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MTBPS 2021: Maintaining/Building sustainable public finances towards economic recovery

The Medium Term Budget Policy Statement (MTBPS) proposes a five-year fiscal consolidation to narrow the budget deficit and stabilise government debt. Fiscal consolidation is largely achieved through spending cuts, notably a reduction in non-interest expenditure in the medium-term as well as the planned introduction of zero-based budgeting (where spending allocations are matched with revenues)[1].

Spending cuts have been a challenge as South Africa's public finances have been deteriorating for some time. This situation was exacerbated by COVID 19 in 2020 and the unrest in August 2021 in KwaZulu-Natal and Gauteng. In addition, the insolvency of state owned companies (SOCs) leading to going concern issues raised by the AG affects this process. The benefits of fiscal consolidation are evident but the main risk of fiscal consolidation for South Africa (SA) is the possibility that the government is unlikely to meet the three main NDP proprieties such as reducing unemployment, poverty and inequality.

This brief provides a snapshot of the emergent outlook with regard to the country's economy, fiscal and expenditure capability for the 2021/22 medium term.

1. The Economic Outlook

- **Global economic outlook**
  - Global growth is projected at 5.9 per cent in 2021 and is expected to decline to 4.9 per cent in 2022.[2]
  - Emerging market and developing economies (EMDEs) are projected to grow at a faster rate than advanced economies and the global average in both 2021 and 2022. However, there are large disparities across the different EMDE regions, with emerging and developing Asia growing the fastest and Sub-Saharan Africa experiencing the slowest growth. These disparities are largely as a result of unequal vaccine access and policy support.
    - The growth rate of advanced economies is projected at 5.2 per cent in 2021 and is expected to contract to 4.5 per cent in 2022.[3]
    - The growth rate of emerging market and developing economies is projected at 6.4 per cent in 2021 and 5.1 per cent in 2022.[4]

[1] THINK Economic and Financial Analysis. 2 November 2020. South Africa: High fiscal consolidation commitment but weak budget viability.
[2] IMF (2021)
[3] Ibid (2021)

- Emerging and developing Asia is expected to grow at 7.2 per cent in 2021 before slowing to 6.3 per cent in 2022, while Sub-Saharan Africa's growth rate remains poor at 3.7 per cent in 2021 and 3.8 per cent in 2022.

- **The main risks to the global economic outlook**

  - Despite economic recovery being projected for 2021, downside risks could impact negatively on the durability of this recovery. The main risks to the global outlook are the following:
    - In the context of slow vaccination rollouts, particularly in low-income and developing economies, the emergence of deadlier variants of SARS-CoV-2 leading to a new wave of outbreaks may mean that countries have to re-impose stricter mitigation measures, which could result in a prolonged decline in economic activity.[5]
    - Supply-demand mismatches resulting from the pandemic could persist longer than anticipated, which can result in sustained price pressures and rising inflation expectations [6]
    - An escalation of trade and technology tensions between the United States of America and China could have negative implications for investment and global economic activity[7].

- **South Africa's economy grows faster than expected in 2021 but worsens over the medium-term**

  - In contrast to the 2021 Budget growth forecast of 3.3 per cent, South Africa's real gross domestic product (GDP) growth is now projected at 5.1 per cent in 2021.[8] Over the medium term, growth is projected to slow down to 1.8 per cent in 2022, 1.6 per cent in 2023 and 1.7 per cent in 2024[9].
  - In the second quarter (Q2) of 2021, the transport, storage and communication; personal services and trade, catering and accommodation industries were the largest positive contributors to GDP growth.
    - Compared to a contraction of 67.9 per cent in Q2 of 2020, the transport, storage and communication industry grew by 6.9 per cent in Q2 of 2021, which translates to a contribution of 0.5 percentage points to growth in GDP[10].
    - Compared to a contraction of 67.6 per cent in Q2 of 2020, the trade, catering and accommodation industry grew by 2.2 per cent in Q2 of 2021, which translates to a contribution of 0.3 percentage points to growth in GDP[11].
    - Compared to a contraction of 32.5 per cent in Q2 of 2020, the personal services industry grew by 2.5 per cent in Q2 of 2021, which translates to a contribution of 0.4 percentage points to growth in GDP[12].

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4 IMF (2021)
5 IMF (2021)
6 Ibid (2021)
7 IMF (2021)
8 National Treasury (2021)
9 Ibid (2021)
10 Stats SA (2021a)
11 Ibid

- **Labour market recovery has been slow**

  - COVID-19 has resulted in millions of people losing their jobs with women experiencing much larger job losses and reduction in hours worked than men[13]. According to the National Income Dynamics Study-Coronavirus Rapid Mobile Survey, whilst there has been evidence of some employment recovery for both men and women, it tends to be slower for women.
  - In contrast to the 2.2 million jobs that were shed by the economy in Q2 of 2020, in Q2 of 2021 the economy shed 54,000 jobs. [14]
  - The country's official unemployment rate, which is calculated using the number of persons who are employed and unemployed but excludes economically inactive[15] persons, has increased from 32.6 per cent in the first quarter (Q1) of 2021 to 34.4 per cent in the Q2 of 2021[16].
    - In Q2 of 2021, the rate of unemployment among women stood at 36.8 per cent and 32.4 per cent for men.
  - The expanded unemployment rate, which considers economically inactive persons, increased from 43.2 per cent in Q1 of 2021 to 44.4 per cent in Q2 of 2021.
  - With the already high levels of unemployment and poverty, the pandemic has compounded these challenges, which puts more pressure on the State to provide social grants and other relief measures.

- **The inflation outlook and the repurchase rate**

  - Inflation remains well within the South African Reserve Bank (SARB) target range of 3-6 per cent. The consumer price index (CPI) inflation forecast for 2021 has been revised upwards to 4.5 per cent, from an estimated 3.9 per cent at the time of the 2021 February Budget.[17]
  - According to the South African Reserve Bank (SARB), the risks to the inflation outlook have been assessed upwards. Volatile oil prices, electricity and other administered prices present short-term risks, while a weaker currency, higher domestic import tariffs and escalating wage demands present long term upside risks.[18].
  - The repurchase (repo) rate[19] remains unchanged at 3.5 per cent per annum.

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[12] Ibid

[13] Casale and Shepherd (2021)

[14] Stats SA (2021b)

[15] A person is considered to be economically inactive if they were able and available to work in the week prior to the Quarterly Labour Force Survey being administered, but did not work or look for work or start their own business.

[16] Stats SA (2021b)

[17] National Treasury (2021)

[18] SARB (2021)

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

- **Business confidence falls, while consumer confidence improves but remains depressed**

    - In comparison to the Q2 of 2021, business confidence weakened in the third quarter (Q3) of 2021 owing mainly to the recent civil unrest in the provinces of KwaZulu-Natal and Gauteng[20].
    - Between the Q2 and Q3 of 2021, consumer confidence improved but remains depressed. This is largely owing to the effects of the COVID-19 pandemic and the related economic restrictions, which have delayed the full recovery of consumer confidence[21].

- **Credit downgrades still remain a factor to observe. According to the MTBPS, further downgrades are considered to be a significant risk to the medium-term fiscal framework**

    - Whilst no additional funding will be given to support debt laden state-owned companies over the medium term, in the context of low projected growth rates in the outer years alongside unsustainable debt levels, spending pressures and the materialisation of contingent liabilities may lead to further credit rating downgrades.
    - Further downgrades will serve to increase the already rising costs of borrowing and servicing public debt, as well as, lowering investment confidence. It will also exacerbate the impact of the pandemic and it may hamper the implementation of key reforms that are intended to assist the country's recovery post-COVID-19.

2. The Fiscal Outlook

- **It is likely to be increasingly difficult to have sustained tax revenues** because of the Covid-19 pandemic which led to historic economic contraction and shrinking revenue. To increase tax revenues, there needs to be a strong and sustained economic recovery that addresses structural imbalances in the economy coupled with greater efficiency in revenue collection**.**

    - Revenue remains below pre-pandemic expectation however in-year revenue came in higher than expected because of a surge in commodity price (mining and quarrying sector) albeit temporary corporate income tax (CIT).
    - Revenue remains below pre-pandemic expectation however in-year revenue came in higher than expected because of a surge in commodity price (mining and quarrying sector) albeit temporary CIT.
    - In-year tax revenue growth [personal income tax (PIT), CIT and VAT] appreciated favourably because of strong recovery in earning –personal income tax, larger social transfers, lower borrowing costs and resilient household consumption therefore strengthening value-added tax (VAT).

[20] BER (2021)

[21] Ibid

- In 2021/22, gross tax revenue is expected to be R120.3 billion higher than projected in the 2021 Budget, with corresponding improvements of R69.8 billion and R59.5 billion expected in 2022/23 and 2023/24 respectively.
  - Over the medium term, tax revenues are expected to increase to R1.72 trillion, or 24.1 per cent of GDP, by 2024/25. Major revenue bases have been revised lower relative to the 2021 Budget as estimates project declines.

- **The expenditure is expected to breach the 2021 Budget review ceiling of R1.51 trillion by R56 billion owing to the COVID-19 lockdowns and public violence, as well as wage bill adjustments.**

  - Over the medium term, any further expenditure will be funded through increased revenue performance or through repriorisation enabling fiscal consolidation. The ceiling is raised by R30.5 billion in 2022/23 and R28.1 billion in 2023/24, compared to the 2021 Budget.
  - With COVID having impacted the economy negatively, many households have required increased support from the State. The government has extended and announced further fiscal relief packages in the current year that includes"
    - Re-introduction of R350 special COVID relief scheme;
    - SASRIA[22] to be provided R3.9 billion for balance sheet support (claims) following the July public violence;
    - An amount of R950 million to South African Police Service (SAPS) and South African National Defence Force (SANDF) for safety and security; and
    - An amount of R5 million for expanding the employment tax incentive (ETI) scheme that will be extended by four months from 1 August.

- **The deficit is likely to remain high** provided there is a commitment to ensuring that changes to spending are funded through revenue performance and reprioritisation.

  - Borrowing conditions have become favourable globally but SA needs to remain prudent as large debt redemptions need to be repaid or rolled-over;
  - The consolidated budget deficit will measure 7.8 per cent of GDP in 2021/22 and narrow to 4.9 per cent in 2024/25; and
  - Over the medium term, any further expenditure will be funded through increased revenue performance or through repriorisation enabling fiscal consolidation therefore reducing the budget deficit and stabilising the debt to GDP ratio

- **Debt has increased seven-fold** since 2007/08 to over R4 trillion in 2021/22 and the global pandemic in 2020 resulted in a sharp increase in borrowing.

  - High government's gross borrowing requirements means the interest payments absorbs most of the revenue generated;

[22] State Owned Insurer covering risks such as public disorder and riots

- Over the medium term, debt is expected to stabilise at 78.1 per cent of GDP by 2025/26. Reducing debt will enable the government to allocate additional revenue to debt service costs. Over the medium term, the gross borrowing requirement will average R503 billion, compared with R550.5 billion at the time of the 2021 Budget; and
- Debt service costs over the medium term will continue to rise but should be stabilised to enable spending on health, education and security. Compared with 2021 Budget projections, debt-service costs are expected to decline from 23.1 per cent to 22 per cent as a share of main budget revenue in 2025/26.

3. 2021 MTBPS spending priorities, fiscal consolidation, COVID-19 and economic recovery

- **As in the recent budgets, the MTBPS priorities support to economic recovery and fiscal sustainability trough fiscal consolidation.**
- **The purpose of fiscal consolidation is still to reduce budget deficit, stabilize debt, improve investor confidence and to minimize exposure to global and domestic risks.**
- **The proposed fiscal consolidation measures include spending restraint, no additional funding for SOEs over the medium term, no commitments to new long term spending despite the temporary surge in revenue collection that resulted from a spike in commodity prices.**

- **Despite slower spending growth in recent years in line with fiscal consolidation, government continues to devote considerable resources to core functions and social priorities - social wage accounts for nearly 60 per cent of consolidated non-interest spending over the MTEF period**

    - Consolidated government spending will amount to R6.4 trillion over the medium term;
    - The MTBPS proposes a net increase in the main budget non-interest spending of R59.4 billion. This constitutes an upward adjustment in spending of R77.3 billion, which is largely offset by drawdowns on the contingency reserve and provisional allocations from the 2021 Main Budget thus bringing total non-interest spending to R1.62 trillion for 2021/22. Table 1 below depicts major spending priorities;
    - A persistent threat to fiscal sustainability is the rampant rise in debt service costs which are expected to by grow by 10.8 per cent over the medium term, as they increase from R269.2 billion in 2021/22 and will reach R368.5 billion in 2024/25;
    - R11 billion provisionally set aside in the February main Budget is allocated for the implementation of phase 2 of the Presidential Employment Initiative - this will support the creation of more than 440 000 short-term jobs, livelihood-support programmes and other interventions expected to catalyse growth and job creation.

Table 1: 2021 Medium Term Consolidated Spending Priorities

Functional Area	Allocated Amount
Learning & Culture	R417.8 billion
Social Development	R399.6 billion
Health	R259 billion
Economic Development	R206.3 billion

Source: MTBPS 2021

- **Government guarantees to state-owned companies, the Renewable Energy Independent Power Producer Programme, public-private partnerships, and obligations to the Road Accident Fund and other social security funds are expected to exceed R1 trillion by 2023/24**
    - The guarantee portfolio increased sharply from R693.7 billion in March 2020 to R789.8 billion in March 2021, of which R567.6 billion (71.9 per cent) has been utilised.
        - The majority of the increase is attributable to the R100 billion COVID-19 loan guarantee scheme introduced in June 2020 Special Adjustments Budget as part of the stimulus package to address the economic impact of COVID-19; however, exposure remains low owing to muted demand for these loans.
    - While Eskom has been aggressively paying off its debt, it still poses a significant risk to public finances. Of the R350 billion issued guarantees, R281.6 billion has been utilised and a further R7 billion is committed. Profitability is persistently hampered by capacity shortages and adverse economic conditions as the entity realised a net loss of R18.9 billion for the 2020/21 financial year and thus continues to be reliant on debt to finance its operations.
        - To enable Eskom to execute its borrowing plan and access capital markets, the Minister of Finance approved a special dispensation to allow Eskom to access additional guaranteed debt of R42 billion in 2021/22 and R25 billion in 2022/23, and this falls within its existing guarantee facility.
    - Policy uncertainty on government's user-pay principle explicitly threatens the profitability of SANRAL. Government has extended a total guarantee facility of R37.9 billion to the agency, of which R28.4 billion had been used by 31 March 2021. Notwithstanding this support, the entity has been unsuccessful in issuing bonds in the market since 2017 and thus will remain a significant burden on public finances.
    - Accumulated liabilities of the Road Accident Fund (RAF) were last estimated at R450 billion and the unpaid claims backlog was R14.8 billion in 2020/21. Delays in the reform of the Road Accident Benefit Scheme means the entity is operating on a financially unsustainable model that remains a contingent risk to public finances.
    - Denel is technically insolvent and thus experiencing difficulties in meeting its obligations as they fall due. Government provided recapitalisations of R1.8 billion in 2019/20 and R576 million in 2020/21 to stimulate revenue generation; and extended a R5.9 billion guaranteed debt facility. The MTBPS proposes an allocation of R2.9 billion to settle further debt repayments.
    - Over the medium term redemptions of government guaranteed debt will average R19.3 billion, a considerable decline from R35.6 billion in 2020/21 and R27.5 billion in 2019/20.

- Government recognises that state owned companies (SOCs) are important enablers of economic development, however concedes that maladministration has led to the deterioration of the financial position of several major SOCs, which remains a large contingent risk.

- Despites its benefits, the main risk of fiscal consolidation is that government is unlikely to meet the three main NDP proprieties (. i.e. addressing unemployment, poverty and inequality). Departments will continue to perform at low capacity levels, which could be detrimental to service delivery and achievement of economic recovery and various long-term goals envisioned in the NDP Vision 2030.

4. The Division of Revenue

- **The Government remains steadfast in its commitment towards ensuring that public finances are placed on a more sound and sustainable footing, and thus growth in non-interest expenditure within the three spheres of government will be closely managed over the 2022 medium term. The Government proposes the following with regards to the equitable share of nationally raised revenue among the three government spheres over the 2022 medium term:**

    - The national government will receive a share of 48.4 per cent of nationally raised revenue, whilst provincial government will receive 42 per cent and local government will receive 9.6 per cent.
    - The national government equitable share of nationally raised revenue will decline by 1.8 per cent, provincial equitable share will increase by 0.7 per cent and local government's equitable share will increase by 4.1 per cent.

- **Several changes are proposed to the provincial and local government conditional grant frameworks of the medium term and these include:**

    - Agriculture colleges have been shifted to the national government and will be funded through the Comprehensive Agricultural Support Programme Grant.
    - The administration of the Early Childhood Development Grant will be moved from the Department of Social Development to the Department of Basic Education from 2022/23.
    - A number of components have been introduced into the HIV, TB, Malaria and Community Outreach Grant over the years. However as of 2020/23, this grant will be renamed the District Health Programme Grant consisting of two components namely: (i) HIV/AIDS component, funding HIV/AIDS- and tuberculosis-related services; and (ii) a district health component, funding community outreach services and services related to COVID-19, human papillomavirus and malaria
    - The incentive component of the Provincial Roads Maintenance Grant will be removed for 2022/23 due to delays in developing objective allocation criteria. National Treasury will continue to work with the Department of Transport to develop objective criteria for the incentive component.
    - The 2021 Budget stated that the scope of the municipal infrastructure grant would be expanded to help municipalities improve their asset management practices; however, this

change has been delayed, so funds will not be allocated to a new indirect component of the grant at the beginning of 2022/23.

5. Concluding remarks

- South Africa faces an uncertain fiscal outlook due to many internal as well as exogenous factors. The deterioration of State Owned Entities, the legal processes associated with public-service compensation and high debt levels have impacted on the slow economic recovery.

- Provincial and local governments will continue to face multiple pressures over the medium term as government reduces spending growth and poor economic performance related to the impact of the COVID-19 pandemic and lockdown restrictions thus affecting provincial and local revenues and other funding sources. Over the medium term, provincial and local governments have to ensure that they maintain strict control over their expenditures while maintaining services delivery levels. It is also important for provincial and local governments to ensure that investments in revenue-generating infrastructure/activities are not delayed any further by the COVID-19 pandemic, so that these investments can come to fruition and contribute to the economic recovery of the country.

- Financial constraints facing the country put a strain on the budget and it is vital for SOEs to fulfil their developmental mandates in order to contribute to SAs development. Irregular, fruitless and wasteful expenditure that has been incurred by SOEs is concerning. Oversight on this type of expenditure must be intensified.
    - The poor financial condition and operational performance of several large state-owned companies is one of many significant risks to the economic and fiscal outlook.

    - While Government has committed to avoid further bailouts of state-owned entities (SOCs), implicit guarantees for government bailouts remain elevated should there be further waves of the COVID-19 pandemic as SOCs are still grappling with an adverse and uncertain operating environment; or should there be other unforeseen shocks to the economy as seen with the July 2021 unrests.

    - Also, the management and governance of SOEs will determine the success of the announced budgetary measures.
    - Other key factors relate to:
        - Effective turnaround of municipal performance and governance
        - Effective, economic and efficient use of allocated resources
        - Sound management of procurement process
        - Application of consequences against poor performance and poor financial performance.

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