



BUDGET 2021

RESPONSE TO PUBLIC HEARINGS ON THE 2021 FISCAL FRAMEWORK AND REVENUE PROPOSALS



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

**STAY
SAFE**

PROTECT SOUTH AFRICA

LIST OF ORGANISATIONS THAT MADE SUBMISSIONS

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- Amandla.Mobi
- Budget Justice Coalition
- Congress of South African Trade Unions (COSATU)
- Financial and Fiscal Commission (FFC)
- Fiscal Cliff Study Group
- Healthy Living Alliance (HEALA)
- National Council Against Smoking
- Organisation Undoing Tax Abuse (OUTA)
- Parliamentary Budget Office
- PriceWaterhouseCoopers
- Research Unit on the Economics of Excisable Products
- 1 Road Consulting
- South African Institute of Chartered Accountants (SAICA)
- South African Institute of Tax Practitioners

MAIN COMMENTS FROM PUBLIC HEARINGS

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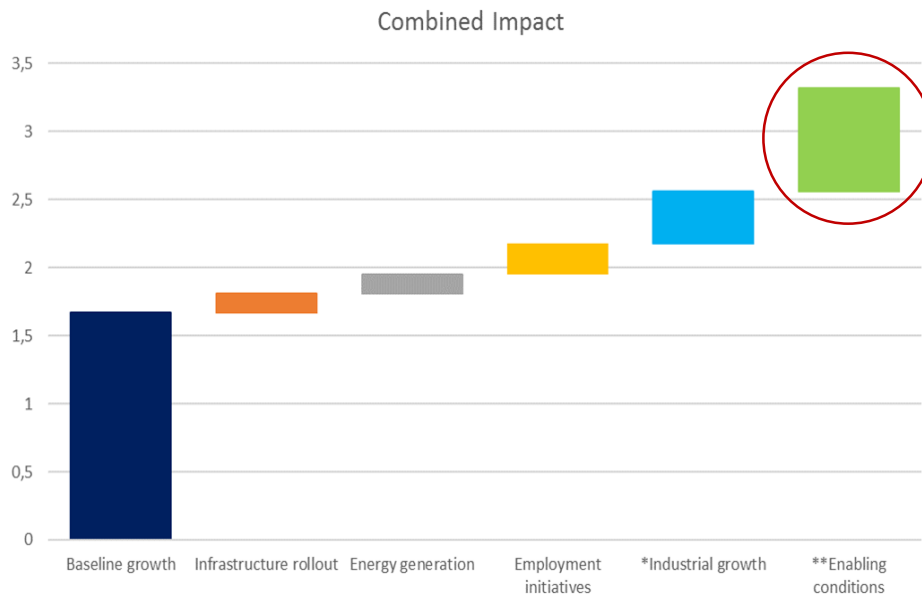
- 1. Economic growth and reforms:** budget is disproportionately focused on structural reforms to unlock private sector investment; investment projections are very likely to be overestimated; the role of government infrastructure investment in supporting economic growth.
- 2. Revenue and tax proposals:** contrasting views on tax increases for wealthy and high-income individuals and companies as well as excise duties; an increase in health promotion levy; capacitate SARS to deal with tax and customs evasion; illicit trade in tobacco products; SARS governance and structure; international comparison of South Africa's income tax rates.
- 3. Expenditure:** projected trends for non-interest spending by function and economic classification over the MTEF; whether the budget is underfunding social spending; how national and provincial departments and municipalities will absorb the spending cuts and what might be foregone in terms of service delivery; approaches for wage bill reductions; infrastructure areas of priority.
- 4. Fiscal policy:** mixed views on fiscal policy stance; whether the budget supports economic growth over the MTEF; proposal for a fiscal rule
- 5. Other matters raised:** concerns around SOCs continuing to be a drain on the fiscus; unresolved challenges faced by municipalities; need to implement Auditor General's recommendations to deal with corruption and maladministration; urgent finalisation of the Public Procurement Bill; recommendations for procurement practices

STRUCTURAL REFORMS WILL RAISE GROWTH AND CREATE JOBS

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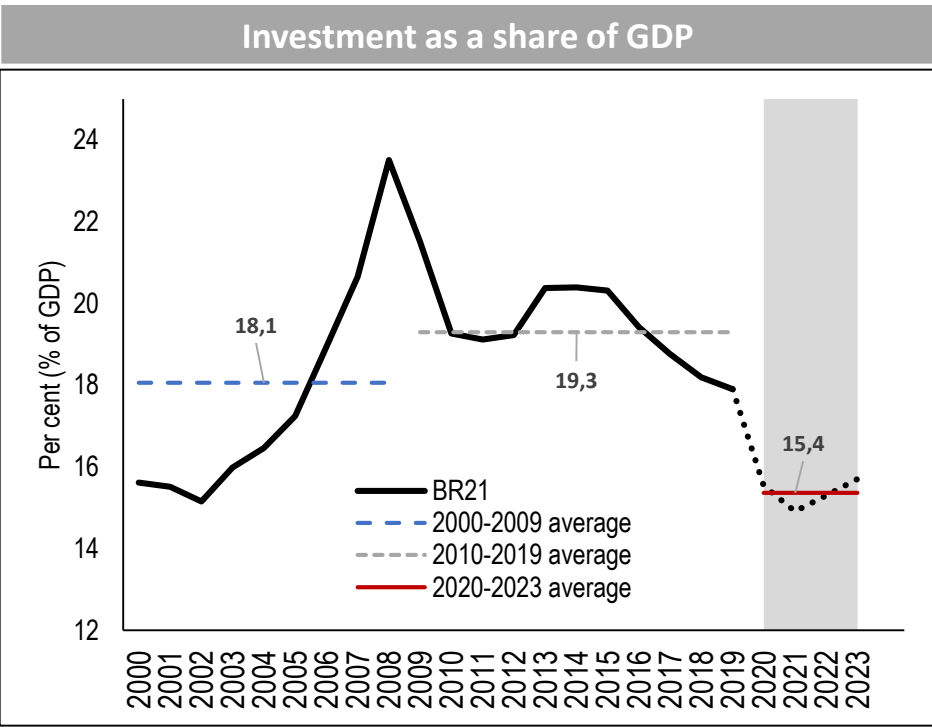
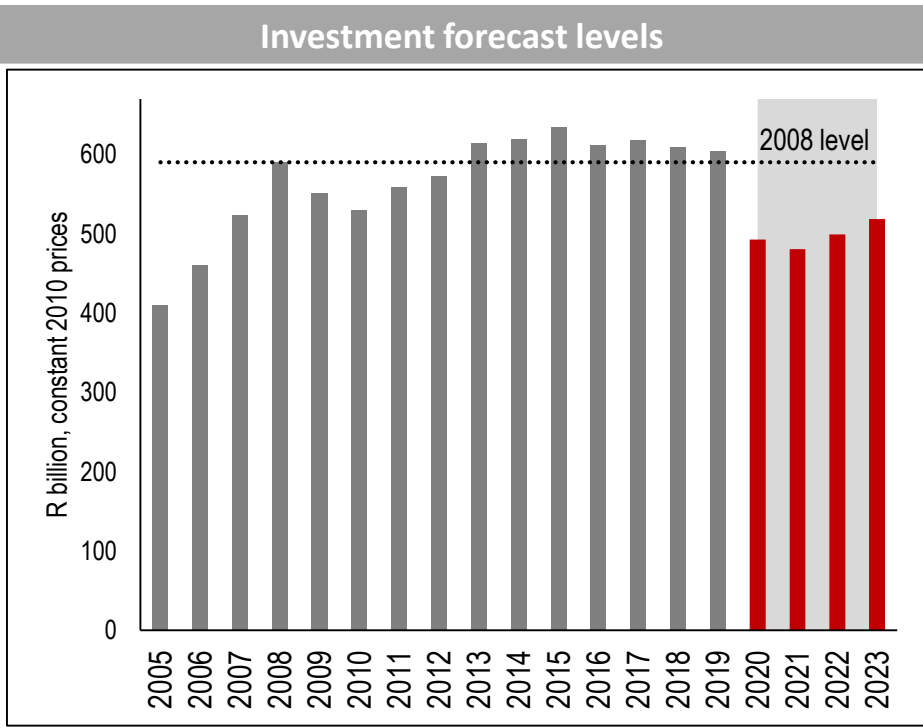


- Our structural weaknesses (i.e. **unreliable electricity supply**, high levels of concentration, excessive red tape, high cost of doing business) limit the rate at which the economy can grow and create jobs.
- The biggest impact on growth comes from resolving these structural constraints to growth by creating an environment in which private sector activity can flourish.



- “The state provides the institutions and infrastructure that enable the economy and society to operate” – National Development Plan
- Our structural reform agenda as articulated in the Economic Reconstruction and Recovery Plan is aimed at removing the brakes on growth.
- Operation Vulindlela** has been put in place to support Cabinet to accelerate the implementation of **high-impact structural reforms** which are required to achieve higher levels of economic growth.
- For example, the CSIR estimates that there is about 3 400 MW of electricity capacity that could be deployed by the end of 2022 if the appropriate regulatory regime were in place to support embedded (self) generation.

UNLOCKING PRIVATE SECTOR INVESTMENT IS CRITICAL FOR ECONOMIC RECOVERY



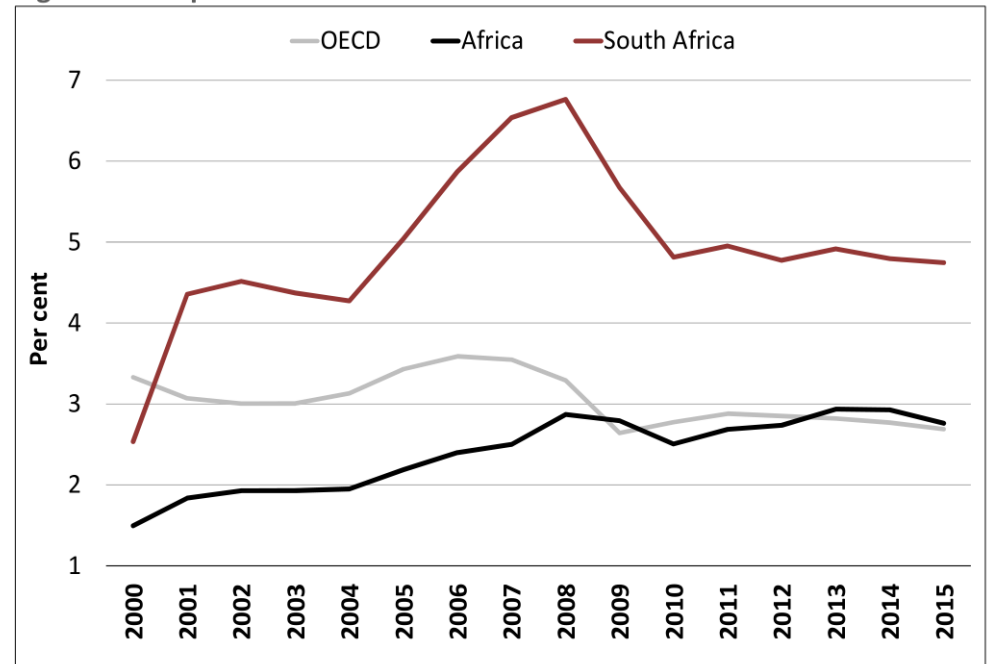
Source: Stats SA, National Treasury

- The **private sector (70% of GFCF) is the lead contributor to investment**
- The positive effects of fiscal consolidation and the easing of electricity supply constraints can support a recovery in private investment.
- **Shifting the composition of government spending** from consumption to investment will support economic recovery and raise our potential growth.

THE REDUCTION IN THE CORPORATE INCOME TAX (CIT) RATE

- Comments received stated that the current rate is close to our peer countries, there is a lack of evidence to suggest that a CIT rate cut will assist investment, and that the effective tax rate is already much lower at around 9 per cent.
- The Budget Review acknowledges that the CIT rate is not out of line with other African countries, however it also states that the contribution of CIT to GDP in those countries is substantially lower due to tax holidays, tax exemptions, and investment allowances in those countries.
- Tax holidays reduce the tax base and create distortions between sectors, which is inequitable and negative for economic growth

Figure 4.3 Corporate income tax as a share of GDP*



*Average corporate income tax to GDP ratios for OECD and 16 African countries (Cape Verde, Cameroon, Democratic Republic of the Congo, Ivory Coast, Ghana, Kenya, Mauritius, Morocco, Niger, Rwanda, Senegal, South Africa, Swaziland, Togo, Tunisia and Uganda)

Source: OECD

THE IMPACT OF LOWERING CIT ON ECONOMIC GROWTH

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- Multiple previous Budgets have highlighted that government would like to broaden the base and potentially lower tax rates.
- To facilitate economic growth, tax system need to be as efficient as possible by minimizing distortions and obstacles to investment, innovation and employment
- OECD (2010) states that **“corporate income taxes are the most harmful type of tax for economic growth, followed by personal income taxes and then consumption taxes, with recurrent taxes on immovable property being the least harmful”**
- Davis Tax Committee (2015) stated that **“the impact of a VAT increase on [GDP and employment] would be less severe than that of a rise in PIT or CIT”**
- Further research that indicates that lower corporate income taxes would be a boost for growth done by Lee, Y., & Gordon, R. H. (2005), Acosta-Ormaechea, S., Sola, S., & Yoo, J. (2012) and Myles, G. D. (2009).
- A growth-orientated strategy would be to reduce reliance on corporate income taxes and personal income taxes and increase reliance on consumption taxes and taxes on immovable property, while removing incentives

EFFECTIVE TAX RATES FOR CIT

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- References to the 9 per cent effective tax rate for CIT may be drawing on the OECD (https://stats.oecd.org/Index.aspx?DataSetCode=CTS_ETR).
- For South Africa the “composite effective average tax rate” is 27.1 per cent, while the “composite effective marginal tax rate” is 9.8 per cent.
- The first measure reflects the average tax contribution from an investment, while the second measure shows “the extent to which taxation increases the pre-tax rate of return required by investors to break even.”
- The second measure (METR) does not reflect the contribution from CIT, but relates to the investment return and is dependent on which sector you are referring to, which asset is being purchased and whether the investor is financing their investment with debt or equity, amongst other assumptions.
- For example, World Bank calculated an METR of 10.6 per cent for the forestry and fishing sector in South Africa. This does not mean that a forestry company only pays SARS 10.6% of its profits. The 10.6% METR is effectively the tax component of the user’s cost of capital.
- A lower METR is good as it encourages expansionary investments, but the AETR is a better measure of how much revenue will be generated – so higher is better.

INCREASING TAXES ON THOSE WITH HIGH INCOMES

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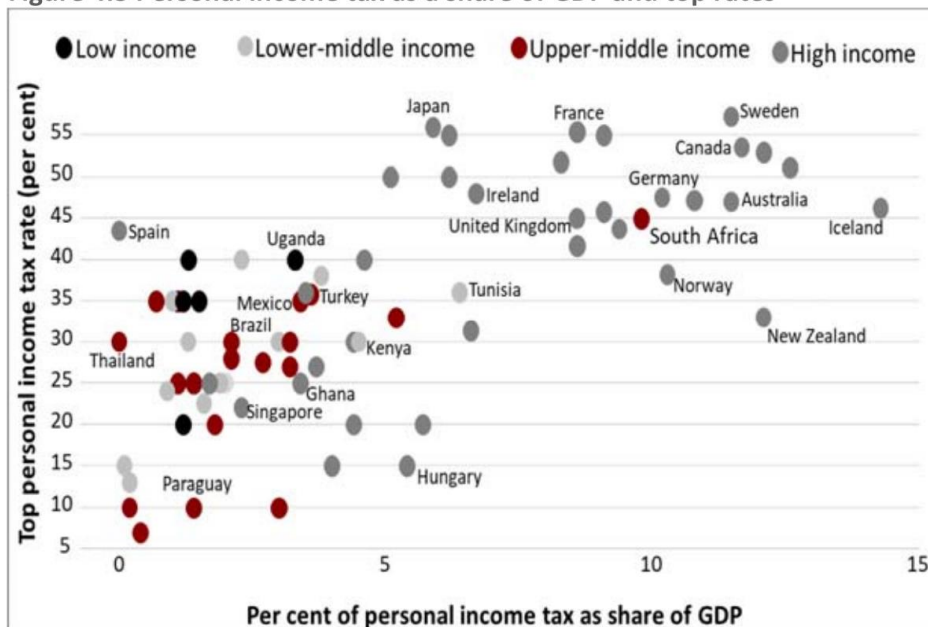


- Comments stated that taxes on the rich should be increased to provide funding for further social expenditure.
- Over the past six years government has introduced numerous measures to increase the tax paid by those with large incomes and the wealthy. These measures include:
 - A 1 p.p. increase in all the personal income tax brackets except the bottom bracket (2015/16) and a new top tax rate of 45 per cent above R1.5 million (2017/18)
 - An increase in the dividends tax rate from 15 per cent to 20 per cent (2017/18)
 - An increase in the capital gains tax inclusion rate from 33 per cent to 40 per cent for individuals and from 66 per cent to 80 per cent for companies (2016/17)
 - A higher tax rate for estate duty of 25 per cent for estates above R30 million (2018/19)
 - An increase in the ad-valorem tax on luxury goods from 7 per cent to 9 per cent (2018/19)
 - A new transfer duty rate of 11 per cent for properties above R2.25m (2015/16) and another new transfer duty rate of 13 per cent for properties above R10m (2016/17)
- The Budget does not extend the venture capital company incentive, which provided tax deductions worth R745 million to high net worth individuals in 2018/19

FISCUS IS BECOMING HEAVILY RELIANT ON PERSONAL TAX

- Personal income tax as a share of GDP has increased from 8 per cent in 2009/10 to over 10 per cent in 2019/20.
- This is mostly due to tax policy measures to increase the personal income tax collections. Our personal income tax system is highly progressive and has tax rates and contributions that are comparable to high income countries.

Figure 4.3 Personal income tax as a share of GDP and top rates



Source: OECD, IMF

- The 2021 Budget provided a small amount of tax relief, that mostly went to lower and middle income individuals, to assist households through the pandemic and to allow for a stronger economic recovery

INCREASES IN EXCISE DUTIES

Comments stated that excise duty increases on alcohol and tobacco should be delayed until after the reviews are complete, while other comments welcomed the increase.

- In assessing the potential changes, National Treasury considered the impact on revenue, behavioural change, illicit trade and the potential social and economic harm from consumption of these products. Annual excise tax adjustment is calculated on the projected retail prices for the next fiscal year, or expected consumer inflation, whichever is the highest. It is also often based on the trade-offs within a fiscal framework, as is the case this financial year.
- National Treasury is concerned about illicit trade and the additional allocation of R3bn to SARS to capacitate its enforcement will help address the impact of the illicit economy on the fiscus. The review process will assist in providing better forward guidance to industry on the level of excise duties that can be expected.

Comment that the health promotion levy should be increased to 20 per cent.

- National Treasury is reviewing the short-term impact of the levy on and will use these inputs to consider future amendments to the scope and rate of the levy

RESPONSES TO VAT REFUNDS FOR EXPORTERS

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- The commentator raises issues of VAT refunds for exporters, with particular reference to a case that has been litigated recently.
- Context is important:
 - The judgment handed down related to Part A of the taxpayer’s application, while Part B remains to be litigated.
 - A statement in Annexure C of the 2020 and 2021 Budget Reviews is relevant to the industry the taxpayer is part of; “schemes and malpractice to claim undue VAT refunds have been detected in the value chain relating to gold exports.”
- While the judgment was in the taxpayer’s favour in that a four month period was set for SARS to conclude its audit, from the date that all required information was provided by the taxpayer, it also speaks in other ways to the proposals that have been made by the commentator:
 - “While the prejudice to [the taxpayer] in the withholding of the refunds (and future refunds while the audit is proceeding) is astronomical, the prejudice to the fiscus if the audit or inquiry discloses that [the taxpayer] is in fact colluding with others in the supply chain is also astronomical.”

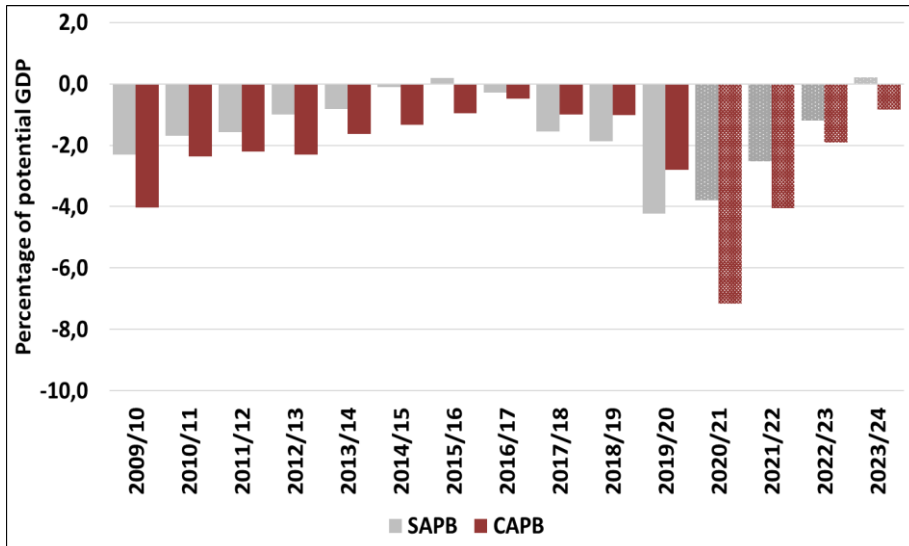
- “The [Tax Administration Act] seems to seek to balance the interests of the taxpayer and the fiscus by allowing SARS to retain the refunds pending the outcome of the audit.”
- “It would be ludicrous if SARS was still obliged to pay out refunds with no security when there was doubt as to the correctness of returns or any other reason to doubt the taxpayer’s entitlement to the refund.”
- “The audit has to be completed in a reasonable time, taking into account the circumstances.”
- “SARS must be afforded sufficient time to carry out the audit, and to ensure that [the taxpayer’s] information does not support a conclusion that [the taxpayer] is complicit in the unlawful scheme described.”
- As the court pointed out, the time required for an audit depends on the circumstances. In some cases days or weeks may suffice; in others months may be required, depending on the complexity of the audit.
- Nevertheless, National Treasury and SARS are open to engaging with the commentator, within the constraints presented by the ongoing litigation, to explore approaches to further improving the balance of interests of taxpayers and fiscus.

SOUTH AFRICA LARGELY RAN STRUCTURAL AND CYCLICALLY ADJUSTED PRIMARY DEFICITS

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Structural and cyclically adjusted primary balances, 2009/10 — 2023/24



- In general, both the cyclically adjusted primary balance (CAPB) and structurally adjusted primary balance (SAPB) have been in deficit since 2009/10, trending with the weakening in economic growth.
- However, the structurally adjusted primary deficit is generally much larger than the cyclically adjusted primary deficit, except for 2017/18 and 2018/19 where there were small or no extraordinary payments that affected the CAPB.
- The CAPB is notably weaker than the SAPB because of the large SOCs equity injections, especially in 2009/10, 2010/11, 2015/16 and 2019/20.
- Structural expenditure events, weigh heavily on the deficit, and thus, as these events are expected to decline over the medium-term, the SAPB will improve markedly.

WHY FISCAL CONSOLIDATION - FISCAL METRICS HAVE DETERIORATED

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- South Africa faces severe economic challenges. Real GDP per person has been falling since 2013/14, meaning that the average South African is becoming poorer, despite high and rising fiscal deficits. Private and public investments are lower than at any time since 2005, having declined to 12.5 per cent and 5.4 per cent of GDP, respectively, in 2019.
- Confidence and investment remain low and the focus of economic policy is to remove structural constraints that obstruct faster growth.
- South Africa provided one of the largest fiscal responses to the pandemic among developing countries. As a result, consolidated government spending has reached a record 41.7 per cent of GDP, compared with 29.6 per cent in 2008/09. To support households, businesses and the public health sector, the consolidated budget deficit widened from 5.7 per cent in 2019/20 to an estimated 14 per cent in 2020/21.
- While a temporary increase in spending was necessary to combat the spread and impact of COVID-19, the medium-term policy stance is focused on repairing the public finances. The fiscal position, which was already weak before the current crisis, has deteriorated sharply, requiring urgent steps to avoid a debt spiral. For several years, increasing debt-service costs have exceeded nominal GDP growth – a trend expected to continue over the medium term.
- If this course is not reversed, the economy will not be able to generate sufficient revenue for the state to service debt. Were that to occur, government would lose the ability to control debt and debt-service costs, as investors conclude that lending rates do not adequately compensate them for risk, leading to greater currency volatility and a protracted capital flow reversal.

WHY FISCAL CONSOLIDATION - FISCAL MULTIPLIERS

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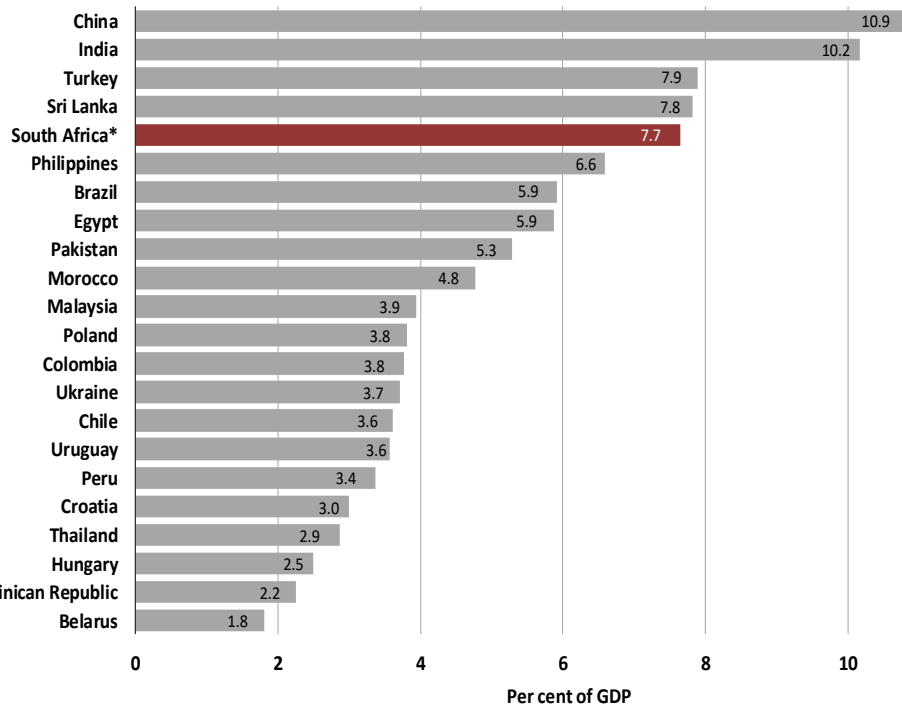
- The 2020 MTBPS noted that, over the past decade, increased government spending has failed to promote growth. Since 2008, real spending growth has averaged 4.1 per cent annually, well above annual real GDP growth of 1.5 per cent. Despite high levels of expenditure, supported by increased debt accumulation, growth has not recovered to pre-2008 levels.
- 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.
- In 2021 Budget, fiscal policy continues to focus on short-term economic support, pro-growth fiscal consolidation and debt stabilisation

- South Africa's fiscal challenge is to balance the immediate need for support to the economy during the pandemic with ongoing efforts to close a large, pre-existing budget deficit. In this context, the fiscal strategy aims to:
 - Narrow the deficit and stabilise the debt-to-GDP ratio, primarily by controlling non-interest expenditure growth.
 - Provide continued support to the economy and public health services in the short term, without adding to long-term spending pressures.
 - Improve the composition of spending, by reducing growth in compensation while protecting capital investment.

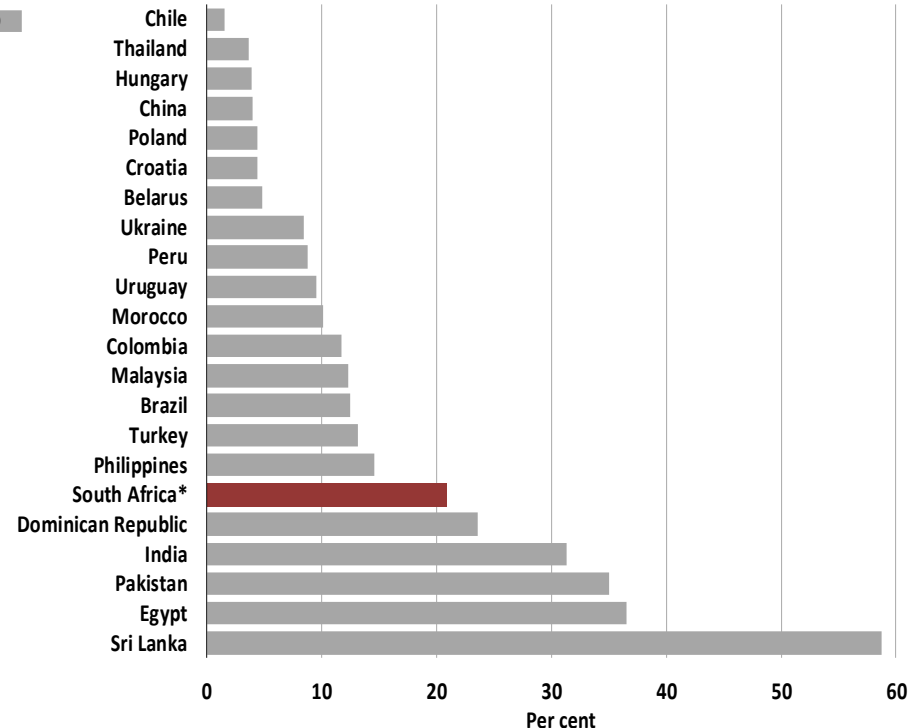
SOUTH AFRICA'S FISCAL POSITION IN GLOBAL CONTEXT

- Over the medium term, debt-service costs are expected to average 20.9 per cent of gross tax revenue. This is twice as large as the median for South Africa's peer group over the period.
- Similarly, South Africa's borrowing remains large by developing-country standards, and debt is projected to grow by 7 per cent of GDP over the next three years.

Average budget deficit, 2021–2023



Average debt-service costs as a share of revenue, 2021–2023



AVERAGE ANNUAL MTEF GROWTH OF SPENDING ITEMS BY ECONOMIC CLASSIFICATION

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Table 5.5 Consolidated government expenditure by economic classification¹

	2020/21 Revised estimate	2021/22	2022/23	2023/24	Percentage of total MTEF allocation	Average annual MTEF growth	Average annual MTEF growth excluding COVID-19
R million							
Economic classification							
Current payments	1 148 546	1 208 223	1 245 844	1 281 571	60.8%	3.7%	4.7%
Compensation of employees	636 958	650 404	656 021	659 269	32.0%	1.2%	1.5%
Goods and services	269 944	279 474	273 394	274 975	13.5%	0.6%	3.7%
Interest and rent on land	241 644	278 345	316 429	347 327	15.3%	12.9%	12.9%
<i>of which:</i>							
<i>Debt-service costs</i>	232 852	269 741	308 013	338 591	14.9%	13.3%	13.3%
Transfers and subsidies	741 494	668 910	678 769	686 282	33.1%	-2.5%	2.9%
Municipalities	151 431	150 662	159 590	161 865	7.7%	2.2%	4.3%
Departmental agencies and accounts	28 006	23 699	23 702	23 892	1.2%	-5.2%	-6.0%
Higher education institutions	46 619	49 116	50 186	50 811	2.4%	2.9%	2.3%
Foreign governments and international organisations	2 279	2 802	2 947	2 977	0.1%	9.3%	7.6%
Public corporations and private	28 804	38 864	43 671	47 416	2.1%	18.1%	12.6%
Non-profit institutions	44 231	40 667	42 064	43 462	2.1%	-0.6%	-0.3%
Households	440 124	363 100	356 610	355 860	17.5%	-6.8%	2.5%
Payments for capital assets	74 817	82 987	92 653	97 393	4.4%	9.2%	12.5%
Buildings and other capital assets	54 083	63 087	68 861	71 703	3.3%	9.9%	0.0%
Machinery and equipment	20 734	19 900	23 792	25 690	1.1%	7.4%	12.3%
Payments for financial assets	87 594	48 240	27 221	24 900			
Total	2 052 452	2 008 360	2 044 487	2 090 146	100%	0.6%	
Contingency reserve	–	12 000	5 000	5 000			
Consolidated expenditure	2 052 452	2 020 360	2 049 487	2 095 146		0.7%	3.3%

1. The main budget and spending by provinces, public entities and social security funds financed from own revenue

Source: National Treasury

AVERAGE ANNUAL MTEF GROWTH BY FUNCTION

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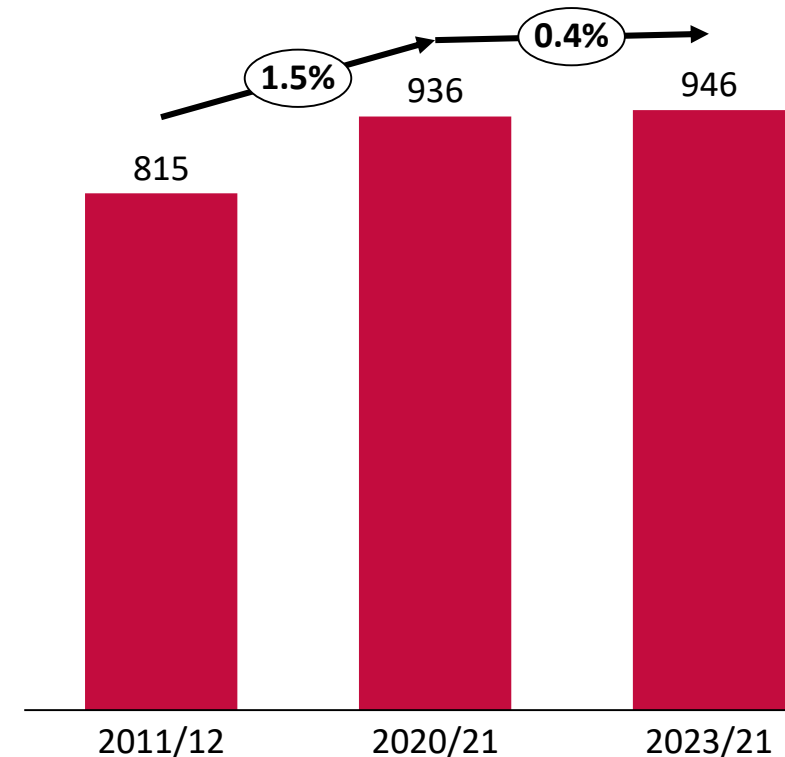
Table 5.6 Consolidated government expenditure by function¹

	2020/21 Revised estimate	2021/22 2022/23 2023/24 Medium-term estimates	Percentage of total MTEF allocation	Average annual MTEF growth	Average annual MTEF growth excluding COVID-19		
R million							
Learning and culture	387 209	402 929	411 027	415 972	23.5%	2.4%	2.7%
Basic education	266 341	272 340	276 982	279 520	15.9%	1.6%	2.3%
Post-school education and training	111 664	119 587	122 824	124 973	7.0%	3.8%	3.3%
Arts, culture, sport	9 204	11 001	11 221	11 479	0.6%	7.6%	6.5%
Health	247 009	248 839	245 893	245 019	14.2%	-0.3%	2.5%
Social development	413 313	335 290	326 176	325 248	18.9%	-7.7%	2.4%
Social protection	256 813	229 354	239 579	240 845	13.6%	-2.1%	3.1%
Social security funds	156 500	105 936	86 597	84 404	5.3%	-18.6%	0.6%
Community development	211 473	218 795	233 966	240 671	13.3%	4.4%	5.6%
Economic development	191 931	207 529	210 871	217 187	12.2%	4.2%	5.0%
Industrialisation and exports	33 089	36 176	36 780	37 148	2.1%	3.9%	1.3%
Agriculture and rural development	25 326	27 400	28 142	28 432	1.6%	3.9%	1.6%
Job creation and labour affairs	31 585	33 396	23 997	24 229	1.6%	-8.5%	3.5%
Economic regulation and infrastructure	86 499	93 144	103 963	109 513	5.9%	8.2%	8.3%
Innovation, science and technology	15 431	17 412	17 988	17 866	1.0%	5.0%	2.1%
Peace and security	218 615	208 570	212 853	213 417	12.1%	-0.8%	-0.1%
Defence and state security	53 968	46 656	47 811	48 132	2.7%	-3.7%	-2.6%
Police services	106 603	104 570	105 946	105 994	6.1%	-0.2%	1.0%
Law courts and prisons	48 263	48 482	49 632	49 919	2.8%	1.1%	0.8%
Home affairs	9 780	8 862	9 463	9 372	0.5%	-1.4%	-3.2%
General public services	62 458	68 429	68 467	69 141	3.9%	3.4%	3.5%
Executive and legislative organs	14 368	14 476	14 818	14 998	0.8%	1.4%	1.2%
Public administration and fiscal affairs	40 934	46 066	45 417	45 853	2.6%	3.9%	4.4%
External affairs	7 156	7 886	8 233	8 291	0.5%	5.0%	3.0%
Payments for financial assets	87 594	48 240	27 221	24 900			
Allocated by function	1 819 600	1 738 619	1 736 474	1 751 555	100%	-1.3%	1.6%
Debt-service costs	232 852	269 741	308 013	338 591		13.3%	
Contingency reserve	-	12 000	5 000	5 000			
Consolidated expenditure	2 052 452	2 020 360	2 049 487	2 095 146		0.7%	20 3.3%

1. The main budget and spending by provinces, public entities and social security funds financed from own revenue

Source: National Treasury

REAL CONSOLIDATED NON-INTEREST SPENDING EXCLUDING COE



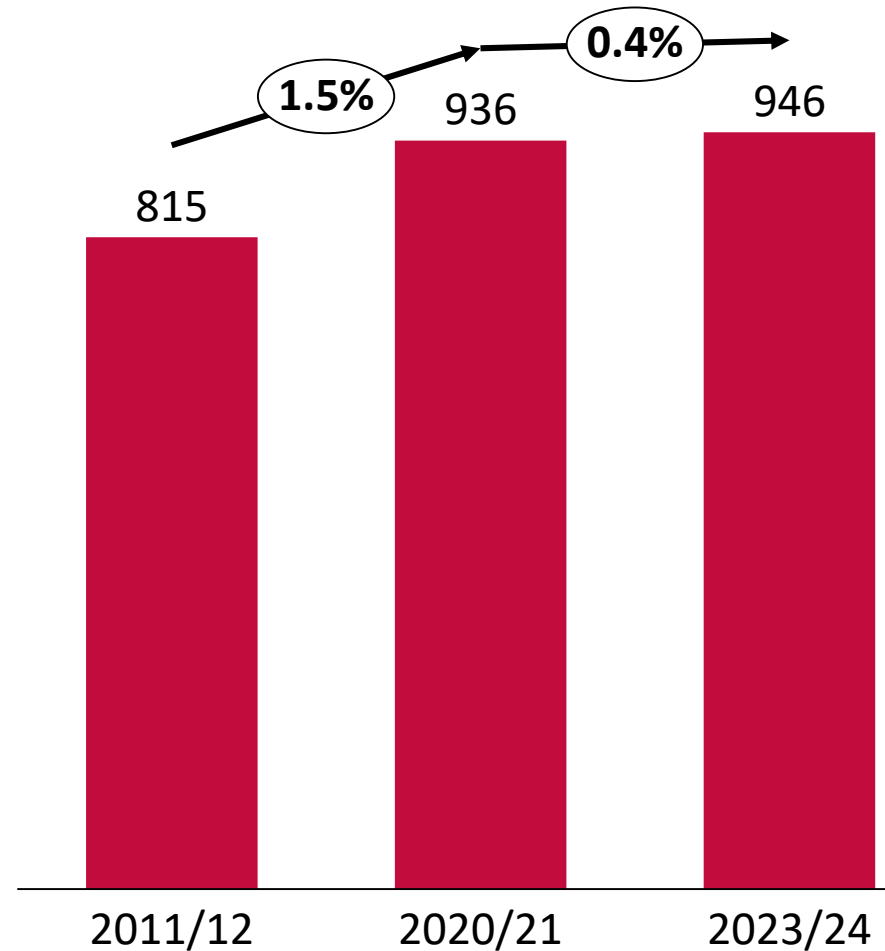
REAL CONSOLIDATED NON-INTEREST SPENDING EXCL. COE GROWS IN REAL TERMS

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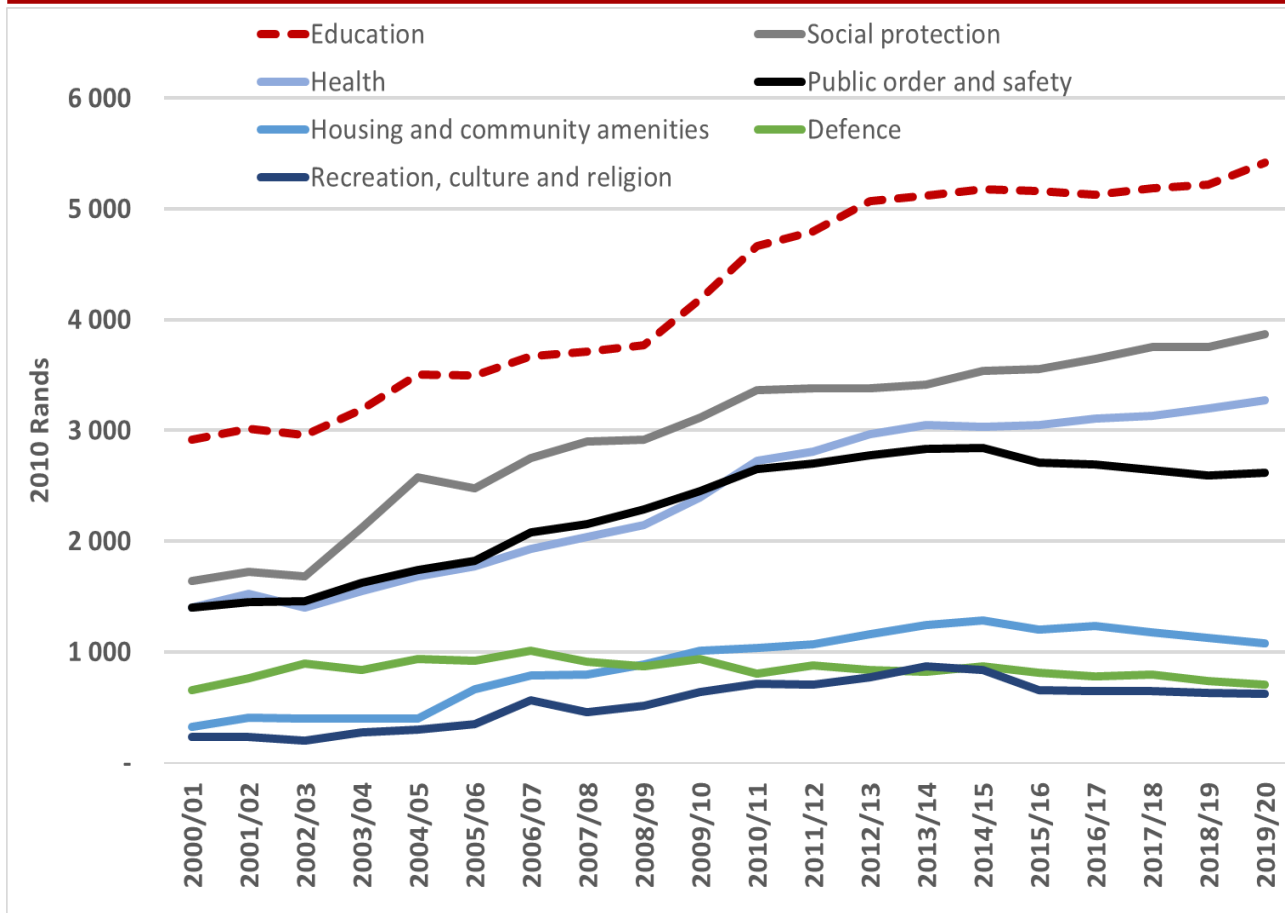
- Over the past decade, government spending excluding interest on debt has grown sharply in real terms, primarily because of increases in public-service compensation.
- The current fiscal measures aim to correct this imbalance by reducing growth in the compensation bill and reducing the share of spending on public-service wages over the medium term, while sustaining small real spending increases on other items.
- These measures will improve the composition of spending by reallocating resources towards growth-enhancing infrastructure investment.

REAL CONSOLIDATED NON-INTEREST SPENDING EXCLUDING COE



THE BUDGET HAS SUPPORTED AN EXPANSION OF REAL SOCIAL SPENDING

Real government spending per capita



Source data: General government spending (Reserve Bank),
Consumer Price Inflation and population (StatsSA)

EXAMPLE (HEALTH): HOWEVER THIS NOT HAS ALWAYS BEEN MATCHED BY AN IMPROVEMENT IN OUTCOMES

EXAMPLE: SELECTED HEALTH INDICATORS

Country	GDP per Capita in US\$	Government Health Expenditure per capita in (PPP\$ 2016)		Total Health Expenditure as % of GDP		Government Health Expenditure as % of GDP		Government Health Expenditure as % of Total Health Expenditure		Life expectancy at birth	
	2016	2006	2016	2006	2016	2006	2016	2006	2016	2006	2015
Algeria	3,921	306	676	3.4	6.6	2.3	4.5	68.5	67.7	73.2	75.9
Argentina	12,773	728	1,140	7.6	7.5	4.0	5.6	53.1	74.4	74.9	76.4
Botswana	6,958	463	521	5.0	5.5	3.5	3.1	69.0	55.9	53.7	65.8
Brazil	8,752	492	591	8.3	11.8	3.6	3.9	43.5	33.2	72.4	75.3
Cambodia	1,270	22	50	6.1	6.1	1.0	1.3	15.7	21.8	63.9	68.6
China	8,116	94	442	3.9	5.0	1.4	2.9	35.1	58.0	74.3	76.1
Egypt	3,686	156	151	4.8	4.6	1.7	1.4	36.0	29.3	69.6	71.3
Ghana	1,941	59	73	5.3	4.4	2.1	1.7	39.0	38.4	59.2	62.4
India	1,762	28	61	3.6	3.6	0.7	0.9	20.5	25.4	65.0	68.3
Indonesia	3,606	63	162	2.7	3.1	0.8	1.4	31.1	44.7	67.4	69.0
Kenya	1,559	36	52	5.9	4.5	1.5	1.6	24.8	36.2	57.3	66.7
Malaysia	9,381	354	531	3.2	3.8	1.7	1.9	53.8	50.5	73.6	75.1
Mexico	8,815	405	507	5.7	5.5	2.4	2.9	42.6	52.1	75.5	76.9
Morocco	2,997	114	218	4.9	5.8	1.8	2.7	36.9	46.9	72.0	75.6
Namibia	4,852	455	600	12.1	9.1	5.3	5.6	44.0	61.9	54.0	63.8
Nigeria	2,208	32	28	3.9	3.6	0.7	0.5	18.4	13.0	48.8	53.0
Peru	6,176	197	436	4.5	5.1	2.2	3.3	49.5	64.1	72.8	74.7
Russia	8,910	621	757	4.8	5.3	2.9	3.0	61.7	57.0	66.7	71.2
South Africa	5,327	385	576	6.6	8.1	3.2	4.4	48.3	53.8	52.6	62.0
Thailand	6,114	306	496	3.1	3.7	2.3	2.9	75.3	78.1	72.5	75.1
Turkey	10,817	655	854	5.2	4.3	3.6	3.4	68.9	78.4	72.9	75.5
Ukraine	2,200	329	227	6.2	6.7	3.7	2.9	60.4	42.4	68.1	71.2
Vietnam	2,172	89	169	5.4	5.7	2.3	2.7	42.4	47.4	74.4	76.1
<i>Weighted averages:</i>											
Low income countries		20	25	5.8	5.4	1.5	1.3	26.8	24.1	57.6	62.5
Lower middle-income countries		52	85	3.9	4.0	1.2	1.3	30.1	32.2	64.5	67.5
Upper middle-income countries		251	532	5.2	5.9	2.5	3.2	48.0	54.6	72.8	75.1
High income countries		2,660	4,354	10.5	12.6	6.4	10.1	61.5	79.9	79.0	80.5

- South Africa's public spending on health services, both per capita in PPP-adjusted \$ and as a percentage of GDP is higher than the average for upper middle income countries
- South Africa's life expectancy, despite considerable recent improvement, was still much lower than our UMIC peers in 2015 and is even lower than the average for both low- and lower-middle income countries.

Source data: World Bank World Development Indicators and Global Health Expenditure Database

- Higher public spending is not the only key to key to realisation of Bill of Rights, but also improvements in quality

SPENDING REVIEWS ARE REVEALING SIGNIFICANT SAVINGS CAN BE MADE

BUDGET 2021



Potential savings

HIV/AIDS conditional grant

- Considerable differences across provinces in HIV/AIDS unit cost.
- Spending in per ART patient in 2019/20 ranged from 2,688 in MP to 5,038 in NC.
- If unit expenditure in high spending provinces were at national average, R802 million per year could have been saved.
- Lower than planned ART uptake (partly due to COVID-19 and lockdown) will also give some savings in HIV grant

Managing overtime

- Potential savings of R237 million could have been realised in 2018/19 if overtime payments had been replaced by additional staff
- More work is needed to determine the viability of amending current commuted overtime policy (requires wider DPSA and bargaining council processes)

Goods and services procurement:

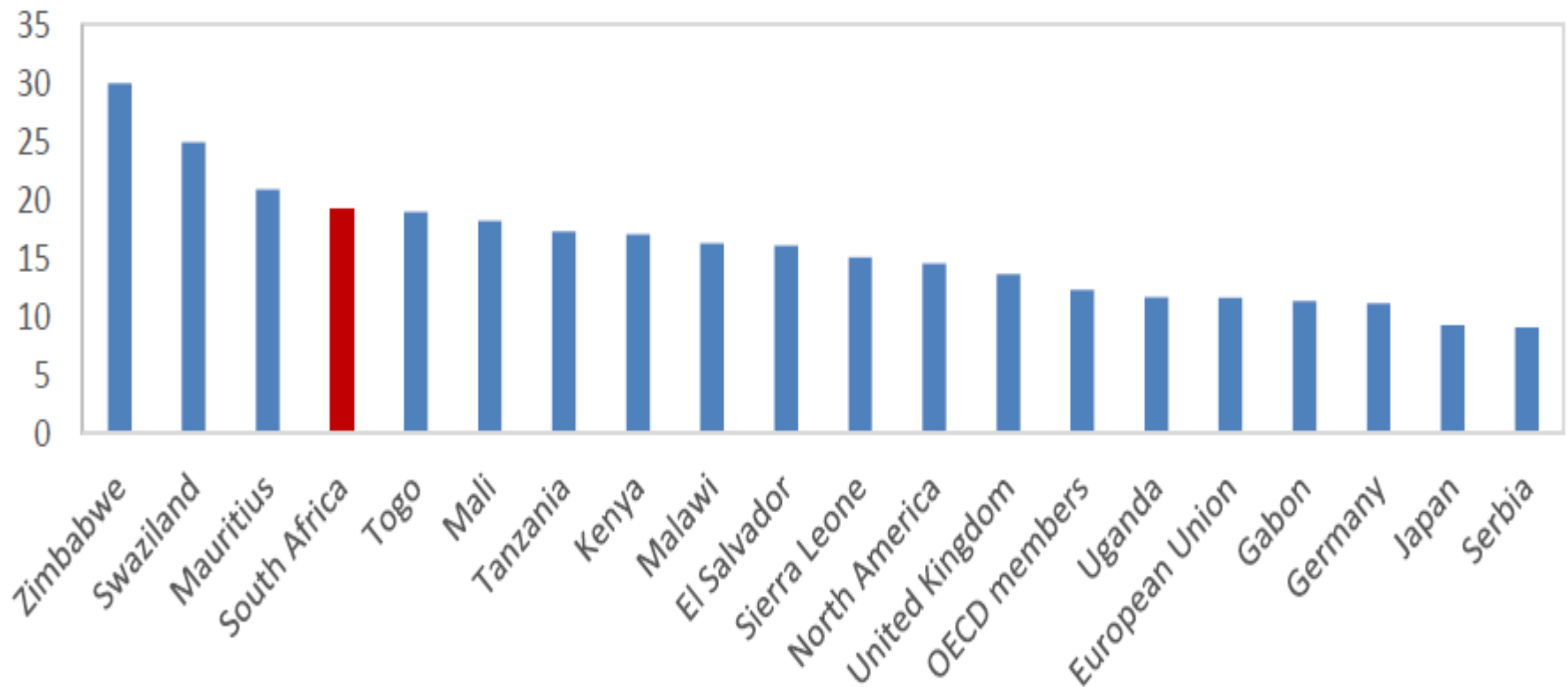
- Spending on Security, food services and medical waste varies considerably across provinces
- R501m could have been saved on security services in 2019/20, if high spending provinces were brought down to national average per capita spending
- R87.9m could have been saved in MP and NC in 2019/20 if their medical waste spending per patient were brought down to national average
- Transversal tenders on medical supplies
- About R4.6bn (58%) of R8bn expenditure on medical supplies in 2018/19 were procured outside transversal tenders
- If transversal tenders on these could achieve 10% price reduction, the savings to the sector would be R655m

Goods & Services:

- Some goods reductions could be absorbed by lower CPI projections
- Also specific areas of potential savings identified in spending reviews

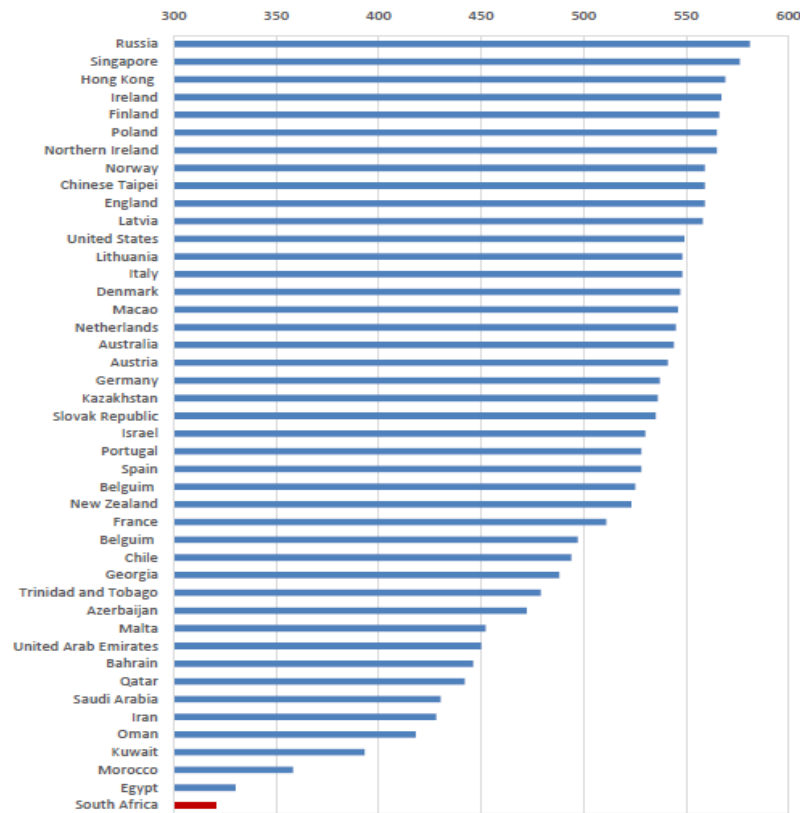
EXAMPLE 2: BASIC EDUCATION SPENDING OUTPACES PEER COUNTRIES

Expenditure on education as a proportion of total government expenditure in 2015



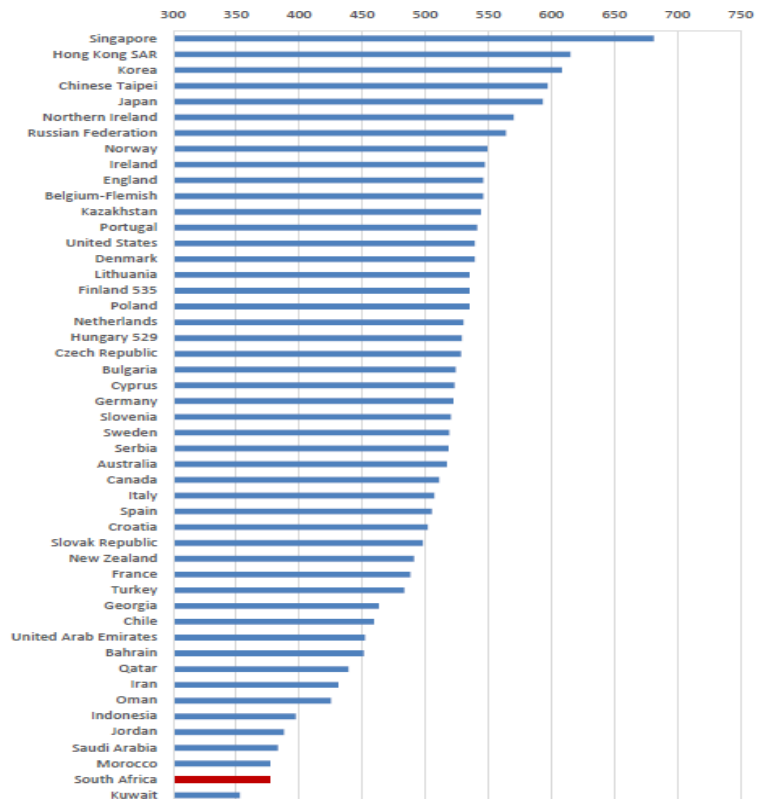
EXAMPLE 2 BASIC EDUCATION: YET OUTCOMES RANK VERY LOW

4th Grade International Achievements versus 5th Grade South African Achievements in Reading in 2016



Source: PIRLS (2017).

4th Grade International Achievements versus 5th Grade South African Achievements in Mathematics in 2015



Source: TIMSS (2015).

Source: IMF (2019)

RESPONSE TO FISCAL RULE PROPOSAL

BUDGET 2021



- A fiscal rule must be clear and credible. Expenditure and budget balance rules are effective in ensuring debt sustainability as well as promoting various degrees of macroeconomic stability.
- One option would be to introduce a debt ceiling. However, the ceiling level must be sufficiently ambitious without requiring an implausible fiscal adjustment. A debt ceiling rule should be accompanied by additional fiscal rules to provide operational guidance.
- These rules should take into account the macroeconomic volatility, the finer technical issues in their creation and adherence, and the developmental needs of the country. Government debt should act as shock absorber and debt should adjust over time towards a long-run target.
- Once the debt target has been set, expenditure ceilings can be calculated that are consistent with the rule. The risks of setting the target and not achieving it are high, given persistently low economic growth and major unresolved extra-budgetary pressures. For example, if government were to move Eskom debt onto its balance sheet, the rule might require major fiscal adjustments.
- The proposals will need accompanying institutional reforms. These could include:
 - Introduction of a new fiscal law to be passed in parliament, in order to make it binding. The law must include escape clauses for extraordinary unforeseen events (e.g. a multi-year recession)
 - A fiscal policy council/review panel, consisting of independent experts, academics and the Parliamentary Budget Office, tasked with providing independent commentary, and a biennial review of the target

HOW BUDGET 2021 SUPPORTS ECONOMIC GROWTH

- **Fiscal sustainability:** Increasingly unsustainable fiscal outlook acts as drag on economic growth:
 - Budget 2021 presents an improved debt-to-GDP outlook relative to the 2020 MTBPS, which should take pressure off interest rates, reduce crowding out, and improve investor sentiment.
- **Short-term support to the economy:** funding for crucial health and employment interventions support the economic recovery:
 - Three-month extensions of the special COVID-19 social relief of distress grant and the Unemployment Insurance Fund’s Temporary Employer/Employee Relief Scheme, and funding for the public employment initiative and for provincial hospitals in 2021/22.
 - Up to R10.3 billion is provided for vaccine rollout for the current year and over the next two years.
 - The contingency reserve increases from R5 billion to R12 billion in 2021/22, given uncertainty around vaccination campaign costs. These interventions do not add to longer-term expenditure.

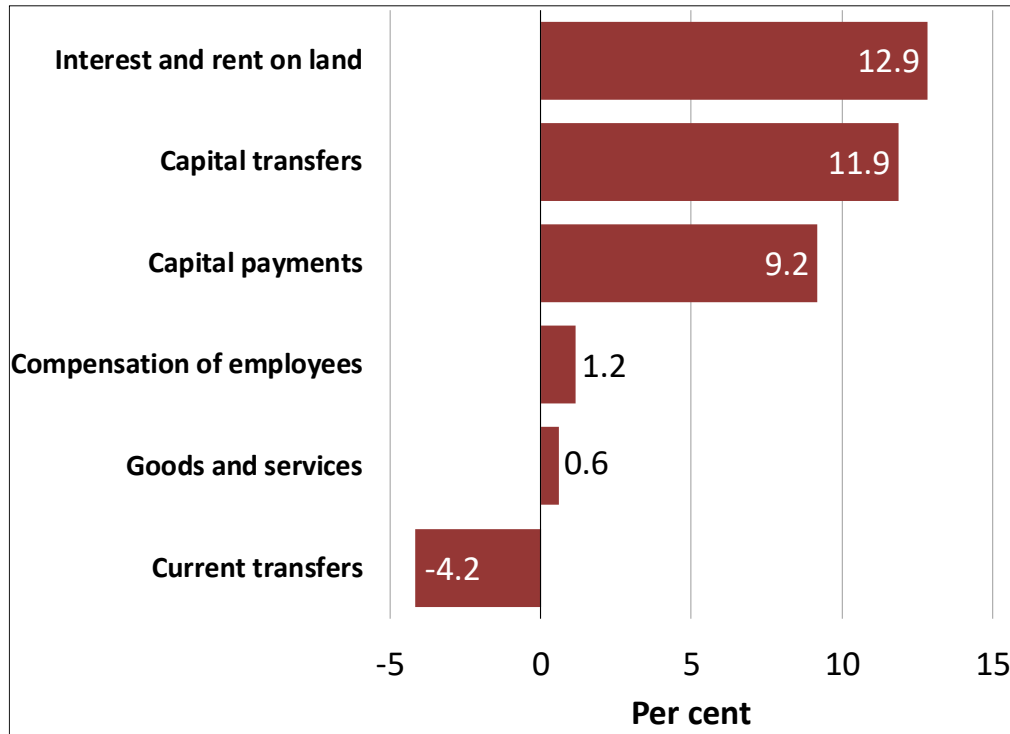
Table 5.2 2021 Budget additions

R million	2021/22	2022/23	2023/24	MTEF total
2021 Budget additions to baseline	22 446	4 602	2 283	29 332
COVID-19: Vaccine rollout	5 200	3 000	–	8 200
COVID-19: Managing second and third wave	8 000	–	–	8 000
Extension of the special COVID-19 social relief of distress grant	2 145	–	–	2 145
Other adjustments ¹	7 101	1 602	2 283	10 987

1. Includes the New Development Bank, financial support to state-owned companies and public entities, and the rescheduling of some infrastructure reductions introduced in the 2020 MTBPS

HOW BUDGET 2021 SUPPORTS ECONOMIC GROWTH (2)

Average spending growth over the MTEF by economic classification, 2021/22 — 2023/24

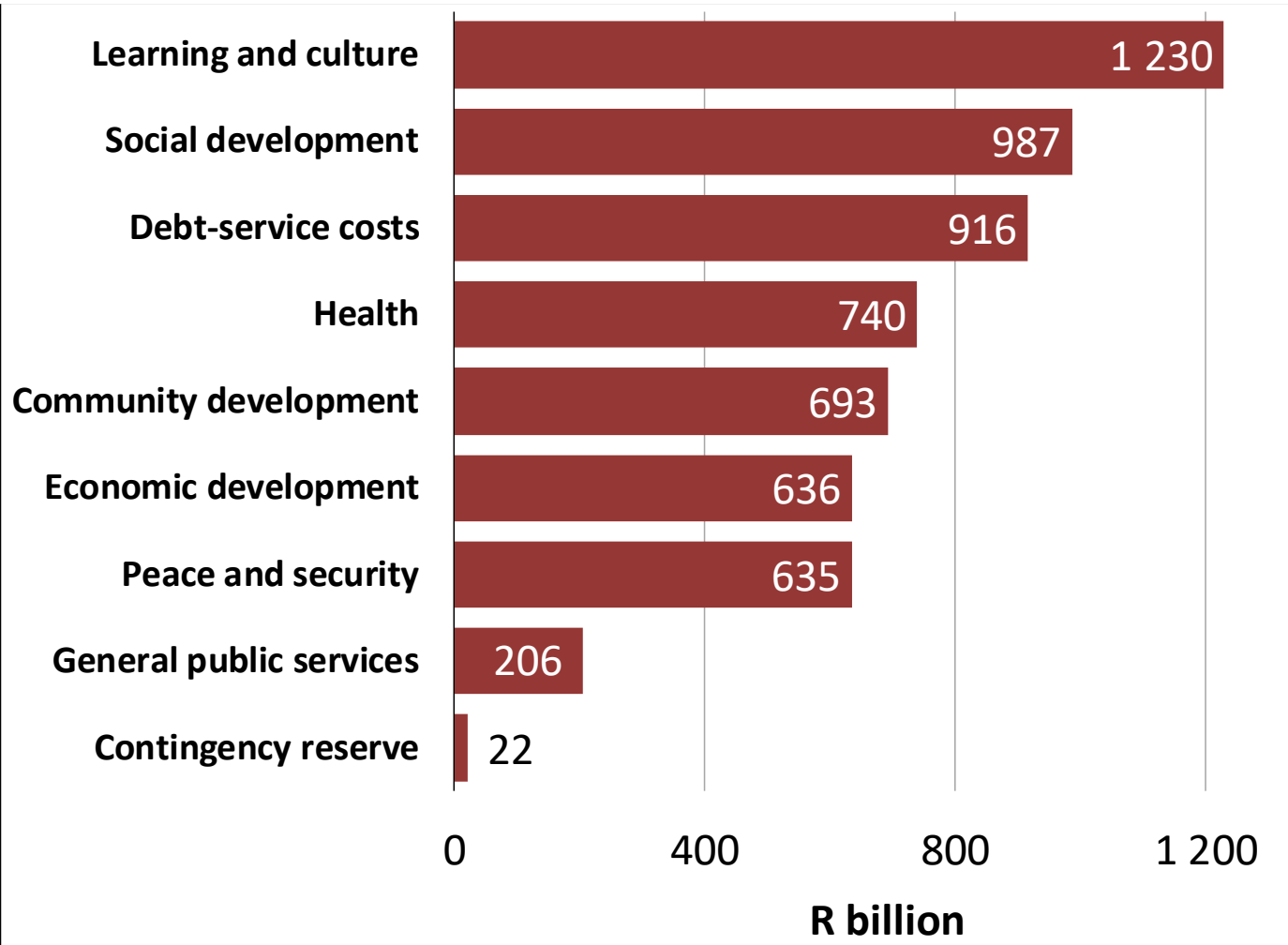


- Government will not implement the additional tax revenue measures announced in the 2020 MTBPS – R5 billion for next year, R10 billion per year in the following two years and R15 billion in 2024/25.

- **Composition of spending:** infrastructure investment grows over the medium term, despite large expenditure reductions:
 - After interest payments, capital transfers and capital payments grow fastest.
 - Budget 2021 also provides funding for key infrastructure reforms related to the Infrastructure Fund.
- **Medium-term support for key areas of expenditure:**
 - Industrialisation and exports (R110bn)
 - Agriculture and rural development (R84 billion)
 - Job creation and labour affairs (R82 billion)
 - Economic regulation and infrastructure (R307 billion)
 - Innovation, science and technology (R53 billion)

MEDIUM TERM SPENDING PRIORITIES

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



- Over half of allocations go towards learning and culture, health, and social development functions over the medium term.
- Debt-service costs, estimated at R916 billion over the MTEF period, is the third largest spending item by function

CONSULTANTS FORM A VERY SMALL PART OF GOODS AND SERVICES

BUDGET 2021



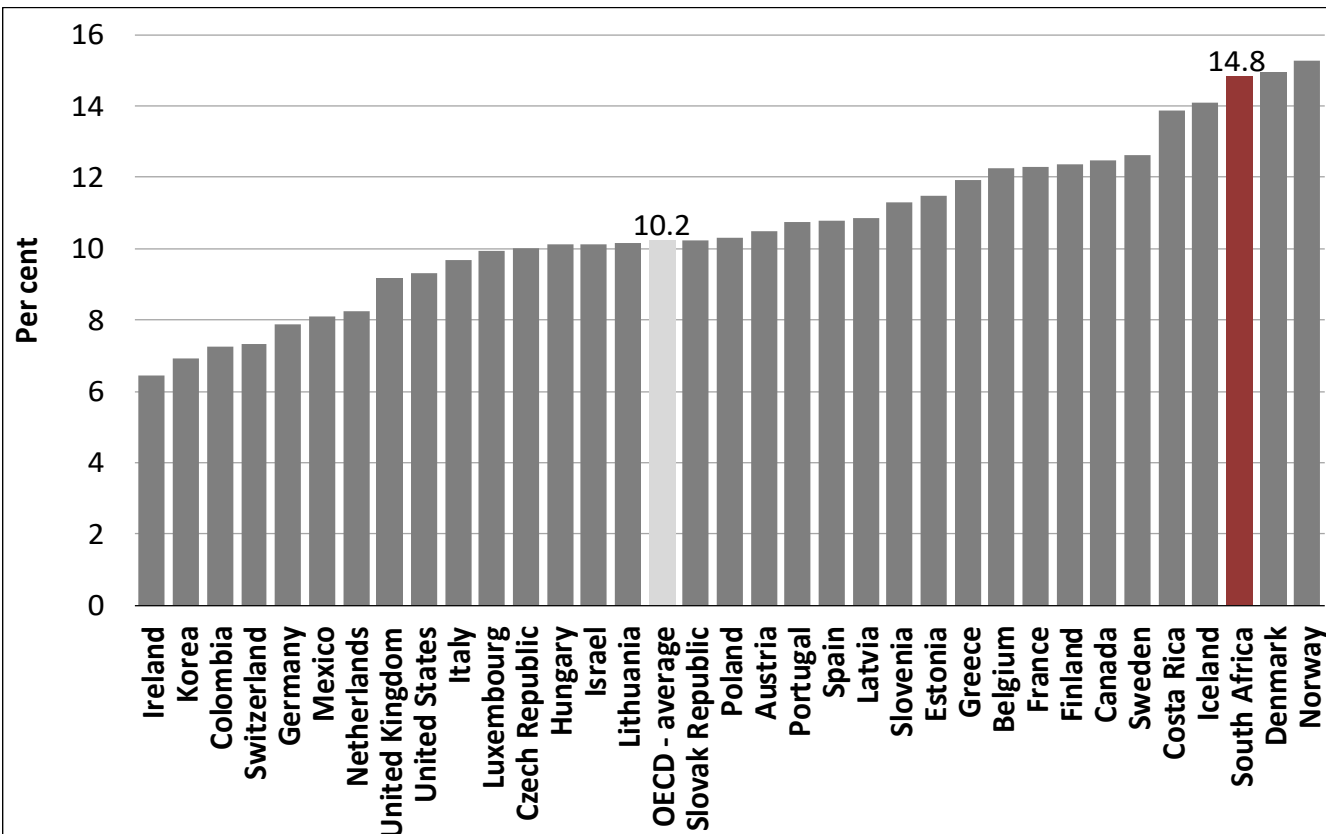
Consolidated expenditure on goods and services

Breakdown of consultants by level of government	2019/20	2020/21	2021/22	2022/23	2023/24	Average annual growth 2020/21 to 2023/24
Selected items of goods and services						
National departments	3 757 235	5 563 437	7 041 958	6 093 750	5 998 454	2.5%
Provincial departments	3 868 343	4 112 543	4 905 945	5 092 174	4 949 447	6.4%
National public entities	2 687 507	2 571 863	3 108 848	2 946 246	3 066 002	6.0%
RDP	751 294	383 587	285 730	277 566	261 239	-12.0%
Social security funds	140 738	2 094 535	2 187 395	2 304 426	2 406 738	4.7%
Total consultants and professional services:						
Business and advisory services	11 205 117	14 725 964	17 529 875	16 714 163	16 681 879	4.2%
<i>As percentage of total goods and services</i>	<i>4.4%</i>	<i>6.0%</i>	<i>6.3%</i>	<i>6.1%</i>	<i>6.1%</i>	
Agency and support / outsourced services	11 036 137	10 455 656	20 437 967	18 724 432	19 272 299	22.6%
Communication	4 528 003	4 646 234	4 831 030	5 079 788	5 210 028	3.9%
Computer services	10 114 145	12 388 901	11 701 219	12 503 473	13 197 459	2.1%
Contractors	37 572 445	33 941 471	41 212 008	40 524 918	41 963 741	7.3%
Fleet services (including government motor tr	8 346 753	8 340 683	8 826 563	9 471 164	9 623 648	4.9%
Inventory	63 713 061	71 020 249	70 505 754	70 782 870	70 648 566	-0.2%
Operating leases	18 579 097	19 280 772	19 408 544	19 930 608	20 473 859	2.0%
Operating payments	28 264 879	24 292 413	22 490 172	20 206 023	21 257 308	-4.4%
Property payments	29 693 705	30 327 537	30 671 178	30 072 884	30 507 721	0.2%
Travel and subsistence	14 096 111	10 095 791	11 700 179	12 449 630	12 879 076	8.5%
Other goods and services items	16 039 470	6 891 470	20 159 149	16 934 435	13 259 537	24.4%
Total goods and services	253 188 924	246 407 141	279 473 640	273 394 389	274 975 121	3.7%

- High growth in consultants is mainly because of COGTA related to EPWP

GENERAL GOVERNMENT COMPENSATION IN GLOBAL CONTEXT

General government compensation of employees as a share of GDP

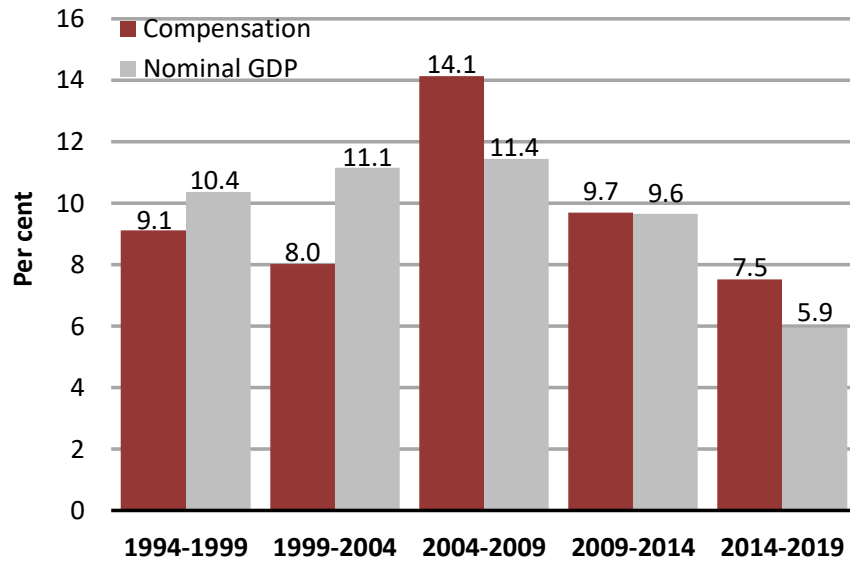


- Compensation accounted for about 34 per cent of consolidated spending in 2019/20.
- Between 2006/07 and 2019/20, compensation was one of the fastest-growing spending items, increasing faster than GDP growth. As outlined in previous editions of the Budget Review and MTBPS, by 2019/20 rising compensation spending had become unaffordable.

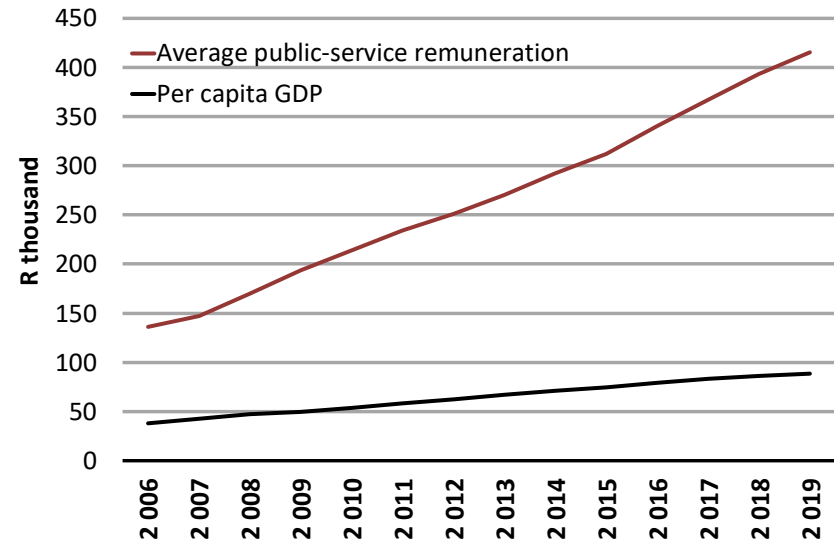
At the general government level (which includes municipalities), South Africa's wage bill as a share of output is approximately 5 percentage points higher than the Organisation for Economic Co-operation and Development average – and on par with Iceland and Denmark.

COMPENSATION HAS OUTPACED ECONOMIC PERFORMANCE AND GDP PER CAPITA

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.

THE DIVISION OF REVENUE IS REDISTRIBUTIVE

Table 1.5 Division of revenue

R billion	2020/21	2021/22	2022/23	2023/24
National allocations	804.5	763.3	736.3	739.0
Provincial allocations	628.3	639.5	643.3	646.8
<i>Equitable share</i>	520.7	523.7	524.1	525.3
<i>Conditional grants</i>	107.6	115.8	119.3	121.5
Local government allocations	138.5	138.1	146.1	148.4
Provisional allocations not assigned to votes	–	11.6	32.1	33.2
Total allocations	1 571.3	1 552.5	1 557.8	1 567.5
Percentage shares				
<i>National</i>	51.2%	49.5%	48.3%	48.2%
<i>Provincial</i>	40.0%	41.5%	42.2%	42.2%
<i>Local government</i>	8.8%	9.0%	9.6%	9.7%

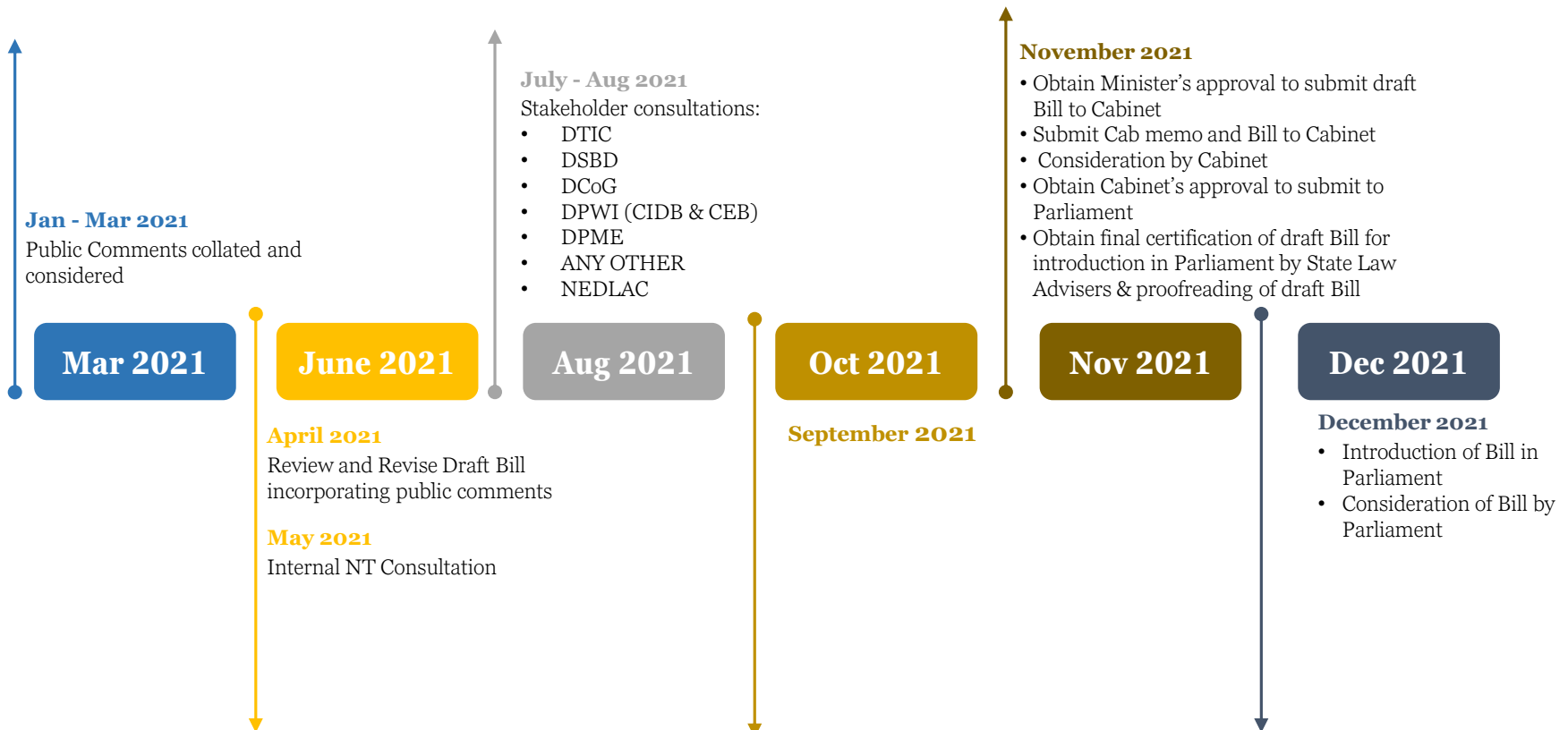
Source: National Treasury

- Allocations through the intergovernmental fiscal system provide higher per capita allocations to rural provinces and municipalities.
- Government is developing indicators focused specifically on rural areas for the provincial equitable share formula to strengthen the equity of intergovernmental transfers.

- Over the 2021 MTEF period, after budgeting for debt-service costs, the contingency reserve and provisional allocations, 48.7 per cent of nationally raised funds are allocated to national government, 41.9 per cent to provinces and 9.4 per cent to local government.

PUBLIC PROCUREMENT BILL TIMELINE

BUDGET 2021



USE OF IT SYSTEMS IN PROCUREMENT

BUDGET 2021



- A review of Supply Chain Management (SCM) technology in the public service confirmed that fragmented systems undermine the effectiveness and efficiency of procurement function. It was also noted that amongst the estimated 56 different technologies employed at national, provincial and local government, very few examples of SCM Information and Communication Technology (ICT) modernisation could be identified.
- Inefficiencies in procurement are often related to the duplication of effort and cost relating to high-volume-low-value transactions and manual processes. International studies have shown that considerable saving of administrative costs and process efficiency can be achieved by automating supply chain management processes and also improve audit outcomes within Organs of State.
- The National Treasury, together with the Provincial Treasuries, are investigating opportunities to use IT to improve transparency by:
 - Openly publishing procurement plans of all organs of state
 - Publishing all tenders awards and suppliers that are awarded (including ownership)
 - Introducing an online bidding platform for tendering processes in effort to improve transparency in the tender process

- Budget 2021 strikes a difficult balance between providing immediate support for the economy and shoring up the country's public finances. Medium-term fiscal policy focuses on:
 - Extending temporary support in response to COVID-19
 - Narrowing the budget deficit and stabilising debt
 - Exercising continued restraint in non-interest expenditure growth while improving the composition of expenditure.
- Returning the public finances to a sustainable position will require ongoing restraint in expenditure growth and implementation of structural reforms to support economic growth.
- The current fiscal strategy reduces growth in the compensation bill and decreases the share of spending on public-service wages over the medium term, while sustaining small real spending increases on other items.
- Significant risks remain for the economic and fiscal outlook