditure projections for the year ahead.

1. The Economic Outlook

- **Global economic outlook and the positioning of South Africa's economic growth**.
    - The global economic growth outlook is expected to improve marginally from its recent slowdown.
    - It is projected to increase from an estimated 2.9 per cent in 2019 to 3.3 per cent in 2020 and 3.4 per cent in 2021[1].
    - With the exception of China, the growth rates of emerging economies are expected to return closer to historical norms, whilst the growth forecast of advanced economies has been revised downwards. Notably, the aggregate growth projections for South Africa's four main trading partners, namely China, the United States, the United Kingdom and Japan, have been marked down for the next 3 years[2].
    - Despite the projected recovery of the global economy, significant downside risks remain:
        - The rising geopolitical tensions between the United States and Iran could have negative implications for the global economic activity and in turn adversely impact the demand for South Africa's raw materials. Furthermore, uncertainty regarding these tensions could result in significant volatility in financial markets and the Rand.
        - The Coronavirus will serve to dampen China's economic growth, which will have implications for the manufacturing sector, particularly in respect of metals. Slower metals production will mean lower demand for minerals or mineral inputs from South Africa.

[1] IMF(2020)
[2] Ibid

- **Economic growth remains sluggish and gross domestic production (GDP) per capita is likely to decline further, exacerbating existing levels of poverty and inequality.**

    - South Africa's economic growth outlook remains subdued. Real GDP is projected to be 0.9 per cent in 2020, 1.3 per cent in 2021 and 1.6 per cent in 2022[3]. Weak growth forecasts can be attributed to the poor financial health of state-owned companies (SOCs), unreliable power supply and the slow implementation of structural reforms.
    - In the first three quarters of 2019, six of the ten production sectors contracted sharply. The agricultural, forestry and fishing sector experienced the largest decline in production of 9.1 per cent, followed by the construction and mining sectors, which contracted by 2.6 and 2.2 per cent respectively[4].
    - Owing to the population growing at 1.4 per cent over the next three years, per capita gross domestic product (GDP per capita) is expected to decline[5].
    - The current account deficit is expected to remain at an average of 3.5 per cent of GDP over the next three years. Over the medium term, imports and exports are projected to grow gradually, in line with investment and consumption trends.
    - In order to raise GDP growth, efforts to reform the electricity sector and to attract private investment, alongside reforms in other network industries are required.

- **This is likely to stifle job creation, increase unemployment, depress tax revenues and increase demands on the fiscus**.

    - Compared to the fourth quarter of 2018, the official unemployment rate has risen from 27.1 per cent to 29.1 per cent in the fourth quarter of 2019[6]. Notably, youth unemployment (individuals aged 15-24) has risen from 54.7 per cent in the fourth quarter of 2018 to 58.1 per cent in the fourth quarter of 2019.
    - With the high unemployment levels and pervasive poverty, this puts more pressure on the state to provide social grants.

- **The inflation outlook**

    - Inflation expectations remain well-anchored. Consumer price index (CPI) inflation is expected to increase from 4.1 per cent in 2019 to 4.5 per cent in 2020[7].The repurchase (repo)[8] rate stands at 6.25 per cent, after a 25 basis point cut in January.

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[3] National Treasury (2020)

[4] Ibid

[5] ibid

[6] Statistics SA (2020)

[7] National Treasury (2020)

[8] The repo rate determines the interest rate to which the central bank lends money to commercial banks — which then affects the amount they lend to their consumers.

- The rising meat and electricity prices will push up inflation.

- **Business and consumer confidence not improving**
  - Business and consumer confidence is very subdued. Key factors that have contributed to the low confidence relate to: weak economic growth, high levels of unemployment and the electricity supply crisis.
  - Gross fixed capital is projected to recover slightly over the next three years. It is expected to rise to 0.2 per cent in 2020, to 1.3 per cent in 2021 and 1.8 per cent by 2022, which reflects a gradual recovery in confidence[9].

- **Credit downgrades still remain a factor to observe and implications for the state on sovereign debt ratings, higher debt premiums and Rand depreciation.**
  - In the context of subdued economic growth, unsustainable debt levels and continuous cash injections to support debt-laden SOEs, the risk of a sovereign credit downgrade is heightened.
  - The risk of South Africa remaining within the investment grade has become more pronounced with this budget, with debt not expected to stabilise within the medium term.
  - A credit rating downgrade by Moody's will increase the already high costs of borrowing and servicing public debt, as well as lower investment confidence**.** South Africa has a developed liquid financial market and is unlikely to be unable to fulfil its servicing costs in the medium term. Volatility in the market would occur in the form of exchange rates if a downgrade occurs. Moody's carries an investment grade rating for SA.

2. The Fiscal Outlook

- **Revenue shortfall has been the lowest since the global financial crises in 2009/10 which is attributed to weak economic growth.**
  - Under collection for 2019/20 is R63.3 billion, which is R10.8 billion higher than what was expected in the 2019 Medium Term Budget Policy Statement.
  - The economy has been sluggish with low employment and wage growth. Unemployment stands at 29.1 per cent. The projected growth in the current budget stands at 0.3 per cent, revised downwards since the 2019 MTBPS.
  - Given the weaker economic growth, this has had an effect on the performance of personal income tax (PIT) and corporate income tax (CIT) which make up more than 80 per cent of the total tax revenue.
  - Tax buoyancy remains low below 0.93 which is the ratio of tax revenue growth to economic growth. This is mainly attributed to the decline in real wage growth due to lower personal income tax receipts.

[9] National Treasury (2020)

- **Over the last few years, National Treasury implemented large tax increases. In the current economic climate making additional increases to several tax instruments, in a low growth economy will be ineffective. New tax increases could have the ability to harm the recovery of the economy.**

- **Hence, the 2020/21 budget does not introduce any new tax instruments to raise additional revenue.**

    - The fiscus needs higher economic growth to be able to absorb tax increases in future.
    - As result, the 2020 budget proposes several tax policy measures for additional revenue.
    - Tax proposals for 2020/21 include; providing above inflation increase in all tax brackets. The adjustment will provide relief of roughly R2 billion for all tax brackets for PIT.
    - Some policy adjustments have been made in respect to CIT to broaden the tax base by limiting tax incentives and introducing the new interest deduction for corporates. Tax incentives create favourable tax treatment to businesses, which reduce the tax base and open up opportunities for tax avoidance.
    - In order to strengthen the governance system and leakages in the tax system, the Minister announced the re-establishment of the Davis Tax Committee (DTC) to address tax leakages. The DTC will undertake a review of tax incentives and removal of inefficient subsidies. Furthermore, following the Nugent Report, the government proposes strengthening the Office of the Tax Ombudsman by separating it financially and operationally from SARS. In addition, there is proposal to setup an Inspector- General to oversee SARS.
    - Other additions in tax proposals include an increase in fuel levy by 25c/litre, excise duties on alcohol and tobacco by 4.4 and 7.5 per cent.

3. Expenditure priorities

- **The expenditure ceiling** - **NT announced spending cuts of 20 per cent over the medium term starting with 6 per cent in 2020/21, and 7 per cent each in the two outer years. The 2020 Budget may have to adjust the expenditure ceiling to account for more bailouts. How will this likely affect spending on NDP priorities? What commitment has been made to eliminate inefficient and ineffective programmes?**

    - The medium term expenditure priorities signal government's immediate and long-term commitments. This is vital in the context of the commitment to protect the poor and vulnerable, whilst keeping abreast with the objectives set out in the National Development Plan (NDP)-Vision 2030.
    - The priorities for the 2020 MTEF period are anchored on the consolidated government spending of R6.14 trillion over the 2020 MTEF period. When excluding debt service cost, expenditure is set to decline on average in real terms. This is mainly due to baseline reductions and reallocation of R260. 9 billion (R100.8 billion to programme baseline, and R160.2 billion on the wage bill).

- Similarly with the 2019 MTBPS, the 2020 Budget prioritises the social wage by allocating 55.4 per cent of non-interest expenditure to learning and culture, health and social development (Refer to Table 1 for allocations and focus areas).

Table 1: Medium Term Expenditure Priorities by Function and Key Focus Areas

Function	MTEF Allocation	Key Focus Areas
Learning and culture receives	R1. 2 trillion	-Construction of new schools -Replacement of inappropriate schools -Introduction of robotics in Grade R-Grade3 -Feasibility study for a new university of science and innovation in Ekurhuleni
Social development	R970 billion	-poverty reduction through social welfare and grants -empowerment of women, children and people with disabilities
Health	R731 billion	-increased access to quality health care for all residents

Source: National Treasury (2020) adapted

- **In line with the fiscal consolidation path, which is in response to economic growth and revenue constraints, the 2020 Budget proposes a range of downward adjustments (refer to Chapter 5 of the 2020 Budget Review). Most of the baseline reductions are in critical spending areas such as human settlements (R146 billion), public transport (R13.2 billion), basic and higher education (R5.2 billion), Department of Health (R3.9 billion), Municipal Infrastructure Grant (MIG) (R2.8 billion).**
    - These adjustments could adversely affect the state's capacity to efficiently deliver basic services, create jobs and realise the strategic objectives set out in the NDP-Vision 2030.
    - The projected economic growth rate of less than 2 per cent over the 2020 MTEF period is far from the NDP target of 5.4 per cent annual average growth. This could also make it difficult to change the trajectory of high unemployment (at 29.1 per cent by the fourth quarter of 2019), poverty and inequality.
    - The Executive should rigorously implement the cost saving measures outlined in the Budget.
    - More importantly, this necessitates intense oversight by legislatures, civil society, the media and the public.

- **The budget deficit is likely to widen further, due to increased demands of state owned companies (SOCs).**

    - A decline in nominal GDP and revenue shortfalls resulted in widening of budget deficit but reducing the growth of the wage bill will improve fiscal sustainability.
    - The consolidated budget deficit is expected to narrow from 6.8 per cent in 2020/21 to 5.7 per cent of GDP in 2022/23 although debt does not stabilise over the medium term.
    - The SOCs[10] pose a major risk that could widen the budget deficit and raise debt-service costs. Eskom has a deteriorating financial position, the Road Accident Fund is government's second liability and SAA for which government has set aside over R16 billion over the medium term.

- **Debt is increasing rapidly over the medium term, rising at an annual average rate of 12.3 per cent – more than double the average growth rate for total expenditure.**

    - The escalating support for SOCs and slowdown in economic growth has a negative impact on debt levels.
    - This implies that more debt funding is required or much more expenditure cuts are required to fund SOCs.
    - Contingent liabilities from SOCs is likely to increase strongly and "crowd out" other spending categories.

Table 2: Summary of recapitalisation and bail-outs of SOCs

R billion	ESKOM	SAA	Denel	SAA Express	SABC	Total
2008/09	10			0,4		**10,4**
2009/10	30	1,5				**31,5**
2010/11	20					**20**
2011/12	-	-	-	-	-	**-**
2012/13	0,7	-	0,4	-	-	**1,1**
2013/14	-	-		-	-	**-**
2014/15	-	-	-	-		**-**
2015/16	23	-	-	-	-	**23**
2016/17	-	-	-	-	-	**-**
2017/18	-	10	-	-	-	**10**
2018/19	-	5	-	1,2	-	**6,2**

[10] Look at Annexure B for a breakdown of financial performance of SOCs

2019/20	49	5,5	1,8	0,3	3,2	**59,8**
2008/09-2019/20	**132,7**	**22**	**2,2**	**1,9**	**3,2**	**162**

Source: 2020 Budget Review

3. The Division of Revenue

- **Expenditure cuts proposed over the medium term in the 2019 Budget, has been revised upwards and amounts to a net reduction of R156.1 billion in the 2020 Budget, due to the need to respond to increased fiscal pressures.**
  - This reduction will be effected through a reduction in non-interest expenditure, measures to reduce growth in the public-service wage bill and cuts in transfers to sub-national government.

Table 3: Provincial and local allocations

Spheres of Government R'billion	**2019/20 Revised Equitable Share Allocation**	**2020/21 Equitable Share Allocation**				**2021/22 Equitable Share Allocation estimate**			**2022/23 Equitable Share Allocation estimate**	
		2019 DoRB	2020 DoRB	Variance	DoRB % growth	2019 DoRB	2020 DoRB	Variance	2019 MTBPS	2020 DoRB
Provinces	505,6	542,9	538,5	-4,4	6,5%	578,6	574,0	-4,6	607,6	607,6
Local government	69,0	75,7	74,7	-1,0	8,3%	82,2	81,1	-1,1	87,2	87,2
Total	574,6	618,6	613,2	-5,4	6,7%	660,8	655,1	-5,7	694,8	694,8

Source: National Treasury (2019 and 2020)

- **Provincial Equitable Share Allocation**
  - The Equitable Share for Provinces' amounts to R538.5 billion for 2020, which is R4.4 billion less than the R542.9 billion estimated in the 2019 Budget.
  - Similarly, the 2021/22 equitable share is lower by R4.6 billion than the R578.6 billion estimated in the 2019 Budget.

Note:

The provincial equitable share of nationally raised revenue, may be reduced in the 2020/21 Budget Adjustments period, should the proposed changes to the wage bill, be agreed upon by the Public Service Co-ordinating Bargaining Council.

Source: National Treasury (2020), Budget Review, p. 67.

- **Reductions[11] to Provincial Conditional Transfers**

  - Reductions amounting to R16.2 billion are effected to ***direct***[12] Provincial Conditional Grants over the medium term.
  - While ***indirect***[13] Provincial Conditional Grants, namely, the *School Infrastructure Backlogs Grant* and the *National Health Insurance Grant* are reduced by R123.0 million and R611.0 million, respectively.

Note:

In order to manage the effects of Grant reductions, the following was taken into account:

- Past spending and performance;
- Does the Grant fund salaries, medicines and food; and
- Has there been significant growth in the allocations in recent years.

Hence, Grants that persistently under-performed received larger cuts to their baselines.

The Cities of Buffalo City, Msunduzi and Mbombela are been suspended from the Public Transport Network Grant, for failing to effectively spend their grant allocations.

Larger cuts were also made to the Grant allocations of urban municipalities that have more capacity to offset the cuts by increasing their own contributions.

Source: National Treasury (2020), Budget Review, p. 68.

- **Implications of reduced transfers to Provinces**

  - As a consequence of fiscal consolidation efforts, Provinces have had to identify a number of measures in order to avoid compromising services and these include:

    - Provinces have maintained compensation limits;
    - They have reduced costs by merging provincial public entities, improved integrated planning to avoid the duplication of services and enhanced contract management to ensure the correct pricing of projects;
    - They also had to identify savings of 5 to 7 per cent in their Budget for each year over the medium term.

[11] Excludes technical adjustments.

[12] Grant funding is directly transferred to the respective Provincial Department for implementation.

[13] Grant funding is spent and projects implemented by the administering national department on behalf of the province.

- There are, however, limits in Provinces' ability to effect cost reductions, savings and reprioritisation. More needs to be done to advance the search for new revenue sources or alternatively assess the effectiveness of current revenue sources for optimal revenue generation, given that 80 per cent of provincial transfers are allocated through the equitable share.

- **Local Government Equitable Share Allocation**

  - The Local Government Equitable Share amounts to R74.7 billion for 2020, which is R1.0 billion less than the R75.7 billion estimated in the 2019 Budget.
  - Similarly, the allocation for 2021/22 is lower by R1.1 billion than the R82.2 billion estimated in the 2019 Budget.

- **Reductions[14] to Local Government Conditional Transfers**

  - Local Government Conditional Grants (***direct***) are reduced by R16.8 billion over the medium term.
  - While ***indirect*** Grant allocations, namely, the *Integrated National Electrification Programme Grant* is reduced by R1.2 billion over the medium term.

- **Implications of reduced transfers to Local Government**

  - A number of rural municipalities' budgets are primarily funded through transfers (i.e. more than 80 per cent), and thus service delivery within these areas can be severely impacted by reduced transfers.
  - The revenue-generation capability of rural municipalities is limited given the socio-economic profile of its population and thus it is important that these municipalities make every effort to collect revenues owed to it.

Note:

To support municipalities in improving revenue collection, the National treasury will work with a select number of municipalities on a pilot to retrofit smart meters and test whether revenue collection increases sufficiently.

The Department of Cooperative Governance and Traditional Affairs has also been funded to run a payment culture campaign.

Source: National Treasury (2020), Budget Review, p. 73.

[14] Excludes technical adjustments.

- **Reform to the Local Government Conditional Transfer System**

    - As part of the continued reform of the Local Government Transfer System, the scope of the *Municipal Infrastructure Grant* will be expanded to allow for the purchase of specialised waste management vehicles in order to broaden waste management services to poor households.

- **Addressing Local Government Unfunded Budgets**

    - The adoption of unfunded budgets by Municipal Council, in recent times became a bad precedent.
    - National Treasury has turned this bad practice around by implementing more effective consequence management for wayward municipalities, by withholding their equitable shares.
    - Nearly three-quarters of all municipalities having funded budgets in 2019/20 (this is the highest proportion since National Treasury started assessing the sustainability of all municipal budget in 2013/14).

Note:

National Treasury should issue an explanatory note on the legality of withholding a municipality's equitable share, given that it is a Constitutional mandate.

> Section 214(1)(a) of the Constitution of South Africa requires an Act of Parliament to provide for "the equitable division of revenue raised nationally among the national, provincial and local spheres of government", (Constitution of the Republic of South Africa, 1996).

Concluding remarks

- The 2020 Budget supports the fiscal consolidation efforts of previous budgets, but is unable to stabilise Government debt in the medium term.

- The 2020 Budget speaks to structural reforms, yet past budgets raised the need for structural reforms as well. Structural reforms need to be acted on with much greater urgency if the South African economy is to move from a stagnant and declining economy towards a sustainable growth path.

- National Treasury and the respective national departments should inform Parliament about the effectiveness of past initiatives to reduce the cost of doing business, particularly for Small, Medium, Micro-Business Enterprises.

- Intense oversight on SOCs must implemented by legislatures and other assurance providers to improve efficacy and profitability of such companies.

- Consequence management must be enforced by the Executive in order to deal with irregular, fruitless and wasteful expenditure (see attached Annexure A for financial performance of selected Departments and Annexure B for entities).
- Reductions to sub-national government transfers need to be accompanied by improved revenue collection and the exploration of new revenue sources in order to uphold service delivery.

REFERENCES

National Treasury (2020), *Estimate of National Expenditure.*

National Treasury (2020), Medium Term Budget Policy Statement 2020.

National Treasury (2020) *Medium Term Budget Policy Statement Speech.*

Annual Reports of Departments and entities 2016/17; 2017/18 and 2018/19

Auditor-General South Africa, 2019, PFMA: National and Provincial audit outcomes

Annexure A: Financial performance of selected Departments 2016/17 to 2018/19

Departments	Audit Outcome			Unauthorised expenditure	Irregular expenditure	Fruitless and wasteful
	2016/17	2017/18	2018/19	R'000	R'000	R'000
Correctional Services	Qualified	Qualified	Qualified	121	3,354,488	80,233
Police	Qualified	Qualified	Qualified		1,183,375	8,302
Defence		Qualified	Qualified	0	5,134,255	404,550
Basic Education	Unqualified with findings	Qualified	Qualified	6,488	1,858,659	2,133
Environmental Affairs	Adverse	Adverse	Qualified	0	150,416	11,103
Public Works	Unqualified with findings	Unqualified with findings	Unqualified with findings	261,169	113,179	1,157
Water and Sanitation	Qualified	Qualified	AR not tabled			
Energy	Qualified	Qualified	Qualified	50,604	101,594	199,290
Health	Unqualified with findings	Unqualified with findings	Unqualified with findings	0	94,348	2,033
Transport	Unqualified with findings	Unqualified with findings	Unqualified with findings	1,339,145	746,072	151
International Relations and Cooperation	Unqualified with findings	Qualified	Qualified	416,069	1,456,804	11,690
COGTA	Qualified	Qualified	Qualified			
Justice	Qualified	Qualified	Qualified		5,134,255	404,550

Annexure B: Financial performance of selected SOCs 2016/17 to 2018/19

SOE	**Audit Outcome**			**Losses/ profits**	**Irregular expenditure**	**Fruitless and wasteful**
	2016/17	2017/18	2018/19	R'000	R'000	R'000
SAA	Did not table AR	Did not table AR	Did not table AR			
ESKOM	Qualified	Qualified	Qualified	(20,729,000)	25,659,000	552,000
PRASA	Did not table	Qualified	Disclaimer			
DENEL	Unqualified with no findings	Did not table	Disclaimer	(1,749,000)	2,118	136,000
SABC	Adverse	disclaimer	qualified	(482,359)	5,220,726	454,185
TRANSNET	Unqualified with findings	Qualified	Qualified	(11,974,000)	58,045,000	484,000
SAA Express	Did not table	Did not table	Did not table			
ARMSCOR	Unqualified with findings	Unqualified with findings	Unqualified with findings	235,311	22,161	2,515
ALEXKOR	Unqualified with findings	Unqualified with findings	Did not table			
POST OFFICE	Unqualified with findings	Qualified	qualified	(1,171,564)	1,232,276	367,647