RESPONSE TO PUBLIC HEARINGS ON THE 2020 MTBPS

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

List of organisations that made submissions for public hearings on the 2020 MTBPS

- Amandla.Mobi
- Budget Justice Coalition
- Congress of South African Trade Unions (COSATU)
- Dear South Africa Campaign
- Financial and Fiscal Commission (FFC)
- Fiscal Cliff Study Group
- Healthy Living Alliance (HEALA)
- Katsia Capital Partner
- Old Mutual Investment (Johann Els)
- Organisation Undoing Tax Abuse (OUTA)
- Parliamentary Budget Office
- Pay the grant campaign
- Peter Meakin
- The South African Institute of Chartered Accountants (SAICA)

Main comments from public hearings

1. **Economic growth and reforms:** Credibility of macroeconomic and fiscal projections, the need for implementation of the reconstruction and recovery plan; the role of government infrastructure investment plans in boosting aggregate demand.

2. **Revenue and tax proposals:** Raise taxes from wealthy and high-income individuals and large profitable companies; impose land tax instead of income taxes; an increase in health promotion levy; capacitate SARS to deal with tax and customs evasion.

3. **Expenditure:** The implications of spending cuts on service delivery especially in 2021/22; how provinces and municipalities will absorb the spending cuts, intensify efforts to carry out expenditure reviews; zero-based budgeting approach implementation and alternatives; approaches for wage bill reductions; proposals for achieving savings.

4. **Fiscal policy:** Mixed views on fiscal policy stance (austerity/stimulus); comments around the size of fiscal consolidation; the likely impact of fiscal consolidation on the economy; establishment of a committee which focuses on inclusive fiscal policy.

5. **Other matters raised:** concerns around SOCs continuing to be a drain on the fiscus; R10.5bn proposed further allocation to SAA; unresolved challenges faced by municipalities; municipal debt to Eskom and water boards.

Economic growth forecast compared with other institutions

Institution	Last update	2020	2021	2022
National Treasury	**MTBPS 2020**	**-7.8**	**3.3**	**1.7**
IMF	October 2020	-8.0	3.0	-
SARB	September 2020	-8.2	3.9	2.6
BER	October 2020	-8.3	3.4	1.8
Reuters - average	October 2020	-8.5	3.4	2.0
Reuters - median	October 2020	-8.5	3.5	1.9
Bloomberg*	October 2020	-8.5	3.4	2.0
World Bank	June 2020	-7.1	2.9	-

**Bloomberg weighted average*

Source: NT, IMF, WB, SARB, BER, Reuters, Bloomberg

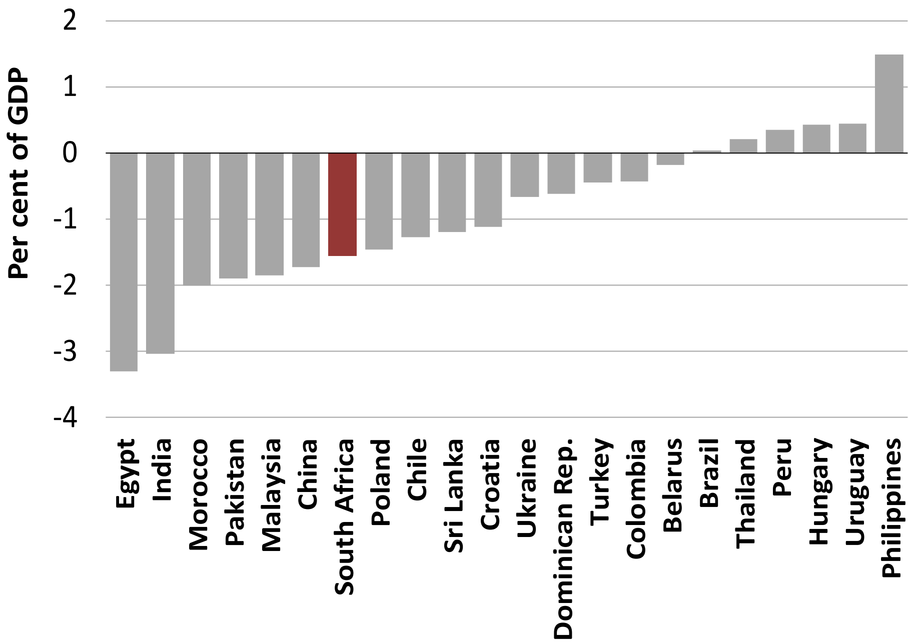
Revenue and tax proposals

2020
MTBPS
Medium Term
Budget Policy Statement

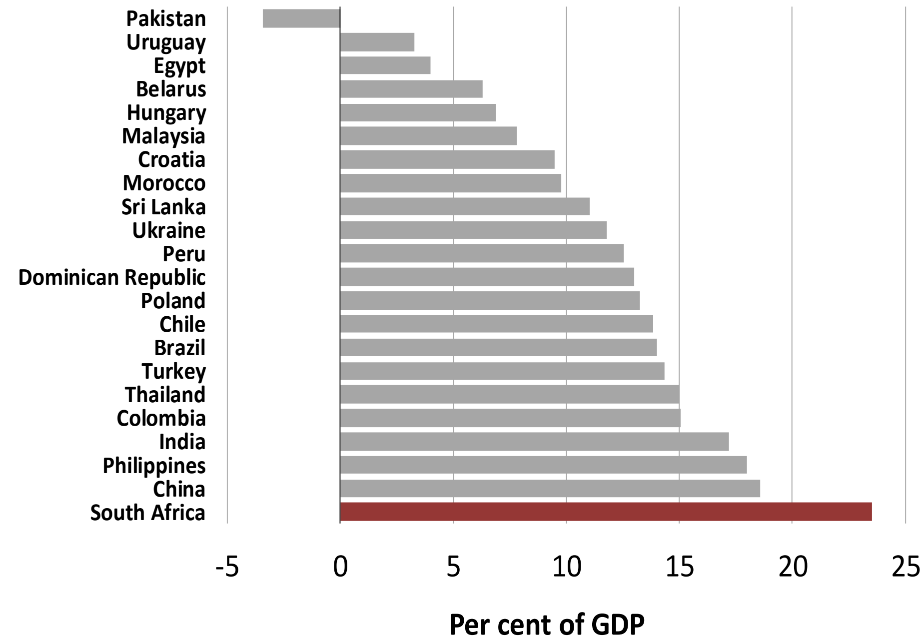
- **National Treasury has noted that there were a number of tax proposals raised in the public hearings, including:**
  - An increase in the health promotion levy rate and an expansion of the tax base to include fruit juices
  - Increasing tax revenue through higher taxes on high net worth individuals, including through a progressive net wealth tax, the limitation of deductions (such as for retirement fund contributions) and increasing capital gains taxes rates and security transfer taxes
  - The lowering of taxes at the top end of the income distribution to encourage wealthy individuals to stay in South Africa and continue to contribute tax and expand their businesses to create jobs
  - The replacement of income taxes with a land tax
- The MTBPS does not usually include tax proposals, however it did restate that government is planning on increasing taxes in the 2021 Budget to raise an additional R5 billion in revenue for 2020/21, and continues to project an additional R10 billion in revenue 2021/22, R10 billion in 2022/23 and R15 billion in 2023/24 from tax measures.
- The proposals will all be considered when determining the mechanisms to raise revenue over the next four years

South Africa in global context

Average primary balance, 2009 – 2019



Projected three-year increase in debt



Source: IMF Fiscal Monitor, October 2020

- In comparison with a wide range of other developing countries, South Africa's average primary balance over the last 10 years falls in the middle of the distribution.
- But South Africa's three-year increase in debt to GDP is the among the largest.
- Fiscal distress is mounting in developing countries amid historically high indebtedness. In this environment of rising fiscal pressures, South Africa is losing ground to its peers.

Why fiscal consolidation - fiscal metrics are deteriorating

Over the past five years, the fiscal environment has been characterised by:

- Interest payments absorbing a growing share of limited public resources, which increasingly crowds out spending on social and economic investment. Debt-service costs are now 4.8 per cent of GDP, up from 3.3 per cent in 2016/17.
- A sharp drop in public infrastructure investment, mostly driven by declines in spending by state-owned companies. Between 2016/17 and 2019/20, total public infrastructure spending fell from R250 billion to R183 billion, or from 5.7 to 4 per cent of GDP.
- A deteriorating government balance sheet, including state-owned companies and municipalities struggling to pay salaries and other operational costs.

Options to stabilise the fiscus are becoming increasingly limited. Growth reforms are only expected to begin yielding results over the next several years, implying continued weakness in revenue collection over the period ahead.

Why fiscal consolidation- fiscal multipliers

- Recent research in South Africa concluded that spending multipliers are positive, albeit generally smaller than 1. The Reserve Bank estimates that the fiscal multiplier declined from 1.6 to less than zero between 2009 and 2019, as South Africa approached its fiscal limits.
- In general, infrastructure investment multipliers tend to exceed consumption spending multipliers. The literature shows large negative multipliers from revenue increases, suggesting that South Africa's growth slowdown over the past five years may be related to rising taxes.
- The National Treasury's view is that the potential growth rate is low, the country is reaching its fiscal limits, and the fiscal multiplier is low (or possibly negative).
- This implies that a large fiscal consolidation to narrow the budget deficit and stabilise debt – complemented by implementation of structural reforms – is more likely to support economic growth than continued spending funded by higher borrowing and taxation.

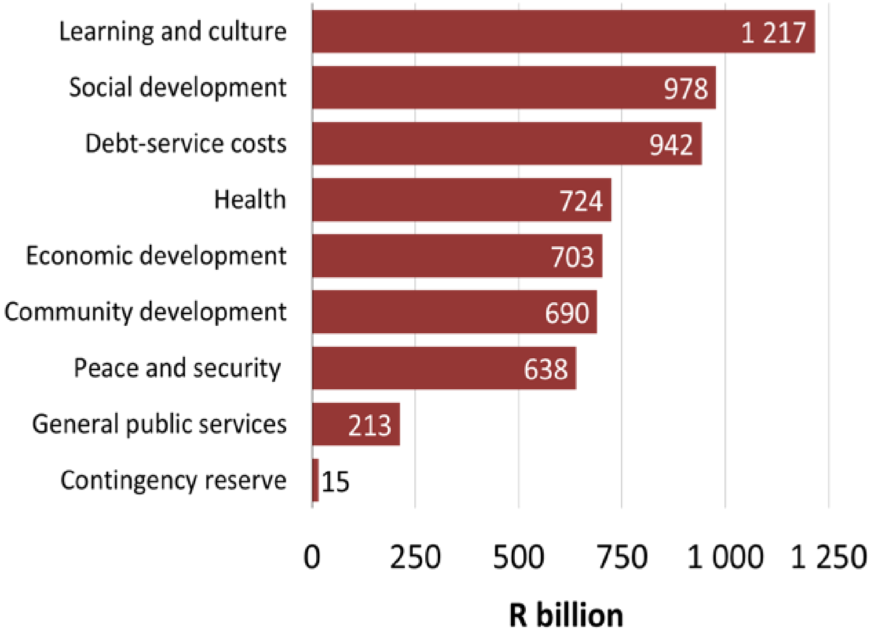
The implications of proposed spending cuts

- The persistent gap between spending and government revenue requires difficult decisions about the structure, effectiveness and affordability of certain programmes.
- To ensure sustainability, high-level policy discussions are needed on:
  - The approaches to providing financial support to students in post-school education.
  - The subsidy mix for urban transport systems.
  - The structure of the human settlements delivery programme.
  - The number and size of departments, ministries and public entities in national and provincial governments.
  - Management of the functions assigned to the three spheres of government.
  - Measures to strengthen the social protection system for the most vulnerable.
  - Containing the public-service wage bill.

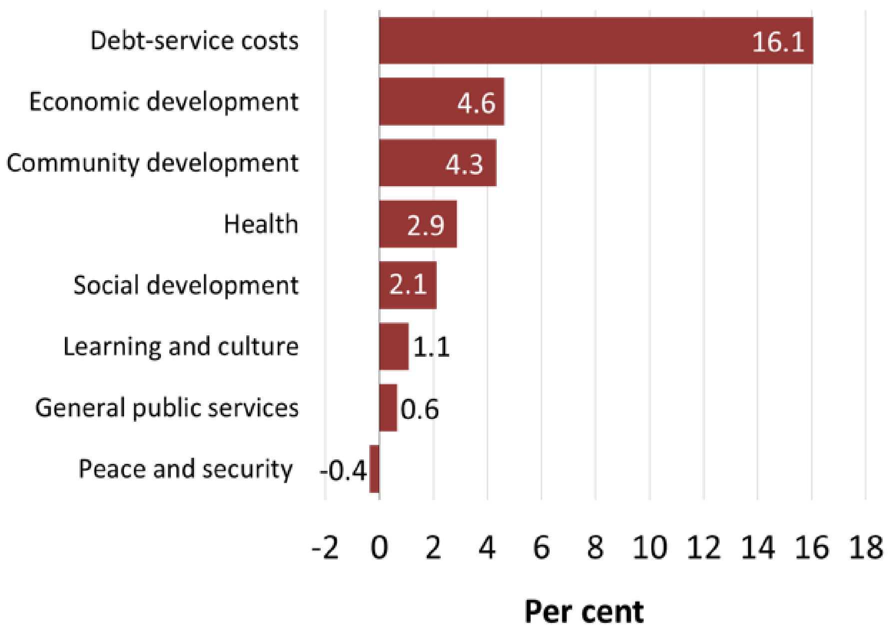
Expenditure priorities and fastest-growing functions

2020 MTBPS
Medium Term Budget Policy Statement

Consolidated government expenditure by function, 2021/22 – 2023/24



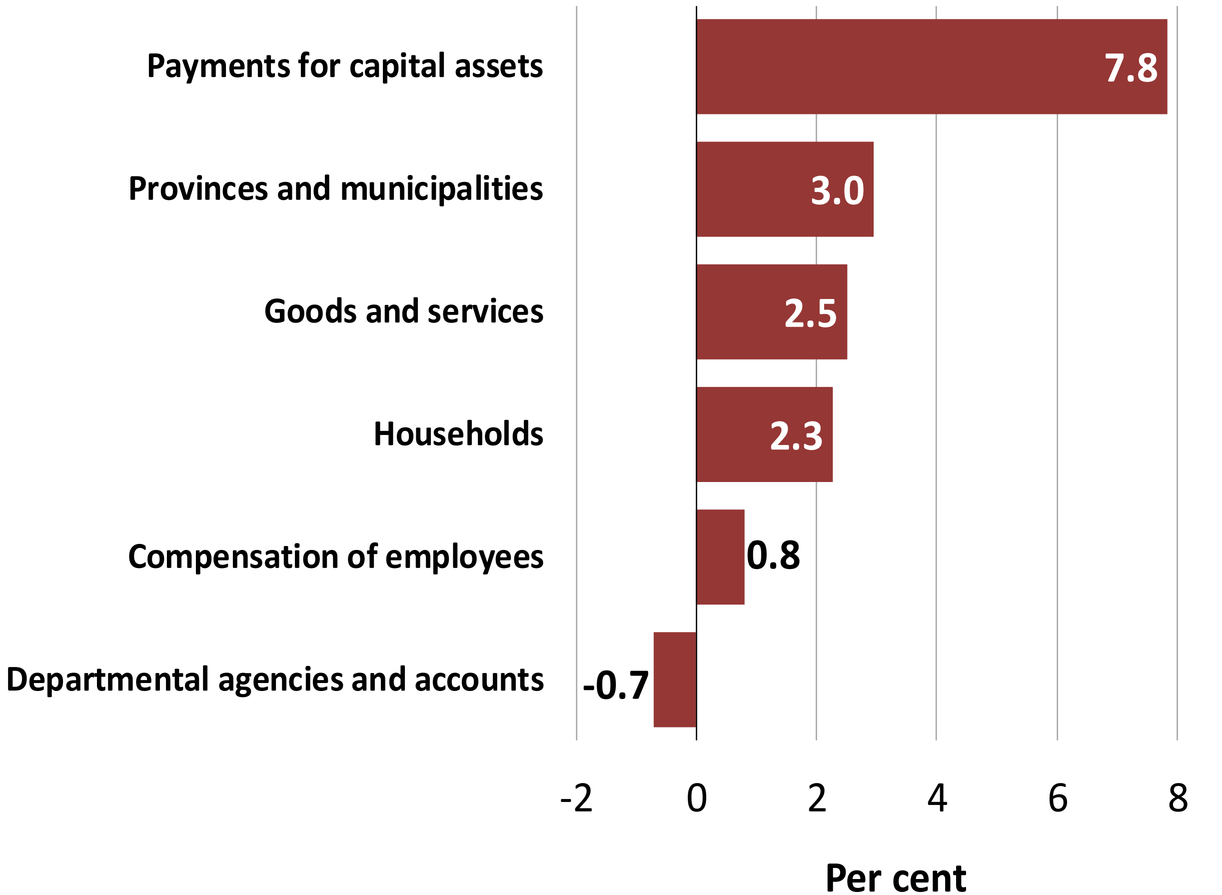
Average nominal growth in consolidated spending, 2020/21 – 2023/24



- Over the medium term, the learning and culture function continues to receive the largest allocation of funds, mainly for basic and post-school education and training
- The ‘social wage’ (defined as spending on learning and culture, health, social development, community development) accounts for about two-thirds of total non-interest consolidated expenditure

The proposed spending reductions will improve the composition of spending from consumption towards investment

Average nominal consolidated spending growth, 2020/21 – 2023/24*



**Excludes COVID-19 fiscal relief measures in 2020/21*

Government should intensify efforts to carry out expenditure reviews aimed at increasing efficiency of spending and combating waste

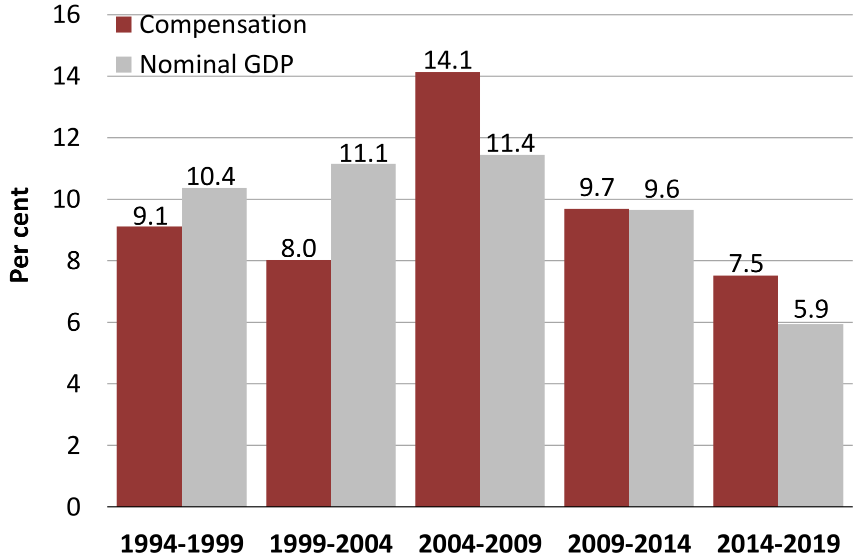
- Since June 2020, the National Treasury has been reviewing government spending to improve efficiency. More than 30 spending reviews across all functions have been conducted.
- The reviews make use of large data systems to understand service-delivery outcomes, and how these might change under different scenarios. Preliminary findings indicate that:
  - Many policies are designed and adopted without considering their total costs and affordability.
  - Multiple institutions share overlapping responsibilities or mandates, leading to duplication of work.
  - In several high-spending procurement areas, including information and communications technology, and infrastructure, it appears that government is overpaying for goods and services.
  - The spending reviews will be used to inform the zero-based budgeting approach that government will use to review baseline allocations in the 2022 MTEF period.

Efforts to improve the quality of expenditure

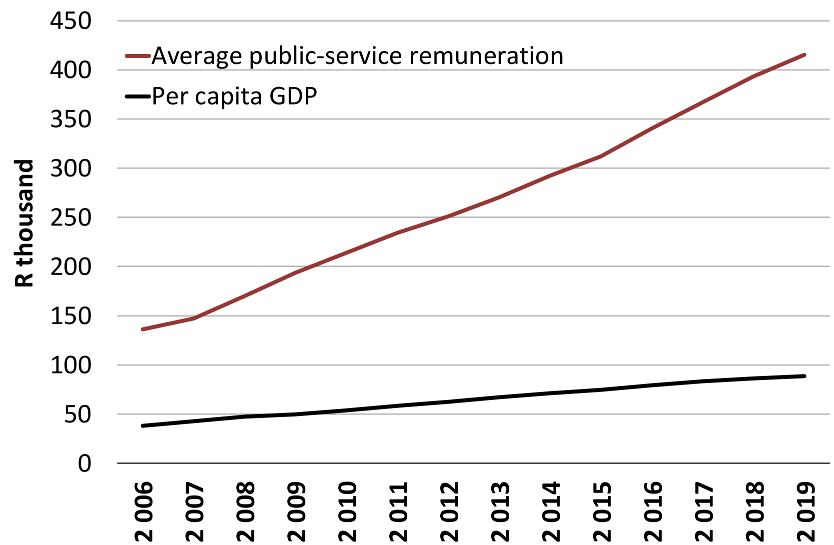
- Over-emphasis on incremental changes to annual budgets – and rising allocations – without adequate analysis of programme effectiveness.
- To address this problem, some reforms to the budgeting process are necessary, and government proposes to implement the principles of zero-based budgeting supported by comprehensive expenditure reviews that are under way – to analyse and justify departmental spending.
- These initiatives will help to streamline bureaucracy, eliminate programmes that no longer add value and reform those in need of improvement.
- Government is committed to finalising the Public Procurement Bill during 2021/22 following the end of the public comments phase, and reviewing the full range of national, provincial and municipal provisions.
- Significant procurement reforms will be supported by greater use of automation and technology. This will include the provision of real-time information regarding tax compliance, and the profile and historical performance of prospective service providers.
- Concurrent reviews of regulations governing public-private partnerships will promote greater efficiency and encourage private-sector participation.

Wage bill trends

Compensation and nominal GDP growth

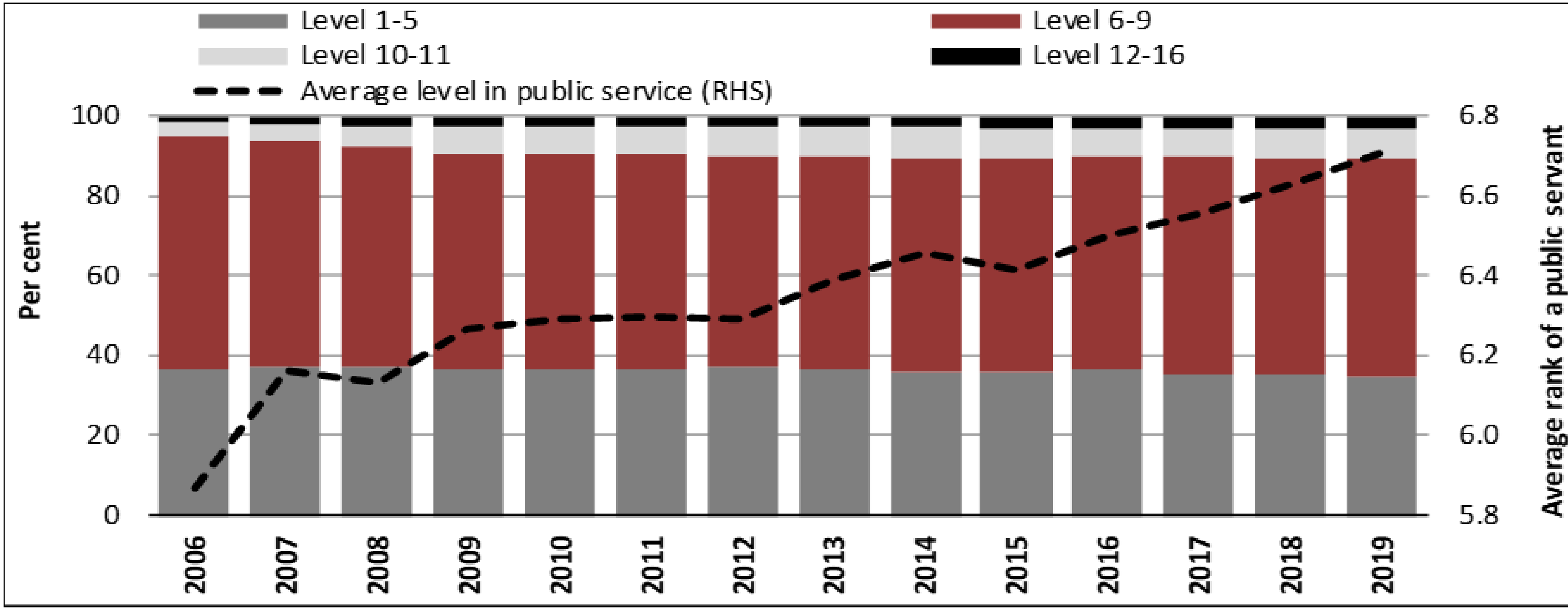


Public-service remuneration and per capita GDP



- Until the mid-2000s, public-service compensation spending grew more slowly than nominal GDP. Since 2004, however, this relationship has reversed, and the ratio of compensation spending to GDP has increased to about 11%.
- Since 2006/07, average public-service remuneration has increased at a faster pace than per capita GDP, and is now 4.7 times larger partly the result of slow economic growth and high levels of unemployment.
- Remuneration for employees of national and provincial governments tends to be higher than that of private-sector workers. More than 95 per cent of public servants earn more than the bottom 50 per cent of registered taxpayers.
- Statistics South Africa survey data also suggests that public-sector compensation growth has outpaced private-sector compensation growth over the past decade, as discussed in the 2019 MTBPS.

Distribution of public servants by rank



- An increase in personnel numbers over the period, from 1.15 million to 1.33 million, accounts for the remainder of the increase.
- The majority of civil servants fall in levels 6 to 9

Achieving wage bill reductions

- Government proposes growth in the public-service wage bill of 1.8 per cent in the current year and average annual growth of 0.8 per cent over the 2021 MTEF period.
- Government has not implemented the third year of the 2018 wage agreement. Notwithstanding that the matter is before the labour court, government is actively engaging with labour unions to find a solution to a more sustainable cost of employment.
- Furthermore, the Budget Guidelines propose a wage freeze for the next three years.
- Additional options to be explored include harmonising the allowances and benefits available to public servants, reconsidering pay progression rules and reviewing occupation-specific dispensations.