PBO Briefing on 2020 Revised Fiscal Framework 30 June 2020

Parliamentary Budget Office

PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

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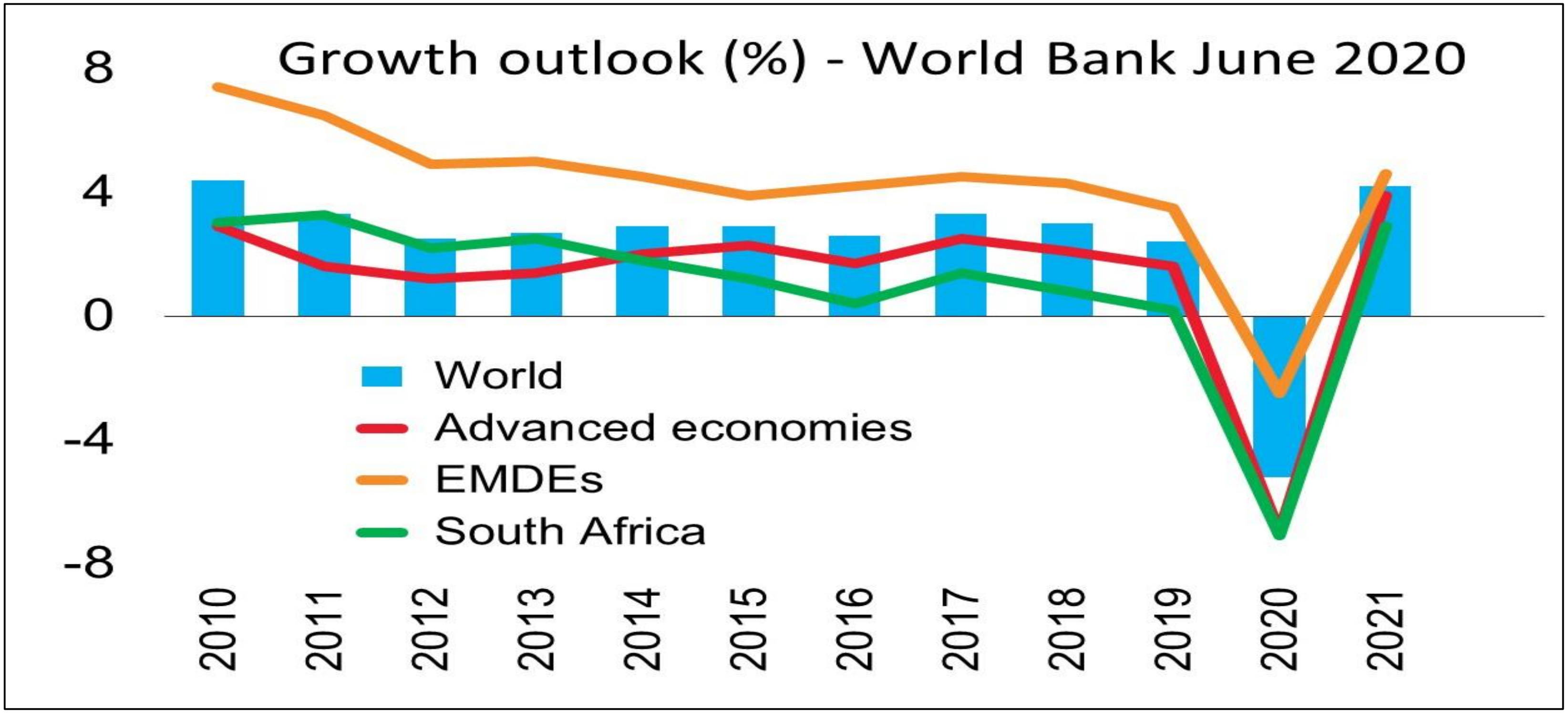
Introduction

- The PBO was established to support the Finance and Appropriations Committees in both Houses of Parliament with the implementation of the Money Bills and Related Matters Act 2009;
- The purpose of the presentation is to assist members in considering and processing the 2020 Supplementary Budget
- According to President Ramaphosa the country must do whatever it takes:
  - To limit the damage to our economy, society and people
  - To get the economy back onto a path of recovery, including the green economy
  - To provide relief packages where necessary in the future to support small and medium-sized businesses
  - To provide a new social compact for inclusive growth
  - To produce our own food and healthcare supplies
  - To strengthen the informal sector
  - To implement new infrastructure programmes and maintain current infrastructure

Covid-19 Global and Domestic Economic Implications

Deep global and domestic recession

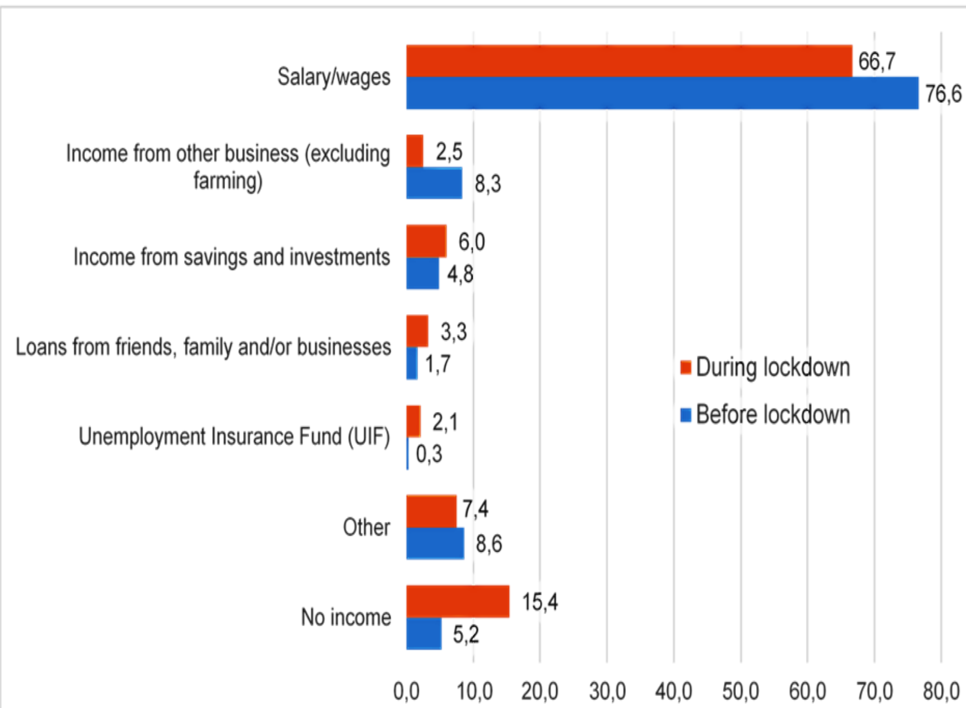


- Global outlook is a deep recession across the world (90% of the world)
- Forecasts are uncertain, including impact of new waves of infection
- Global trade is negatively affected by the pandemic (expect about 10% decline in 2020)
- Increasingly inward looking approach of major economies hurts trade
- Inventories and spare capacity has increased during lock downs
- Outlook for SA worse than most developing economies
- Expectation that bankruptcies and unemployment will increase a lot
- See Additional slides below for updates on bankruptcies, retrenchments and quarter 1 of 2020 unemployment

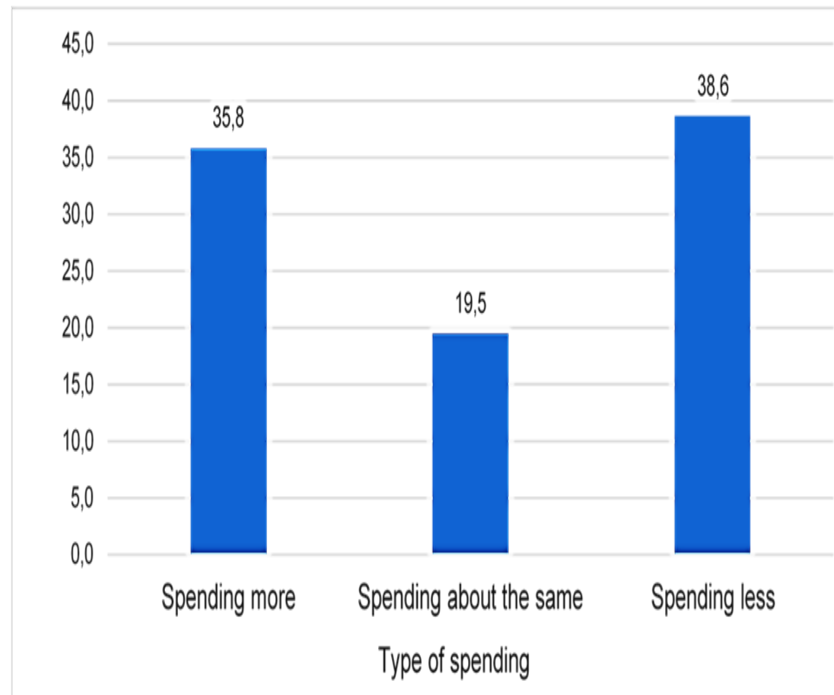
Impact of Covid-19 on the consumption of South African Households

- Household consumption is the largest part of South African GDP
- 41% of respondents said they had to incur new debt to cover their expenses

Percentage change in income source for respondents, before and during the national lockdown*.



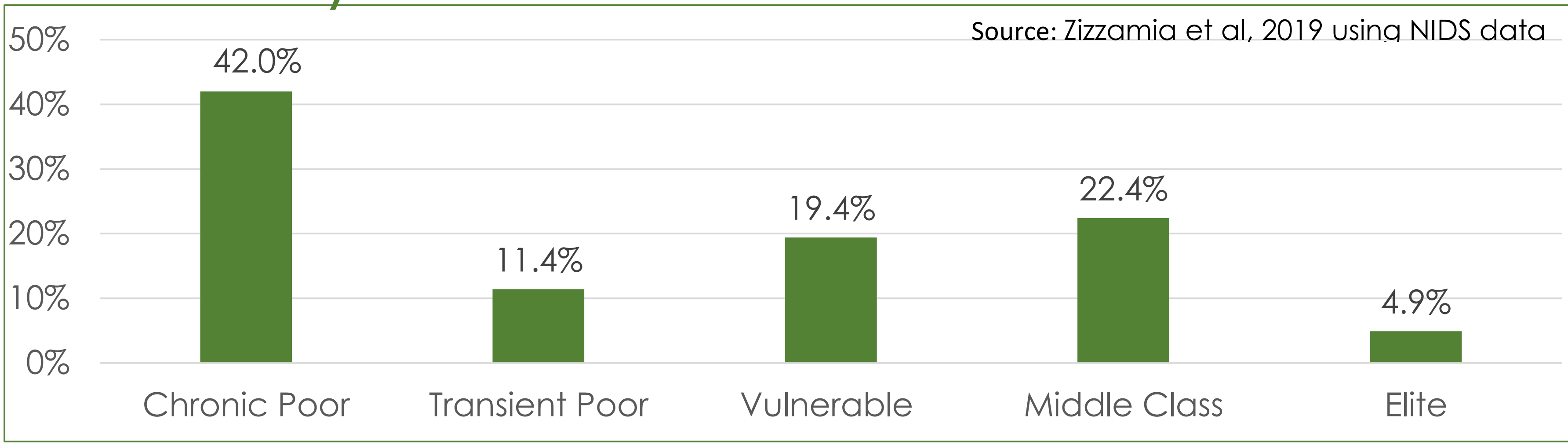
Weekly spending behaviour of respondents during the national lockdown*, as a percentage.



Source: StatsSA, *"Results from Wave 2 survey on the impact of the COVID-19 pandemic on employment and income in South Africa"*, 2020.

*** The national lockdown in the graphs refers to its first 6 weeks, beginning on the 26th of March 2020- to the 6th of May 2020.**

Increasing levels of poverty and food insecurity



- The consequences of the pandemic are much harsher on the poor
  - For e.g., it takes just 5 weeks of inadequate nutrition for a healthy one year old baby to become malnourished, underweight and be at risk of stunting, which leads to lifelong implications
- A large share of households were vulnerable to poverty before Covid-19 (about 1/3 in 2017, according to Zizzamia et al, 2019)
- The health and welfare of future generations (both rich & poor households) depend on government actions and spending today
- Government decides on the size of the response, the distribution of the costs and allocation of resource across society

Government policy stance to support recovery

- We know that the economy has been in a period of sharp decline
- Hunger, unemployment, declining investment and other socio-economic losses will continue until we control the pandemic
- There remains much uncertainty and apprehension in society
- **Now is not the time to instil and increase panic** – it is a time for firm and caring leadership from government
- Government is an anchor during these difficult and uncertain times
  - Its choices now will be important in shaping a recovery
  - Its spending must increase to help impoverished households
  - Its spending has to support the private sector to contain and recover from the economic damage and reverse job losses
- It will take time and a social compact to recover from the pandemic and its socio-economic impact
- The time frame of government's response cannot rapidly pivot to a return to fiscal consolidation
- We have to accept that the budget deficit and debt to GDP ratio will grow and have to remain higher for a number of years

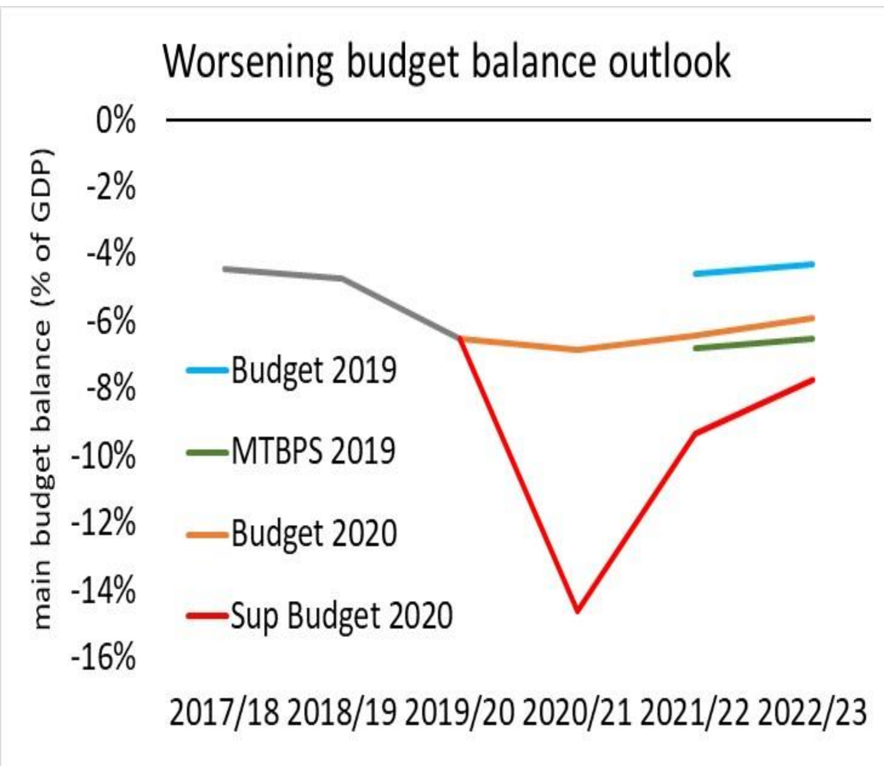
Covid-19 Public Finances Implications and Revised Fiscal Framework

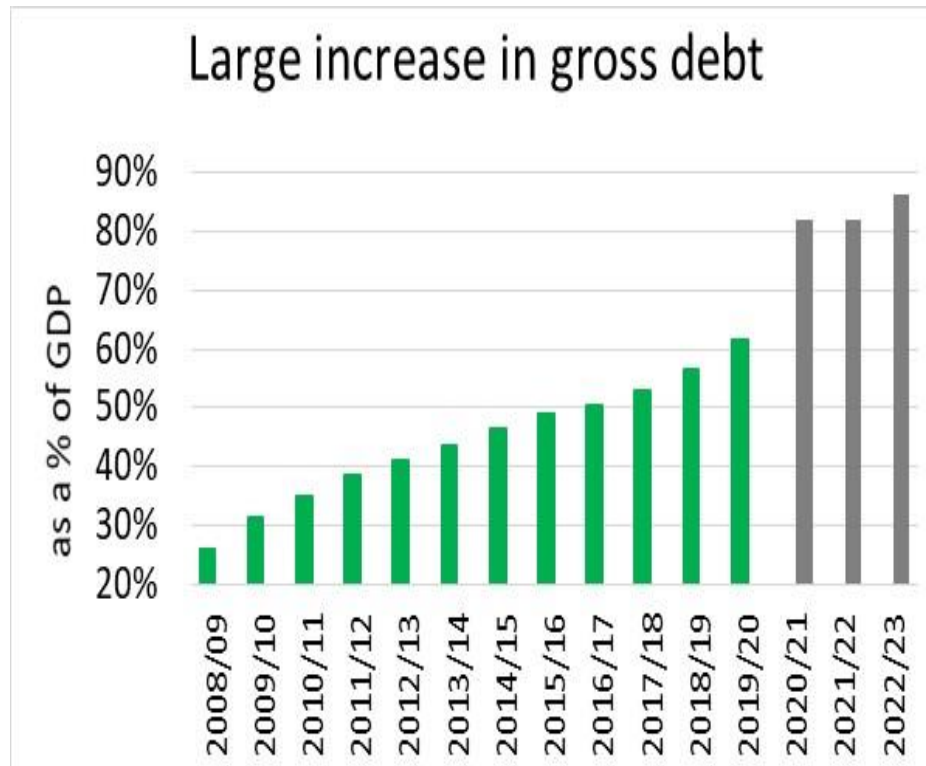
Revised fiscal framework

R billion	2020/21 Budget	2020/21 Revised	2020/21 Change	2021/22 Medium-term estimates	2022/23 Medium-term estimates
Main budget revenue	**1 398.0**	**1 099.5**	**-298.5**	**1 268.2**	**1 378.8**
	25.8%	*22.6%*		*23.8%*	*24.5%*
Main budget expenditure	**1 766.0**	**1 809.2**	**43.2**	**1 763.8**	**1 809.3**
	32.5%	*37.2%*		*33.1%*	*32.2%*
Non-interest expenditure	1 536.7	1 572.7	36.0	1 500.6	1 508.2
	28.3%	*32.4%*		*28.2%*	*26.8%*
Debt-service costs	229.3	236.4	7.2	263.1	301.1
	4.2%	*4.9%*		*4.9%*	*5.4%*
Main budget balance	**-368.0**	**-709.7**	**-341.7**	**-495.6**	**-430.5**
Redemptions	**-64.7**	**-67.2**	**-2.5**	**-64.9**	**-150.0**
Domestic long-term loans	-52.5	-52.5	–	-60.5	-134.2
Foreign loans	-12.2	-14.7	-2.5	-4.4	-15.8
Total	**-432.7**	**-776.9**	**-344.2**	**-560.5**	**-580.5**
Financing					
Domestic short-term loans (ne	48.0	146.0	98.0	56.0	64.0
Domestic long-term loans	337.7	462.5	124.8	388.4	451.4
Foreign loans	29.3	125.2	95.9	31.9	63.2
Change in cash and other bala	17.7	43.2	25.5	84.2	1.9
Total	**432.7**	**776.9**	**344.2**	**560.5**	**580.5**

Poor economic performance affects public finances

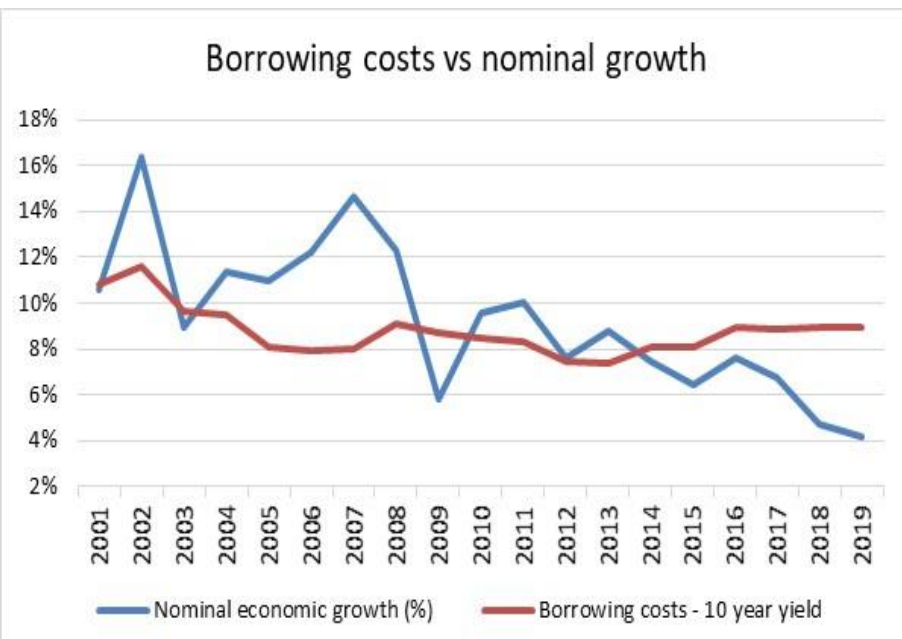
Growth Outlook	2020	2021	2022
National Treasury - February 2020	0.90%	1.30%	1.60%
National Treasury - June 2020	-7.20%	2.60%	1.50%
International Monetary Fund - April 2020	-0.70%	3.80%	
South African Reserve Bank - May 2020	-5.80%	4.00%	
World Bank - June 2020	-7.10%	2.90%	

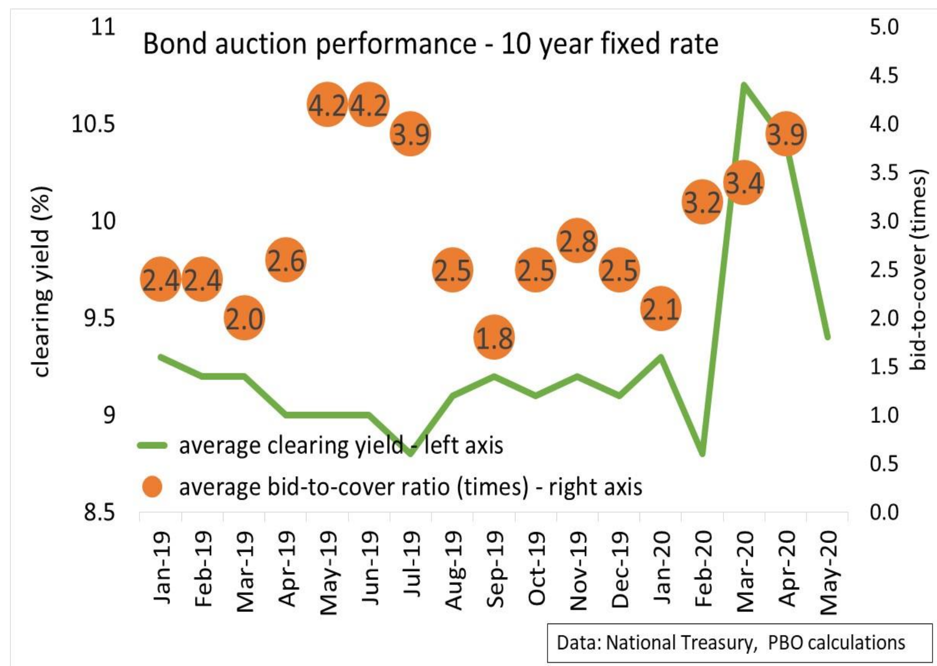




The outlook for public finances

- Public finances had an unfavourable trajectory during the fiscal consolidation, period as nominal growth declined while borrowing costs rose
- The gap between revenue and expenditure increased. Debt, debt services costs, and borrowing costs increased
- Government is targeting a primary surplus by 2023/4 requiring expenditure cuts and revenue adjustments of R250bn over the next 2 years
- The proposed approach to cut government expenditure during a recession to try to stabilise debt will be unlikely to increase growth and lower debt to GDP levels.
- Faster growth & lower borrowing costs could improve public finances





Fiscal framework and credit rating within current global context

- Most countries experience:
  - multi-notch credit ratings downgrades of governments and businesses since March 2020
  - large increases in expenditure, lower revenues and increased deficits and debt level
- The size of the debt and debt repayments have to be assessed with regard to the social and economic returns to society and the economy
- Increased expenditure now and in the short-term:
  - will help to save lives
  - mitigate the worst outcomes for the economy
  - will have high fiscal multipliers
  - help save certain businesses & jobs
  - increase aggregate demand and aggregate levels of capacity utilisation and employment
  - will also support and even grow businesses in healthcare and food provision

Revised Priority Expenditure for Immediate Covid-19 Needs

Refocusing of current spending priorities

2020 Budget Priorities	Supplementary Budget priorities

• Strengthening the macroeconomic framework to deliver certainty, transparency and lower borrowing costs
• Focusing spending on education, health and social development
• Modernising “network industries” and restructuring our state-owned enterprises
• Opening markets to trade with the rest of the continent
• Implementing a re-imagined industrial strategy
• Lowering the cost of doing business
• Focusing on job-creating sectors, such as agriculture and tourism
	• Responding to the COVID-19 pandemic has become government’s central priority
	• Frontline functions: health, social development and peace and security to focus and scale up their efforts
	• **Primary Health**
	  • Government prioritised public health to save lives
	  • Scaling up capacity in the public health system
	  • Contracting of private hospitals to supplement public-sector capacity
	• **Social development**
	  • Scaling up and maintaining social assistance interventions for distressed and vulnerable households
	  • Reprioritising funding to prepare social facilities for safe reopening and service delivery
	  • Funding of psychosocial services for people affected by the pandemic
	• **Peace and security**
	  • Increased deployment of the police service and national defence force during the lockdown
	  • Other departments required to reprioritise funding and roll out their own responses

Reprioritisation

Givers

R million	2020/21
Main budget non-interest expenditure (2020 Budget Revi	**1 536 724**
Proposed upward expenditure adjustments	**145 000**
Proposed downward expenditure adjustments	**-100 885**
National departments' baseline suspensions	-54 403
Repurposing of provincial equitable share	-20 000
Provincial conditional grant suspensions	-13 848
Local government conditional grant suspensions	-12 633
Other adjustments	**-8 109**
National Revenue Fund payments	13
Downward revisions to skills development levy	-2 122
Lower skills development levy due to 4-month holiday contribution	-6 000
Revised non-interest expenditure	**1 572 730**
Change in non-interest expenditure from 2020 Budget	36 006

Takers

R million	2020/21
Support to vulnerable households for 6 months	40,891
Health	21,544
Support to municipalities	20,034
Other frontline services	13,623
Basic and higher education	12,541
Small and informal business support, and job creation	6,061
Support to public entities	5,964
Other COVID-19 interventions	1,766
Allocated for COVID-19 fiscal relief package	**122,425**
Land Bank equity investment	3,000
Provisional allocations for COVID-19 fiscal relief package	19,575
Total	**145,000**

Change to the non-interest expenditure amounts to R36 billion of which R19.6 billion is a provisional allocation

Suspension of baselines in a selection of National Departments (1 month into 2020/21 FY)

R million	2020/21 Main budget	Suspension of funds (COVID-19 purposes)	Allocated to (COVID-19 purposes)	2020/21 Total net change	2020/21 Total adjusted allocation
Cooperative Governance	96 234	-6 012	16 967	10 955	107 188
National Treasury	815 109	-20 863	30 188	9 325	824 434
Basic Education	25 328	-7 245	5 150	-2 095	23 233
Higher Education and Training	116 857	-14 856	5 000	-9 857	107 000
Health	55 516	–	2 914	2 914	58 430
Social Development	197 718	-15 482	40 956	25 474	223 192
Defence	52 439	-1 212	4 092	2 880	55 319
Police	101 711	–	3 700	3 700	105 411
Agriculture, Land Reform and Rural Development	16 810	-3 307	914	-2 394	14 416
Human Settlements	31 325	-5 496	3 235	-2 261	29 064
Trade, Industry and Competition	11 082	-2 271	500	-1 771	9 311
Transport	62 047	-6 871	2 231	-4 640	57 407
Total	**1 768 781**	**-97 759**	**121 364**	**23 605**	**1 792 386**

Suspension of baselines in a selection of National Departments (of which)

R million	2020/21 Main budget	Downward revisions: Suspension of funds (COVID-19 purposes)	Downward revisions: Virements from	Reallocations: Allocated to (COVID-19 purposes)	Reallocations: Virements to	2020/21 Total net change proposed	2020/21 Total allocation proposed
Economic classification							
Current payments	**494 990**	**-8 785**	**-1 446**	**15 711**	**2 801**	**8 281**	**503 271**
Compensation of employees	187 668	-1 426	-17	812	127	-503	187 165
Goods and services	77 891	-7 359	-1 429	7 724	2 673	1 610	79 501
Transfers and subsidies	**1 215 936**	**-88 066**	**-8 894**	**100 146**	**8 943**	**12 129**	**1 228 065**
Provinces and municipalities	781 934	-44 491	-1 991	47 901	2 020	3 439	785 373
Departmental agencies and account	143 296	-16 256	-3 947	5 429	4 242	-10 533	132 763
Households	201 477	-17 082	-453	42 790	203	25 458	226 935
Payments for capital assets	**15 303**	**-908**	**-1 730**	**2 494**	**326**	**182**	**15 485**
Payments for financial assets	**42 552**	**–**	**–**	**3 013**	**–**	**3 013**	**45 565**
Total	**1 768 781**	**-97 759**	**-12 069**	**121 364**	**12 069**	**23 605**	**1 792 386**

Suspension of baselines in a selection of National Departments (cont.)

- Compensation of employees: Filling of vacancies suspended until later in the financial year (15 votes↓ , 3 votes ↑)
- Local government equitable share: To support municipalities with the increased expenditures related to the provision of services, including shelter for the homeless
- Most conditional grants: Delay in planned projects to prioritise unplanned COVID-19 interventions such as the provision of basic services in municipalities
- School infrastructure backlogs grant: The start of new projects will be delayed. The R600 million for the provision of water and water tanks to 3 433 schools without access to potable water
- Restitution: A portion of the payments is likely to be postponed due to the restrictions on economic activity
- Food security: Fewer farmers supported due to restrictions on economic activity

Suspension of baselines in a selection of National Departments (cont.)

- Public corporations and private enterprises: Allocations for incentives will be suspended by postponing activities to the next financial year and reducing support to firms. However, R500 million is reprioritised towards firms that are in distress as a result of the restrictions on economic activity

To note:

- Passenger Rail Agency of South Africa (R1.02 billion): Rolling stock fleet renewal programme: Underspending in capital projects means that the agency has sufficient cash balances to minimise the impact on planned projects
- Revenue support to the Passenger Rail Agency of South Africa (R1.3 billion): To cover the reduction in revenue due to restrictions on economic activity
- Revenue support to the South African National Roads Agency (R2.8 billion): To cover the reduction in revenue due to restrictions on economic activity. Additional support to pay debt that was due.

Repurposing of Provincial Equitable Share towards

R million	2020/21	Funds reprioritised for Covid-19
Eastern Cape	71 415	2 651
Free State	30 017	1 114
Gauteng	112 118	4 169
KwaZulu-Natal	111 442	4 140
Limpopo	62 329	2 314
Mpumalanga	44 105	1 638
Northern Cape	14 290	529
North West	37 548	1 394
Western Cape	55 208	2 051
Total	**538 472**	**20 000**

R20 billion of which R15 billion towards Health and R5 billion towards other

Change in spending priorities: Conditional grants

R million	Total suspensions	Reprioritisation	Net suspensions
Municipal infrastructure	4 401	4 401	–
Urban settlements development	3 357	2 257	1 100
Public transport network	2 998	1 096	1 902
Water services infrastructure	689	689	–
Integrated national electrification programme (municipal)	500	–	500
Human settlements development	1 728	–	1 728
Provincial roads maintenance	1 756	–	1 756
Education infrastructure	6 621	4 400	2 221
Health facility revitalisation	1 066	1 066	–
Other grants	3 703	2 126	1 577
Total	**26 819**	**16 035**	**10 784**

Government response to Covid-19 so far

Expenditure	Amount (R' billion)	Effectiveness of intervention
Health – Covid-19 intervention	20	• 1.3 million or over 2% of the population tested • Half tests by private and half public sector. • But a large testing backlog remains • PPE provisions should increase • ICU bed capacity seems low at 3300
Municipal allocation	20	• So far only R5bn of the R20 bn spent • Rural areas and poor urban neighborhoods may not be getting adequate services
Social and basic income grant	50	• It took almost 6 weeks before grants were paid. • By 18 June 2020, only 1.2 million applicants, out of 6.2 million were paid; • Bassier et al (2020) estimate that almost 2 million households would fall below the food poverty line because the child support grant was not provided per child but to each care-giver • (See additional slides below for more on this grant)
Job creation and support for SMEs &Informal sector	100	• There are no recent estimates of uptake.

Government response to Covid-19 so far

Expenditure	Amount (R' billion)	Effectiveness of intervention
Salary income support (UIF)	40	• By 19 June 2020 only 355 267 out of 2.4 million employers had been paid, • By 19 June 2020 R24 bn had been disbursed to 3.7 million workers that means that 60% funds have been spent so far but only less than an estimated 25% of workers have benefitted
Tax relief	70	• There are no recent estimates of uptake. • Stats SA reports in an April survey that only 4.25% of business-owning respondents had made use of the various tax deferral programmes. • Smaller businesses are struggling to apply.
Business loan guarantee scheme	200	• The 3 week delay between announcement and finalisation of the programme meant that businesses had to make other arrangements, including retrench workers • Extremely low uptake from businesses so far • SARB report that applications have increased recently

Is Government's response adequate?

- A fiscal stimulus is an attempt to increase economic activity by reducing taxes, increasing government spending, or both.
- The rule of thumb is that new spending should be large enough to offset the expected economic contraction;
- However, not all of South Africa's announced package is new spending, nor necessarily government spending.
- The net contribution from the Government is R71 billion or 1.4% of GDP.
- An effective Covid-19 response should have been large enough to offset the expected shock to the economy.
- South Africa's effort falls far short of this benchmark.
- The National Treasury ensured that the basic contours of a fiscal consolidation budget remained intact.

Does the additional funding for health address some of the objectives of the NHI?

- The additional funding in health for Covid-19 resulted in the following which address some of the objectives of the NHI:
  - Health system capacity improved
  - Quickly improved the health system to be ready to serve everyone regardless of their ability to pay
  - Massive investments in health infrastructure, improving the quality of existing buildings and movable assets
  - Invested in information technology to collect and manage data
  - Ramped up the capacity to monitor the performance of the health system in real-time
  - Government has strengthened its working partnership with the private sector in response to the national emergency
- The question is, whether these outcomes will have a carry through effect over the new MTEF and beyond!

Covid-19 Weighs Heavily on Government Revenue

Poor economic growth to contract tax revenue base

R' Billion	Outcome	Budget	Revised	Medium Term Estimates			
	2019/20	2020/21	2020/21	2021/22	2022/23	2023/24	2024/25
2019 MTBPS Projected Outcome		-63					
Revenue Outcome	-69						
Covi- 19 Revenue Relief			-26				
Revenue loss due to covid-19 economic decline			-278				
Active Scenario Assumes: Medium term tax increase				5	10	10	15

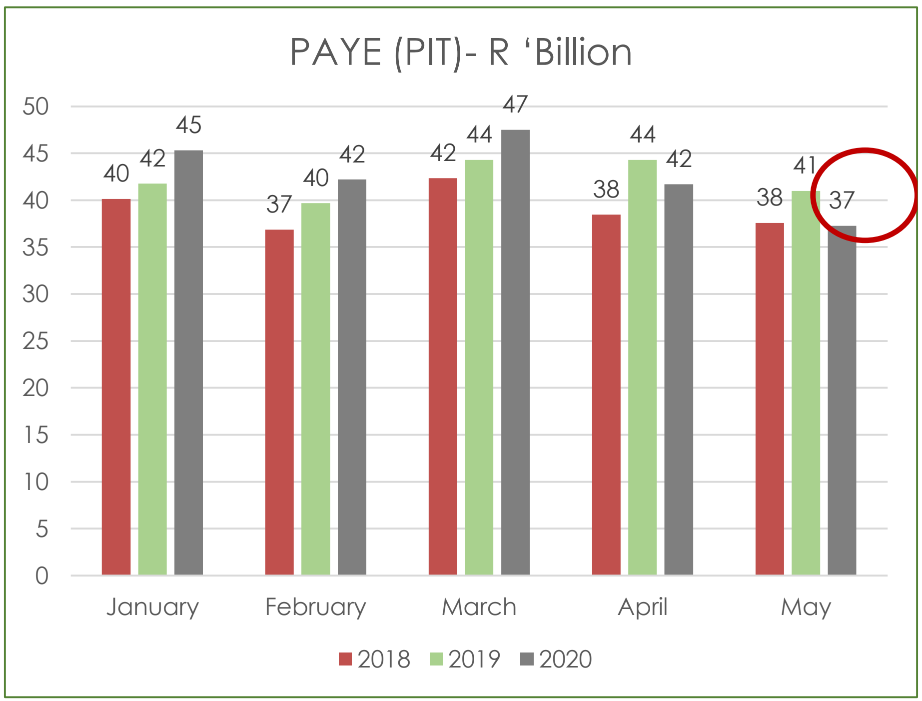
Covid-19 Tax Relief Measures: Business and Individuals

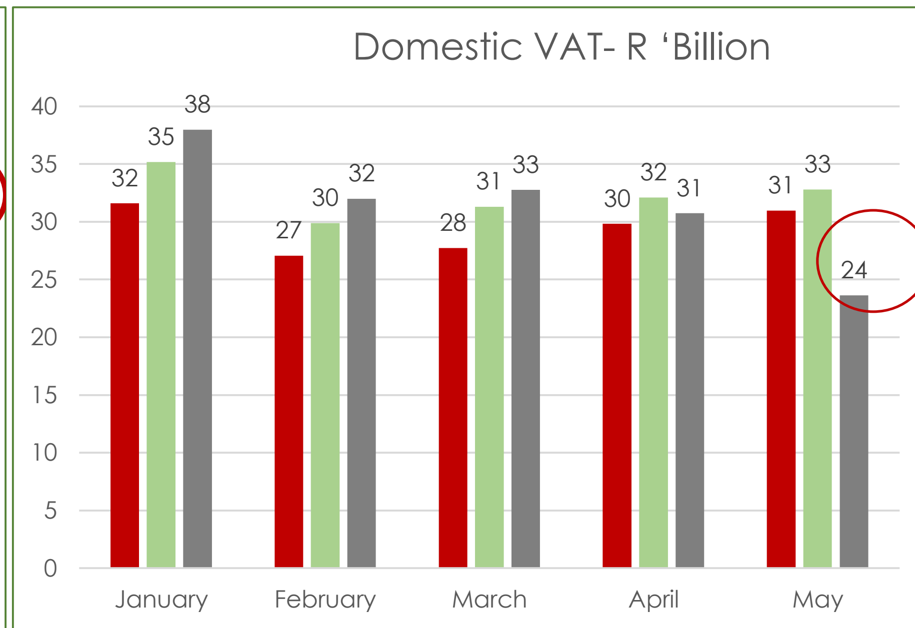
R 70 billion (R44 bn value of tax deferral)

- Employment tax incentive (01April - 31July 20)– R 750, monthly instead biannual;
- Deferral of 35% of PAYE for business with gross income > R 100 million (From 01st April – 31st July 20);
- Deferral of 35% of 1st or 2nd Provisional Tax payment (01st April & 30th September 20);
- Secondary provision tax payment to be made between 01 October 20 and 31 March 21, for business with gross income of > R 100 million;
- 4-month exemption in the skills development levy from 1st May 20;
- 90-day deferral for payments of alcohol and tobacco excise duties from 1st May 20
- 3-month postponement of the filing and payment date for carbon tax liabilities to 31st October 20;
- Postponement of measures to broaden the corporate income tax base (restricting net interest expense deductions, and limiting the use of assessed losses carried forward) to at least 1st January 20;
- 10% increase in the available tax deduction for donations made to the Solidarity Fund from 1st April to 31st July 20.
- Defer tax liabilities without penalty if the business can show it is incapable of making payment due to the pandemic;

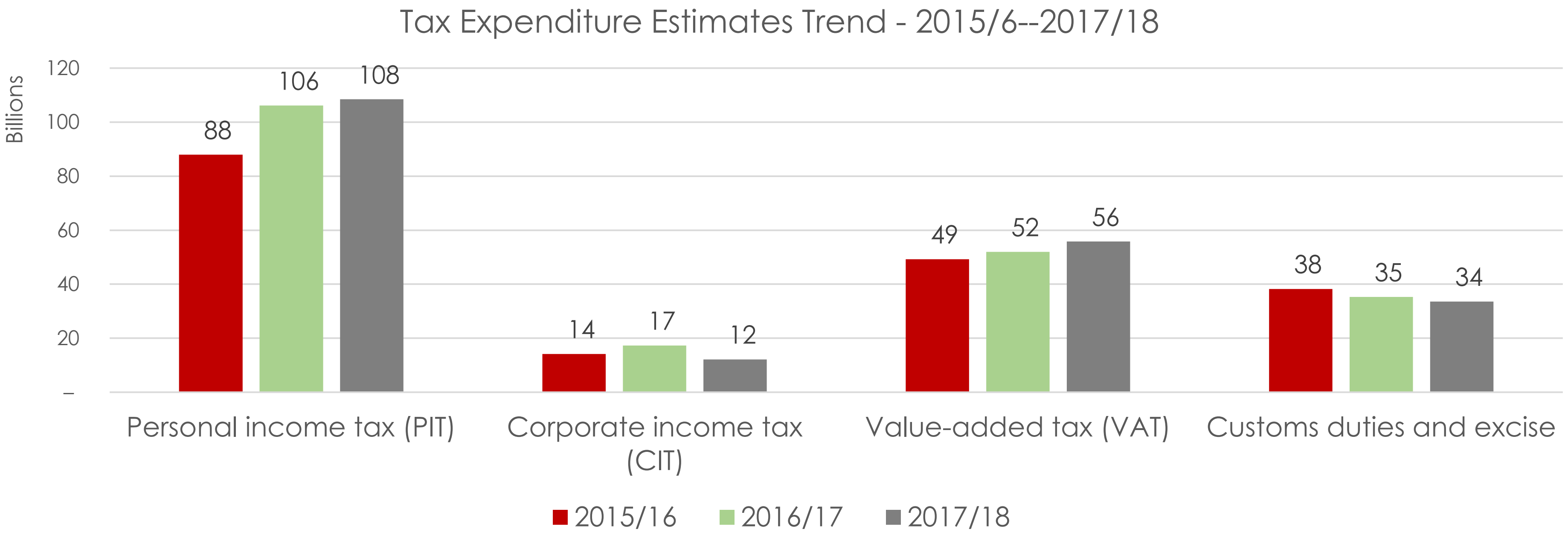
Covid-19 Tax Relief Measures: Business and Individuals

- Tax receipts since the lockdown or 01 April 2020;
- Lack of demand in the economy has weigh heavy on domestic VAT receipts; year-on-year comparison;
- PIT receipts are still to show the loss of wages and salaries since the lock down, but signs are already there;
- Covid-19 tax relief measures also led to lower receipts;





Tax expenditure estimates (Incl. Incentives)



2017/18 Tax Expenditure estimated at R 210 billion or 17. 3% of gross tax revenue:

PIT expenditure main areas	**R108 billion**	**VAT expenditure main areas**	**R 56 billion**
• Pension and Retirement	R77 bn (71 %)	• 19 Basic food items	R26 bn (47%)
• Medical Aid	R24 bn (22 %)	• Fuel (petrol + diesel + paraffin)	R20 bn (36%)
• Other	R 7 bn (7 %)	• Other	R10 bn (17%)
CIT expenditure main areas	**R 12 billion**	**Customs & Excise main areas**	**R 33.6 billion**
• Small Business Corp	R 2.5 bn (21%)	• Motor Vehicles	R28.8 bn(86 %)
• Employment Tax Incentive	R 4.3 bn (35%)	• Diesel Refund	R3 bn (9%)
• Other	R 5.3 bn (44%)	• Other	R1.8 bn (5%)

Municipal Fiscal Situation

Municipalities and Metros Revenues – 2019/20 Q3

Municipalities budget against actual revenues R'000 - Q3 2020				
Financial Year	**Revenue Source**	**Budget**	**Q3**	**%**
FY 2018/19	Operating Revenue	365 642 718	272 937 725	74,6
	Capital revenue	73 217 822	21 018 668	28,7
	Total Revenue	**438 860 541**	**293 956 394**	**67,0**
FY 2019/20	Operating Revenue	420 204 969	292 456 249	69,6
	Capital revenue	69 524 510	49 446 583	71,1
	Total Revenue	**489 729 479**	**341 902 832**	**69,8**

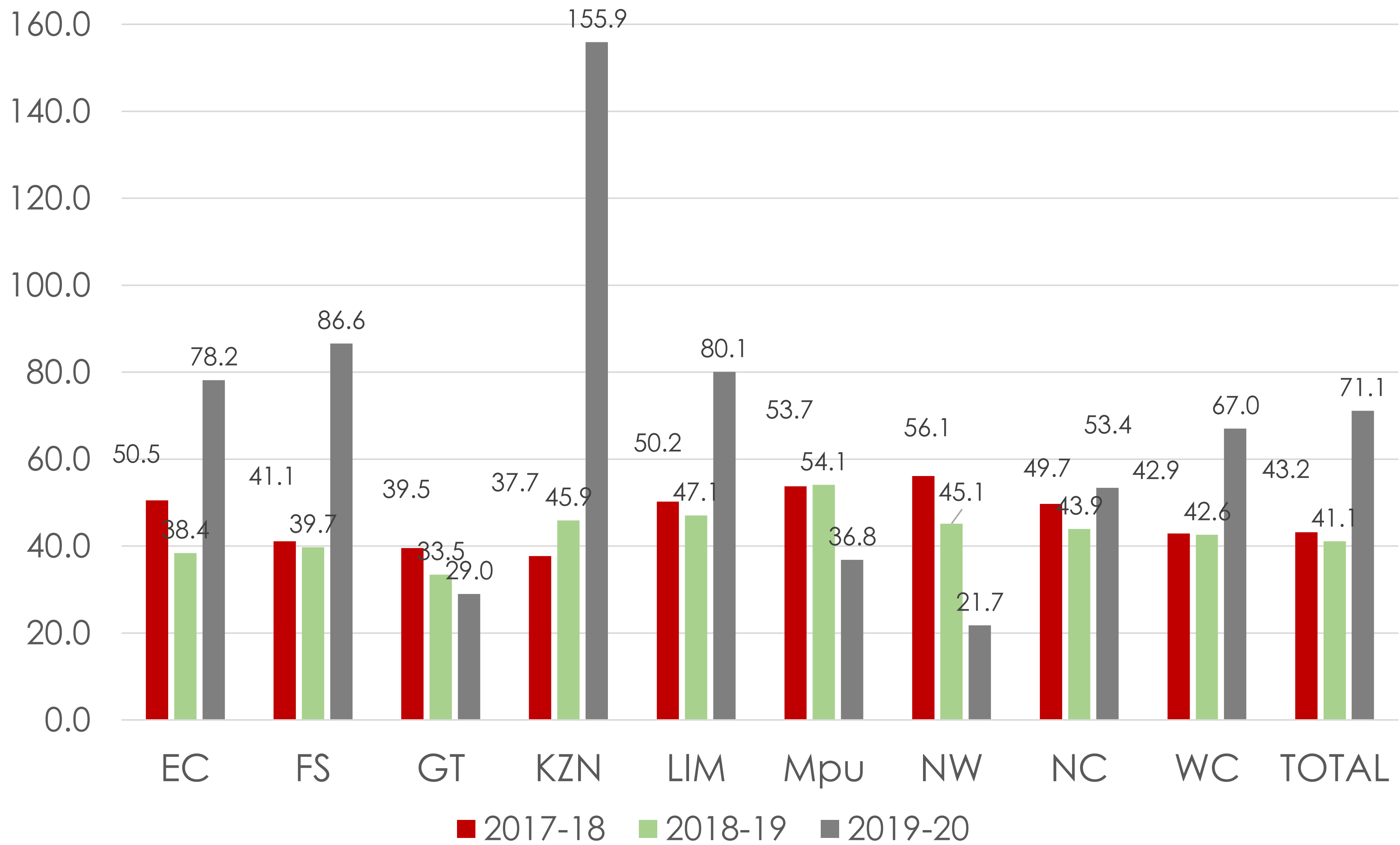
Metros budget against actual revenues R'000 - Q3 2020				
Financial Year	**Revenue Source**	**Budget**	**Q3**	**%**
FY 2018/19	Operating Revenue	220 839 006	164 320 602	74,4
	Capital revenue	37 969 093	7 695 108	20,3
	Total Revenue	**258 808 099**	**172 015 710**	**66,5**
FY 2019/20	Operating Revenue	261 308 286	176 239 290	67,4
	Capital revenue	35 168 123	11 406 973	32,4
	Total Revenue	**296 476 409**	**187 646 264**	**63,3**

Municipalities and Metros Expenditures – 2019/20 Q3

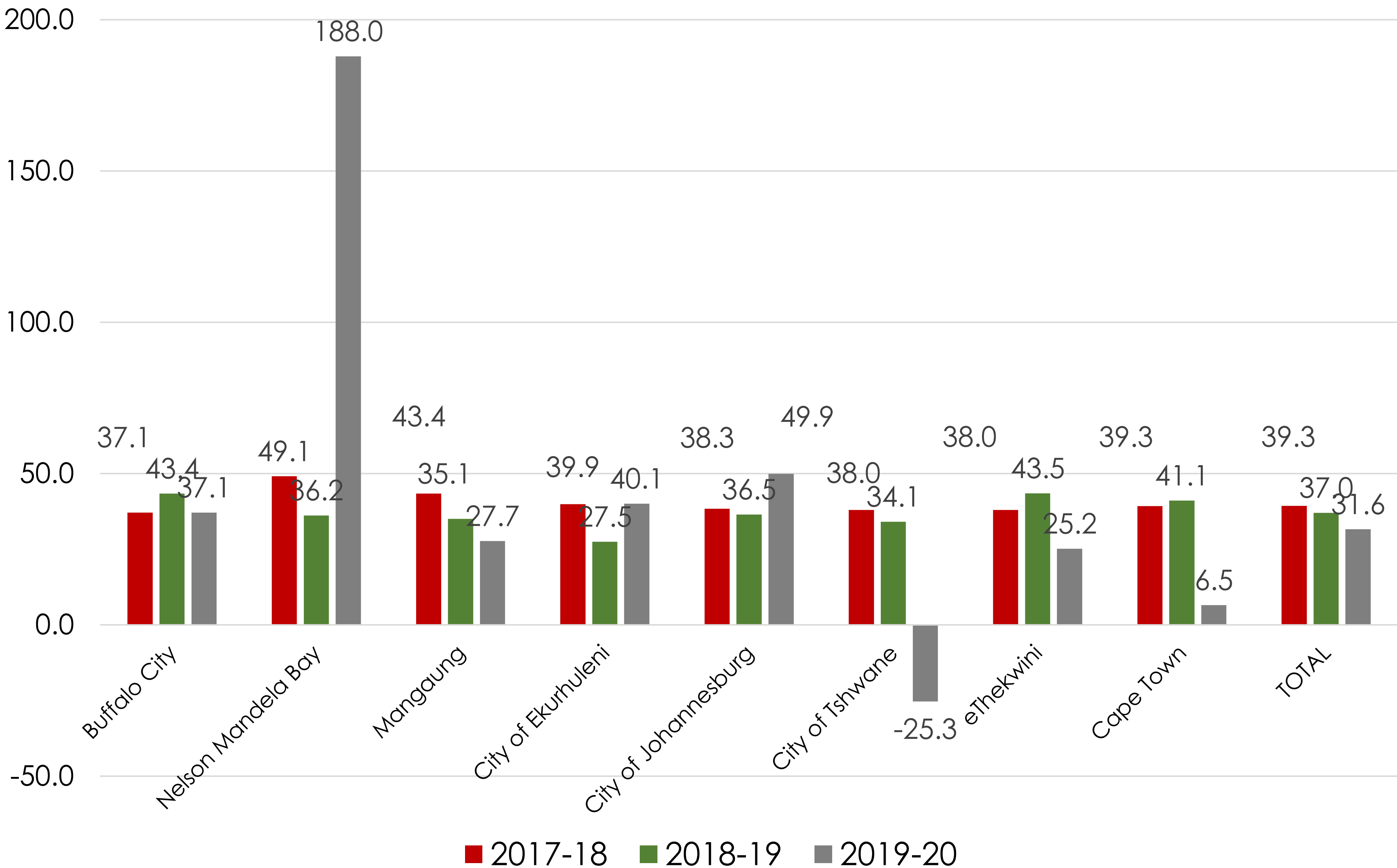
Municipalities budget against actual expenditure R'000 - Q3 2020			
Expenditure	Budget	Actual	%
FY 2018/19	445 196 990	230 875 235	51,9
FY 2019/20	489 805 071	304 156 155	62,1

Metros budget against actual expenditure R'000 - Q3 2020			
Expenditure	Budget	Actual	%
FY 2018/19	164 742 378	127 595 754	77,5
FY 2019/20	285 294 125	173 243 539	60,7

Aggregated municipal capital expenditure -2019/20 Q3



Metros Capital Expenditure – 2019/20 Q3



Municipality governance challenges- AGSA 2019

- About 80% of all municipalities’ financial management and budget implementation process has raised concerns (40%) or require interventions (40%);
- Free State (87%), North West (82%), Northern Cape (63%) and Mpumalanga (55%) has more than half of their municipalities financial health requires intervention.
- Limpopo (79%) and KwaZulu Natal (68%) more than half of their municipalities were noted concerns in their financial health. And more than 70% of Western Cape municipalities had good financial health;
- Based 2019 financial year:
  - 34% of municipalities ended the year in a deficit (expenditure was more than revenue) R6,29 billion
  - An average of 59%of municipal debtors are not recoverable. At 55 municipalities more than 80% cannot be recovered –debt collection at 99municipalities was more than 90 days
  - The creditors are greater than available cash at year end at 51%of municipalities
- Supply chain management non-compliance is the main cause of irregular expenditure;
  - Annual irregular expenditure increased from *R25,2 billion to ^R32,06 billion (almost all municipality incurred municipality 239 to 241)
- Material irregularity process implemented at 9 municipalities (R25 billion loss):
  - Payment for goods or services not received- 33%
  - Assets not safeguarded resulting in theft/vandalism- 50%
  - Unfair procurement leading to overpricing- 17%

The Way Forward

The way forward

- The slides that follow point to an approach towards budgeting that rebuilds the economy in an inclusive and caring manner
- The main thrust of this approach is that government should not be cutting expenditure in the near future to address lower economic growth and revenue
- Instead, government should be stimulating the economy to grow to offset the losses associated with Covid-19 and increase economic activity
- The expenditure should be targeted to help the poorest households and SMMEs while drawing in bigger businesses to build the recovery
- The financing for these expenditure expansions should come from
  - Savings from increasing the efficiency & effectiveness of government spending
  - Higher taxes aimed including those more able to afford higher taxes, e-commerce taxes and increased efforts to reduce BEPS
  - Drawing on the entire balance sheet of government and including the SARB in financing plans
- An inclusive and caring approach would
  - increase the availability and quality of infrastructure and services to businesses and households
  - build automatic fiscal stabilisers within the economy

Measures to save current & future generations

- Government has to develop additional measures and institutions to ensure that resources are used productively, efficiently and corruption-free
- Households and businesses more able to afford the expense have to contribute a larger share to the cost of rebuilding
- New and increased taxes have to be considered
  - Wealth, income and capital gains taxes should be part of the solution
  - A principle should be implemented that rentier incomes based on ownership, market power, licenses and mineral rights (and less on real sector production and productive services) should be taxed more
  - Illicit capital flight, tax evasion, avoidance and slippages, including taxing the revenue of e-commerce, that contribute to base erosion and profit shifting must be tackled with more urgency and increased domestic regulation
- The entire balance sheet of government should be considered for resourcing the response during this crisis, including
  - the UIF surplus and the PIC funds, including a payment holiday to GEPF that would release billions to finance government;
- New borrowing will be required and domestic currency debt should be prioritised because of exchange rate uncertainty;
  - Consider borrowing from the SARB, including reallocating much of the ineffective R200bn loan guarantee towards government's health and economic responses

The (continued)centrality of fiscal consolidation in the midst of a pandemic

- The National Treasury's design of the response to the Covid-19 crisis ensured that the basic contours of a fiscal consolidation budget remained intact.
- In other words, the NT designed the new Covid-19 package to have a very limited impact on the budget.
- They chose to ignore available government resources in their response
- Michael Sachs, former Deputy Director General that headed the NT's Budget Office, recently released a paper that called on government to use its entire balance sheet to bail out the economy
- Government's balance sheet is a financial statement that provides a picture of the state's assets and liabilities
- Sachs said the national balance sheet assets include almost R2 trillion in the Public Investment Corporation and Unemployment Insurance Fund
- Sachs proposal included suggestions that:
  - The UIF surplus could be wound down to zero.
  - The Government Employees Pension Fund could have a payment holiday and release R75 billion a year (while the PIC maintains adequate reserves)
  - The National Revenue Fund's cash balance means that the government could finance itself without borrowing on bond markets for about eight months.

What does it mean when a government runs a primary surplus

- A primary surplus means that other than interest payments government expenditure has to be less than its revenue.
- In other words, government takes more money from the private sector than it puts into the private sector.
- What does that mean for the private sector:
  - Government invests less in providing & maintaining infrastructure & essential services
  - Households & businesses spend more to make up for lack of government provision
  - Poor households (particularly in rural areas and townships) have fewer and lower quality services, e.g., many going without water in homes and schools,
  - Women are forced to spend more time doing unpaid labour
  - Government, a very large customer, buys less causing lower levels of production in businesses and the whole economy
  - Businesses end up with higher costs, smaller revenue and lower profits,
  - Businesses do less investment and employ fewer people
  - Unemployed people and discouraged work seekers have even less access to jobs
  - SMMEs and entrepreneurs have less access to markets
- Government borrowing for spending and investment does not ‘crowd out’ private investment but it can ‘crowd in’ private investment.

Domestic savings is not a constraint on investment and government fiscal policy

- Saving is not a constraint on investment it is the outcome of investment
- Savings is the result of income that grows when increased aggregate demand leads to more economic activity, investment and employment
- Government borrowing does not crowd out private sector investors:
  - The borrowing of government is spent into the economy and increases aggregate demand that crowds in other investments
  - Now, with large economic decline and high uncertainty, private investors require more government debt to stabilise their asset portfolios
  - Government borrowing provides a safe financial asset to the private sector that helps them to stabilise their asset portfolios
  - (see additional slides for more information on why saving have been low in South Africa)

South Africa needs automatic fiscal stabilisers not large fiscal buffers

- Talk about fiscal consolidation at this time in this crisis is inappropriate
- We should be considering the development of fiscal resilience by more rapidly investing in automatic stabilisers.
- Automatic stabilisers include government funded national health insurance, wider and deeper welfare nets, including unemployment insurance and pensions
- These automatic stabilisers provide households with money when economic conditions decline when they need it more
- They are more likely to spend that money during the downturn, which provides much needed economic activity
- They are called automatic stabilisers because the money spent contributes towards tax revenues and helps to stabilise government financing during downturns
- It supports spending and taking advantage of large multipliers in the economy to save businesses and jobs.
- Improving automatic stabilisers is generally more effective than monetary measures such as lowering interest rates, debt service holidays and other relief to households and businesses with debt.

Government's economic approach to fiscal policy in the SBR is outdated

- The approach to fiscal policy is based on an outdated, incorrect macroeconomics perspective.
- It is based on an economic view that:
  - Government should not use fiscal policy to stimulate the economy and that it should run surpluses
  - Government borrowing crowds out private investment
  - Government spending cannot improve the economy or reduce unemployment in the medium to long run
- This view is based on the unrealistic assumption that the economy rests at full employment equilibrium
- This view is not held by most mainstream economists today – they support the use of expansionary fiscal policy in downturns
- They recognise that government deficit spending can support
  - Medium and longer term growth of GDP that 'crowds in' investment and creates jobs reducing the debt to GDP level

Jason Furman (2016) says" Today, the tide of expert opinion is shifting the other way from this "Old View," to almost the opposite view…." He adds that this change was in part "… due to a better understanding of economic policy from the experience of the last eight years, including new empirical research on the impact of fiscal policy as well as observations of the reaction of sovereign debt markets to the large increases in debt as a share of GDP in the wake of the global financial crisis."

Thank You

Additional slides

Other Taxation Developments-

Digital Economy and Taxation Update-

- Global and domestic digital economic activities have, and continue to create huge value for potential additional income tax revenue;
- Digital data increasingly valuable economic resource, but to be transformed into digital intelligence for commercialization; Covid19 also contributed to more digitalization of economic activities globally;

OECD Inclusive Framework (IF) – two pillar approach to tax digital economy-

- Continue to reach consensus multilateral tax measures by end of 2020;
- USA officially withdrew from participating in OECD IF, Opposes the digital service taxation for being discriminatory impact. USA dominate digital economy, with as much more than 50 % of value created in digital economy globally;

Unilateral Approaches- Country specific measures-

- More countries continue to pursue the unilateral policy on taxing digital economic activities;
- Mexico, Nigeria, Kenya, Kazakhstan, Phillipines, Turkey, Italy, and others recently (June 2020) updated their, unilateral tax policies to tax income generated in digital economic activities;
- Costa Rica, Thailand, Chille, Mauritius, Indonesia, Mexico updated their VAT related digital economy mechanisms,

Bankruptcies tracker in 2020

Company	Industry	Status
Edcon Holdings	Apparel	Under business rescue
Comair limited	Aviation	Under business rescue
SA Express	Aviation	Under business rescue
Associated Media & Publishing (AMP)	Magazine	Total shutdown
Caxton magazines	Magazine	Withdrawn from publishing
Phumelela Gaming & Leisure	Sports	Under business rescue
Pretoria Society of Advocates	Legal	Expected to dissolve
Time Freight	Logistics	Total shutdown
Prada South Africa	Apparel	Total shutdown
Hertz Corporation	Car rental	Under business rescue

Source: Daily Maverick "Brace for the wave of bankruptcies" 6 May 2020; Business Insider SA "These SA businesses may not have survived lockdown" 3 June 2020.

Retrenchments tracker in 2020

Company	Affected jobs
Edcon Holdings	20 000
SAA	2 400
SA Express	1 000
Comair limited	Unknown
Cell C	960
Telkom	3 000
SABC	600
ArcelorMittal	Unknown
BidAir Services	2 500
Sasol	Unknown
Glencore	Unknown
Medicross/Netcare	926
Samancor	3 037
Dion Wired /Massmart	1 440

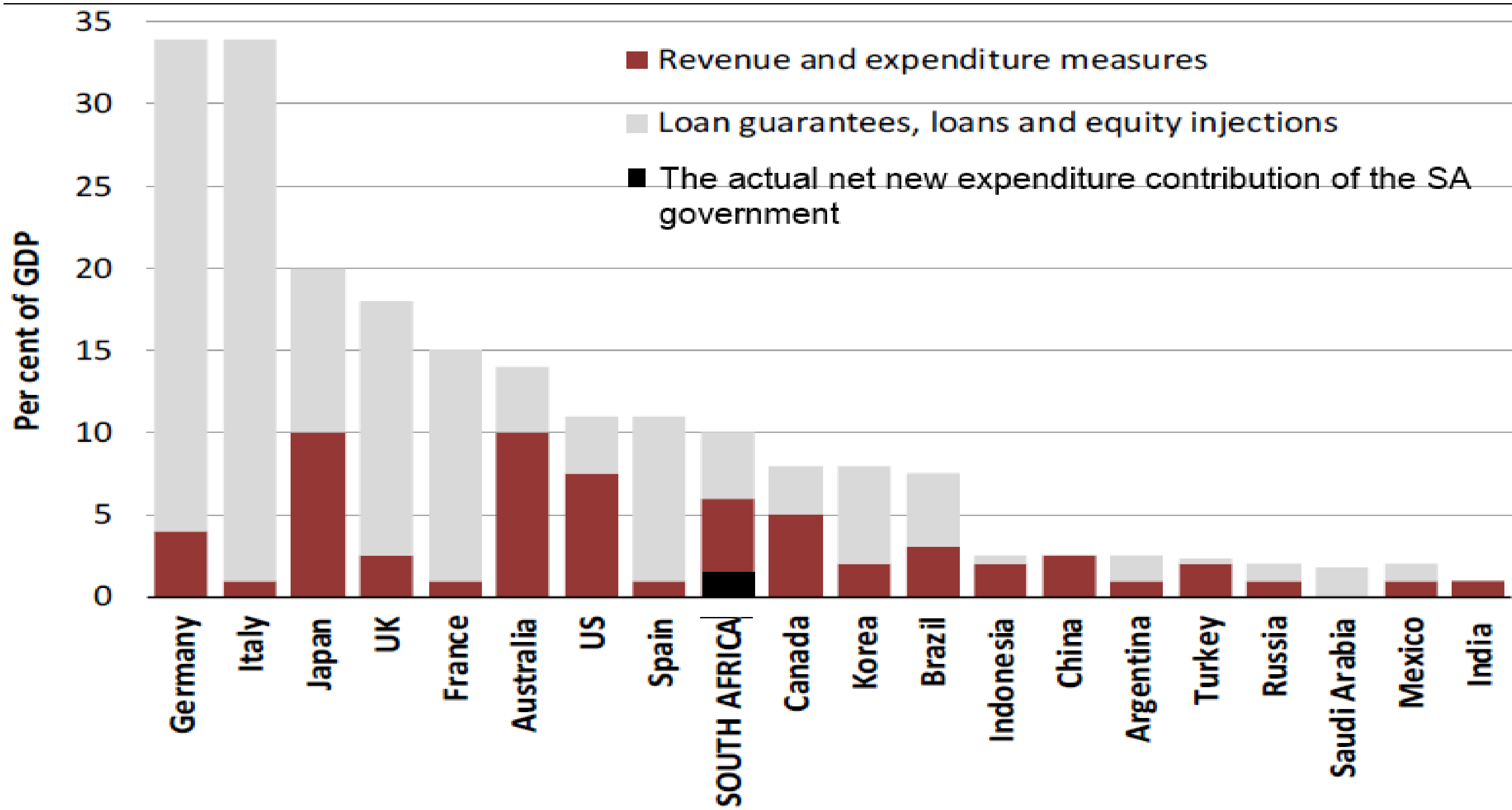
Company	Affected jobs
Sibanye –Stillwater	1 143
Aspen	219
SAB	500
Denel	Unknown
SAFA	Unknown
Democratic Alliance	Unknown
VinPro	18 000
Prasa	Offered voluntary severance packages
Barloworld Logistics	Unknown
Associated Media Publishing (AMP)	67
Avis Budget Rent-a-Car	978
Motus Holdings (Europcar and Tempest)	1 900

Labour Statistics – 1Q 2020

	1Q 2019	4Q 2019	1Q 2020
Labour force ('000s)	22 492	23 146	23 452
Employed	16 291	16 420	16 383
Unemployed - official	6 201	6 726	7 070
Unemployed - broad*	9 995	10 381	10 797
Employed by Gender '000s)			
Male	9 100	9 201	9 149
Female	7 192	7 220	7 234
Employed by Race ('000s)			
Black African	12 201	12 365	12 317
Coloured	1 711	1 680	1 667
Indian/Asian	0 524	0 523	0 535
White	1 855	1 853	1 863
Not economically active ('000s)	15 791	15 581	15 422
Discouraged job-seekers	2 997	2 855	2 918
Other (not econ. active)	12 793	12 726	12 504

	1Q 2019	4Q 2019	1Q 2020
Unemployment Rates			
Official unemployment rate (narrow)	27,6%	29,1%	30,1%
Broad unemployment rate*	38,0%	38,7%	39,7%
Male - official	25,1%	27,2%	28,3%
Female - official	29,3%	31,3%	32,4%
Black African - official	31,1%	32,4%	33,8%
Coloured - official	22,2%	24,9%	24,0%
Indian/Asian - official	11,4%	13,9%	13,0%
White - official	6,6%	7,6%	8,1%
Youth**			
Unemployed - official	3 933	4 238	4 474
Unemployed - broad	6 369	6 557	6 857
Unemployment rate - official	39,6%	41,5%	43,2%
Unemployment rate - broad*	51,5%	52,4%	53,8%
Data: Quarterly Labour Force Survey, Stats SA			

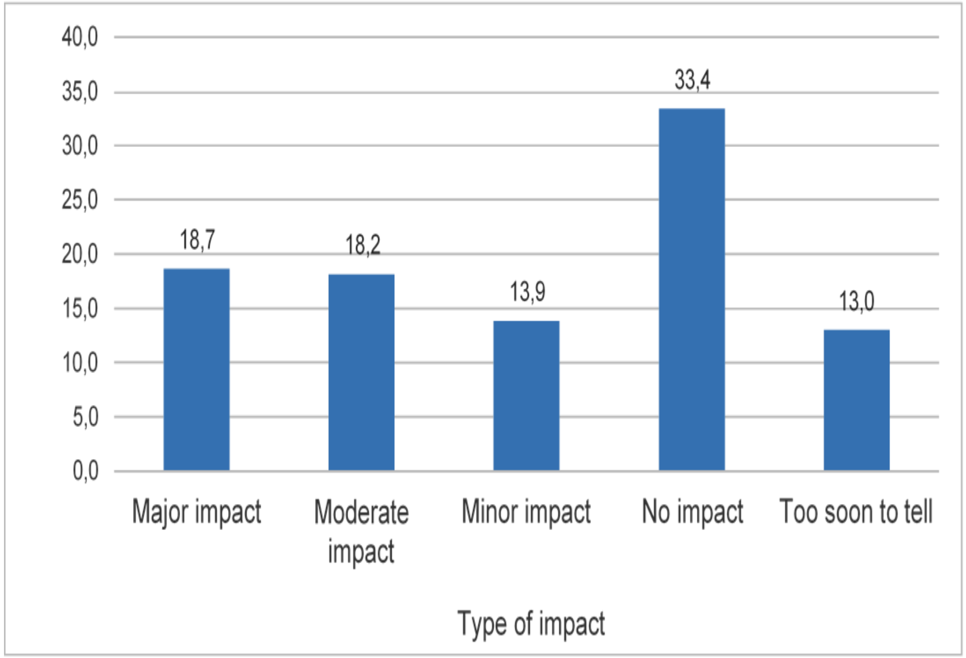
Comparison of economic support announced by G20 governments



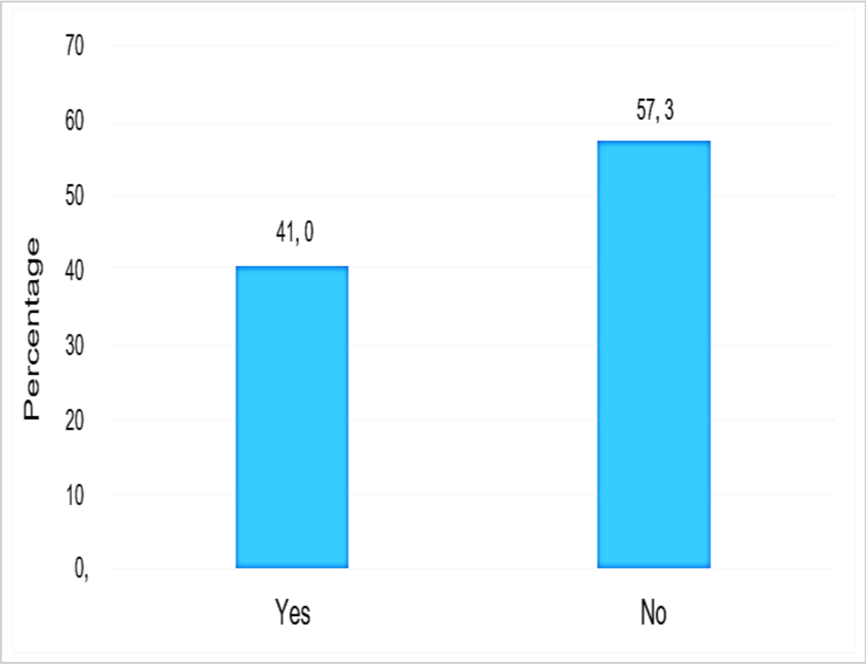
Source: PBO adaptation of chart of National Treasury in presentation of SBR to joint Fiscal and Appropriations Committee meeting of 25 June 2020

Impact of Covid-19 on the indebtedness of South African Households

Percentage of respondents who believe COVID-19 and the national lockdown will have an impact on their ability to cover their financial obligations by the type of impact*



Percentage of respondents on whether or not they had to incur new debt to cover their expenses*



Source: StatsSA, *"Results from Wave 2 survey on the impact of the COVID-19 pandemic on employment and income in South Africa"*, 2020.

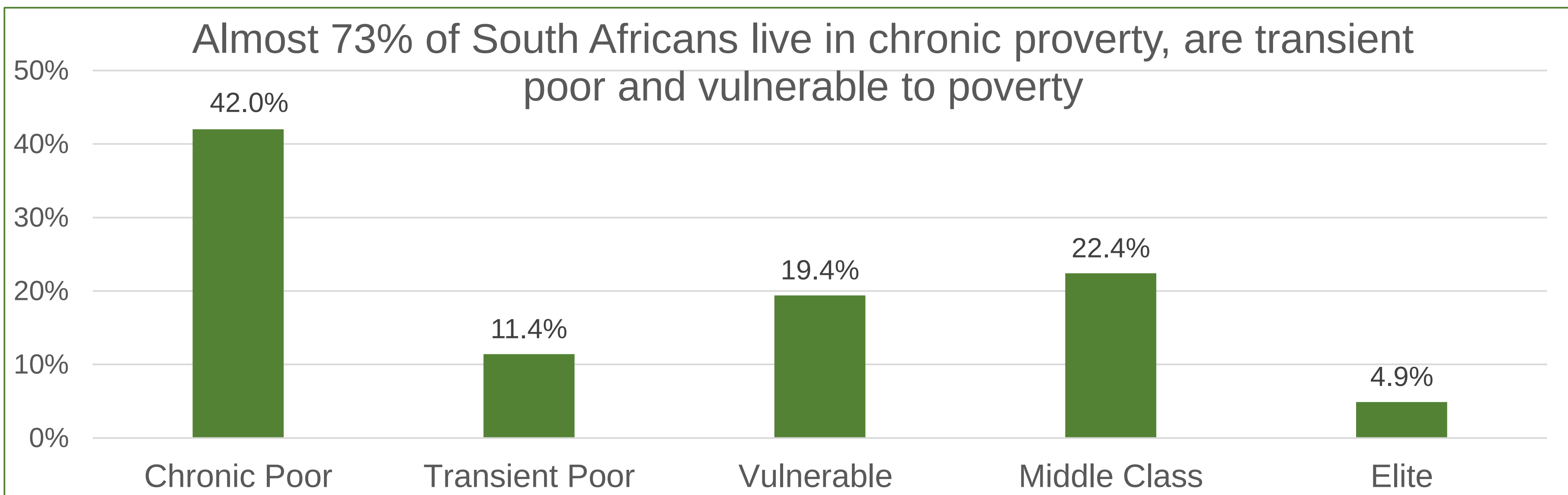
*** The national lockdown in the graphs refers to its first 6 weeks, beginning on the 26th of March 2020- to the 6th of May 2020.**

The effectiveness of the Relief of Distress and Child Grant in the pandemic

- The Social Relief of Distress Grant had 2 unfortunate consequences
  - The first is that the complexities of applying for the grant and Sassa's stringent checks meant that by the third week of May (two months into lockdown), only 10 applicants had received the grant.
  - Second, to avoid "double dipping", applicants cannot receive the grant if they are getting any other governmental support.
  - Applicants, therefore, risk swapping a R700 food parcel for a R350 grant, which most have not yet received.
- According to the NGO Pietermaritzburg Economic Justice & Dignity (PMBEJD), the increase in food costs cancelled out the top-up:
  - "From 2 March 2020 to 23 April 2020, the cost of the household food basket increased by R252.75 (7.8%)".
  - These costs included a 12% increase in rice, 8% in sugar beans, and a 9% in cooking oil. Staples like onions and cabbages also increased,
- Cost pressure is likely to grow for families receiving the child support grant
  - The Child support Grant is lower than the food poverty line
  - only 81% of children under six, and 64% of eligible infants under one receive the grant, meaning that it's failing to reach many vulnerable children.

So why was saving low South Africa

- A large proportion of households live in poverty and are vulnerable to poverty, therefore, their savings levels are low
- Much of the savings of households that are able to save is with institutional investors
- A large proportion of these savings is diverted towards trade in financial assets and management of portfolios consisting of financial assets
- Many corporations use profits and even borrow to pay high dividends and increase share price by share buybacks and not to reinvest
- Corporate behaviour to increase short-term returns and BEPS is a problem



Source: Zizzamia, Schotte and Leibbrandt (2019) based on National Income Dynamics Studies data

So why was saving low South Africa

- Much finance has moved out of South Africa legally and illegally
- Most foreign capital inflows into South Africa have not been long-term FDI but short-term (also referred to as 'hot money')
- Relatively large short-term capital inflows create an imbalance in the economy because they increase liquidity and debt, which is not accompanied by long-term fixed investments ('maturity mismatch').
- This footloose capital searches for high short-term returns, much of which is not reinvested in South Africa but is repatriated out of the country.
- South Africa's current account deficit is largely made up of the financial transfers of profits and dividends out of the country.
- These footloose financial flows cause local investors to become footloose too & to pursue short-term high returns rather than long-term investments.
- In addition to capital flight, the misallocation of capital from long-term productive fixed investment towards short-term financial transactions and debt-driven consumption are amongst the **most important reasons not only for the low rate of savings** in South Africa but also the **poor performance of the economy in terms of investment and employment** creation.

So why was saving low South Africa

10-Year averages for 2010 to 2019 show:

- Net FDI flows averaged zero while short-term foreign capital flows ('hot money') were relatively large
- Financial transfers not the trade balance caused negative current account balance