MEDIUM TERM BUDGET
POLICY STATEMENT

# RESPONSE TO PUBLIC HEARINGS ON THE 2021 MTBPS

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

# LIST OF ORGANISATIONS THAT MADE SUBMISSIONS

- South African Institute of Chartered Accountants (SAICA)
- Amandla.Mobi
- Congress of South African Trade Unions (COSATU)
- Financial and Fiscal Commission (FFC)
- Parliament Budget Office (PBO)
- Healthy Living Alliance (HEALA)
- South African Breweries
- Organisation Undoing Tax Abuse (OUTA)
- SMMEIC

# MAIN COMMENTS FROM PUBLIC HEARINGS

1. **Economic growth and reforms:** (DIFFERING VIEWS) - Higher economic growth in 2021/22 will be temporary as pre-existing structural economic constraints remain salient. Government expenditure as a share of GDP has increased in the previous decade; however, economic growth has slowly trended downwards. This implies structural bottlenecks remain a drag on economic growth. The MTBPS provided a few new ideas or interventions to grow an economy: no new allocations were provided to stimulate a stagnant economy. Massive stimulus package is needed that would help battered businesses, save and create jobs and thus increase state revenues to reduce the debt trajectory to a sustainable level.

2. **Revenue and tax proposals:** future tax policy should focus on widening tax bases rather than increasing tax rates. Priority should be given to providing SARS with the funds that require it to function optimally.

3. **Expenditure:** credibility of the expenditure ceiling; increase social grants spending; prioritise spending towards infrastructure and the provision of essential basic services.

4. **Fiscal policy:** 2021 MTBPS does not address how the poorest households and businesses will be supported and provided relief; credibility of the fiscal framework, as fiscal policy has been generally characterized by slippage; short-term reprioritization would hinder the implementation of government's medium to long-term policy priorities; fiscal consolidation has resulted in real per capita reductions and a suboptimal composition of expenditure.

5. **Other matters raised:** expedited action to restructure SOEs is required, as they remain long-standing due to their burden on the fiscus; focusing solely on reducing expenditure to ensure debt sustainability is insufficient, a growth-led strategy should rather be followed.

# KEY POLICY CONSIDERATIONS (RESPONSES TO POLICY MATTERS RAISED)

- **More debt funded spending does not necessarily result in more growth:**
  - Since 2008/09 government expenditure as share of GDP has increased. However, growth slowed significantly over the same period.
  - Debt rose, and the increasing debt service costs have crowded out other forms of public expenditure including infrastructure and social spending.
  - Policy uncertainty and high levels of public debt deter private investment, employment and growth.
  - Structural constraints (e.g. lack of electricity) severely inhibit the ability of additional government spending to have a positive impact on growth
- **Low potential growth limits the scope for stimulus:**
  - Potential growth has remained below 2 per cent since 2013 (it has fallen below 1 over the past 3 years)
  - This suggests that it is unlikely that additional spending will stimulate growth without increasing inflation in the prevailing environment of low trend growth and high debt levels
  - Higher spending is likely to lead to higher debt-service costs and higher inflation and overall interest rates in an environment of low trend growth
- **A significant proportion of the fiscal framework is dedicated to the social wage**
- **The composition and efficiency of government spending are critical to seeing improved growth outcomes**


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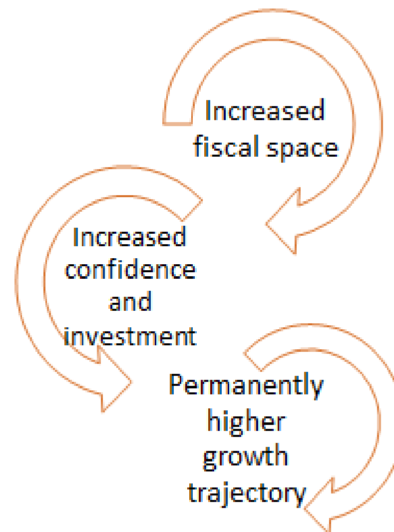
# STRUCTURAL REFORMS ARE CRITICAL FOR GROWTH

- Our structural weaknesses ( e.g. **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.
- Making progress on our structural reform agenda can make a big difference in both the short and longer term:
  - In the short term, the credibility gains can be reflected in a lower risk premium and reduced borrowing costs, which frees up fiscal space;
  - In the medium term, through improved confidence and investment leading to improved growth and improved debt trajectory; and
  - In the longer term through a permanently higher growth trajectory (higher potential GDP).



# TAX INCREASES

MTBPS

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- The MTBPS did not include announcements on tax policy, as these are generally reserved for the Budget in February each year.
- As with many tax policy issues there are conflicting submissions, but these proposals will all be considered for the 2022 Budget.
- In terms of excise duties on alcohol, government has recognised that the excise burdens for wine, beer and spirits are above the policy guidelines of 11, 23 and 36 per cent and the Minister announced a review of both the alcohol and tobacco excise duty regimes.
  - Government aims to publish discussion documents on these policy areas and then consult with industry and the public
- The 2021 Budget stated that there was "no compelling case to increase [personal income] tax rates at this time" and previous budgets highlighted the need to broaden the tax base.
- Also in the 2021 Budget, additional funds were allocated to SARS to bolster their capacity to reduce tax evasion and improve compliance
- Announcements on changes to tax policy will be made in the 2022 Budget

# RELATIVELY HIGH LEVEL OF TAX-TO-GDP VS OTHER MIDDLE-INCOME COUNTRIES

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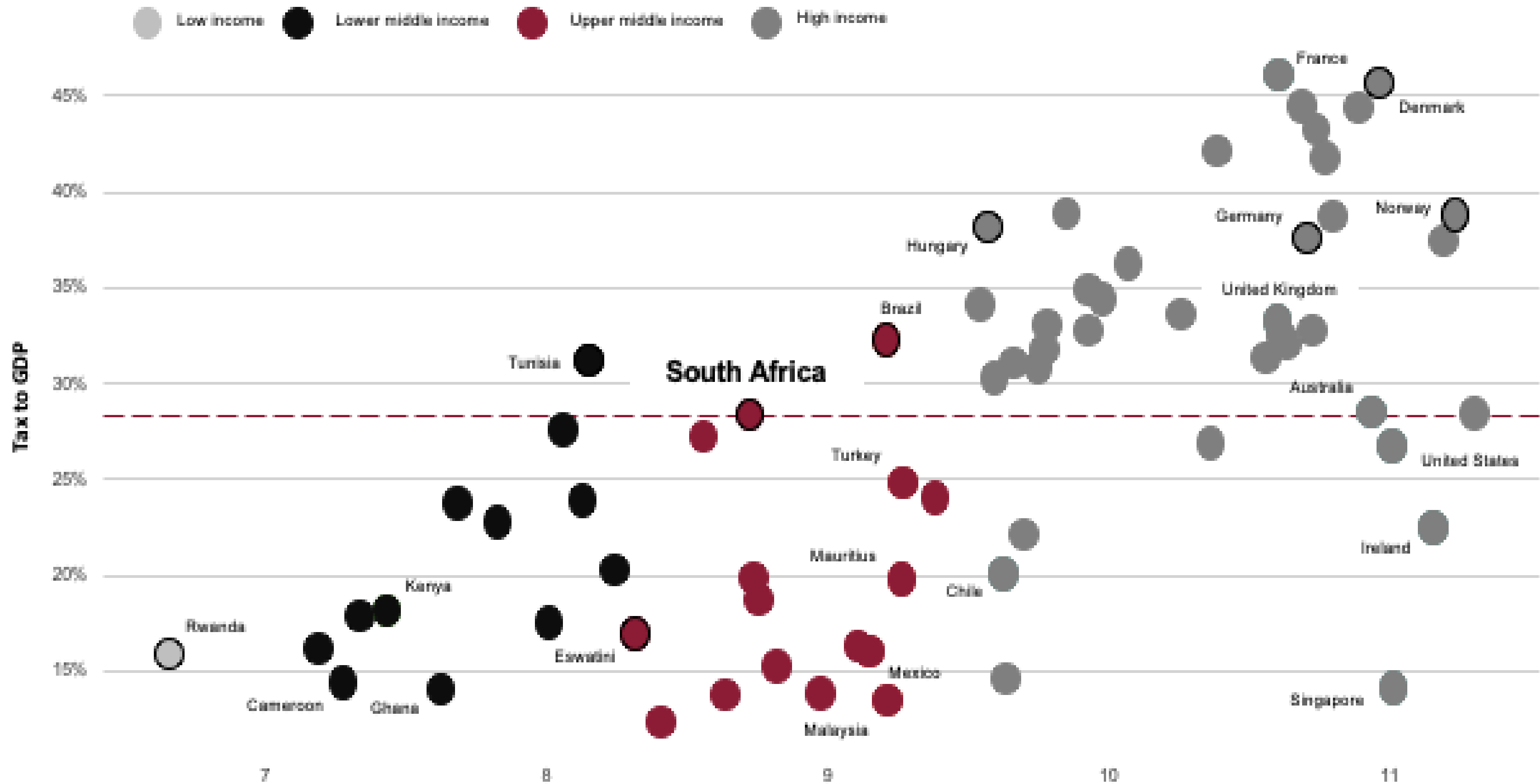




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# GOVERNMENT SPENDING TO STIMULATE GROWTH

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- Government spending excluding interest on debt has grown sharply in real terms, primarily because of increases in public-service compensation
- South Africa's fiscal multiplier is low. The low multiplier is likely due to several reasons, including spending patterns that have historically skewed towards consumption rather than investment.
- Infrastructure investment multipliers tend to exceed consumption multipliers. To promote growth, the share of capital expenditure of total spending is set to increase. These infrastructure projects will be financed in part through the Infrastructure Fund.

# FISCAL RESILIENCE AND DEBT SUSTAINABILITY (1)

## SA's fiscal support package

- The R500 billion fiscal package announced in 2020/21 is one of the ***largest among emerging and G20 countries.***
- South Africa is the ***only sub-Saharan country*** that implemented a fiscal package with double figures (10%) of its GDP.
- ***Emerging markets*** adopted fiscal support packages averaging approximately 6% of GDP
  - African countries only averaged approximately 4% of GDP.
  - The rest of the other sub-Saharan African countries adopted stimulus packages below 5%

  *Source: African Development Institute, 2020*
- These measures were over and above significant monetary policy support to the economy, including through a reduction in the repo rate by the SARB to a 50-year low
- The fiscal support package was introduced despite the fact that the fiscal position was at its weakest in the democratic era

# FISCAL RESILIENCE AND DEBT SUSTAINABILITY (2)

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## Credibility of fiscal framework and expenditure ceiling

- Before the global financial crisis, GDP and fiscal metrics were at sustainable levels
- After the crisis, fiscal policy on average was expansionary between 2009 and 2019. However, economic growth remained weak and fiscal imbalances widened.
- This meant that SA was in a compromised fiscal position before the onset of the COVID pandemic with debt and debt service costs at unsustainable levels.
- Debt-service costs now consume R1 out of every R5 raised in taxes and are the fastest growing item of spending. This is a direct result of accumulating more debt than the fiscus can carry.
- The expenditure ceiling is breached over the MTEF given the support the economy needs (and can afford to provide) at this stage.

# EXPENDITURE PRESSURES – SOCIAL GRANTS

- Government is sympathetic to the current pressures on grant beneficiaries. Nevertheless, over 46 per cent of the entire population currently receives social grants, representing an unusually high coverage for a developing country. If job creation continues to be poor, the sustainability of the system and the overall fiscal position will become a serious concern.
- The social wage represents 59.5 per cent of total non-interest expenditure, mainly driven by basic education, health and social protection (i.e. social grants).
- The budget provides R37.9 billion in direct in-year relief responding to the COVID-19 pandemic. This included the special COVID-19 social relief of distress grant, whose 9.5 million beneficiaries bring the number of social grant recipients to 27.8 million.
- There are already 27.8 million people in the system receiving grants, 9.4 million receiving the Social Relief of Distress grant. Increasing grants beyond current levels would require tough decisions at the political level on how priorities should be readjusted in government.
- The population is projected to increase from 60 million in 2021 to 71 million by 2040, resulting in a higher number of children and old people depending on child social grants, old age pension grants, basic education and health. The increased spending required from government will place pressure on fiscal sustainability.
- Additional spending of a permanent nature would require additional sources of funding, either through reprioritisation of existing expenditure allocations or increased taxes that would hurt the working class
- Government is still researching possible new social support options once the special COVID-19 social relief of distress grant ends in March 2022. Given the significant financial implications, a final decision must still be made on what is affordable given the current fiscal context.

# IMPROVING SPENDING EFFICIENCY AND CAPACITY

- The National Treasury continues to expand the tools available for provinces and municipalities to improve spending and build operational and technical capacity.
- In 2020, The National Treasury and the Government Technical Advisory Centre helped train provincial officials to conduct spending reviews to address inefficiency and poor financial management.
- In 2021, The National Treasury will review provincial infrastructure sector funding policies and propose how grants, incentives and other funding can be best structured to coordinate planning and budgeting. This is intended to improve coordination between national, provincial and local government – including state entities – to strengthen accountability and service delivery.
- National government continues to support provinces and municipalities to deliver their mandates and impose consequences where there is evidence that public finance laws have been violated.
- The Financial Action Task Force (FAFT) report identified significant weaknesses in the country's anti-money laundering and counter-financing of terrorism systems. Many of these weaknesses developed between 2009 and 2018, coinciding with the period of state capture. The National Treasury will work with the Reserve Bank, the Financial Intelligence Centre and other departments to address the deficiencies identified within the 18-month timeframe established by the FAFT. As acknowledged in the report, South Africa is rebuilding the institutional integrity and capacity of key agencies weakened by state capture.
- Additional spending allocation of R3 billion is provided to South African Revenue Service (SARS) to modernise its technology infrastructure and systems, expand and improve the use of data analytics and artificial intelligence capabilities, and participate meaningfully in global tax compliance initiatives. A digitalized SARS is intended to lower costs of compliance, simplify tax administration and improve collections.

# CONCLUSION

- National Treasury notes and appreciates the submissions. The 2021 MTBPS strikes a difficult balance between providing immediate support for the economy and shoring up the country's public finances.
- Government has long directed the majority of public spending to address deeply entrenched poverty and unemployment. The social wage – combined public spending on health, education, housing, social protection, employment programmes and local amenities – remains high by global standards, averaging almost 60 per cent of consolidated non-interest spending over the next three years.
- Since the 2021 Budget, South Africa has benefited from a surge in global demand for our commodities. Higher commodity prices have temporarily increased economic growth and tax revenue. This windfall is welcome, but likely temporary. Moreover, revenue remains well below pre-pandemic projections.
- The consolidation presented in the MTBPS will be supported by structural reforms that unlock private-sector investment and job creation. As such, over the period ahead, government will accelerate structural reforms to promote growth, while keeping fiscal consolidation on course to narrow the budget deficit and stabilise debt.
- Restoring the health of the public finances is also critical for ensuring South Africa is able to weather the storms of a future crisis.
- Significant risks remain elevated for the economic and fiscal outlook

# ANNEX: STRUCTURAL REFORMS ARE CRITICAL FOR GROWTH

**Water**

- Research and consultation is underway through Operation Vulindlela and the DWS to best position the National Water Resources Infrastructure Agency (NWRIA). The project investigates the rationale, business case and regulatory and pricing considerations that informs proposed institutional arrangements. This includes amongst other the issues related to bulk water supply. It would therefore be premature to assume the functions of the NWRIA at this stage. There is a recognition that the NWRIA is not a cure-all for the concerns in the water sector but that the investigation into the considerations for the institutional make-up on an NWRIA is still at a formative stage.

**Transport**

- Corporatisation of the Transnet National Ports Authority, as required by the National Ports Act of 2005, is intended to increase the competitiveness of South Africa's ports by separating the functions of TNPA as the infrastructure owner and Transnet Port Terminals as the terminal operator.
- This separation in functions will enable each to be fulfilled more independently and with greater efficiency, allowing for port revenues to be invested in port infrastructure and for the fair and equal treatment of port terminal operators.
- This reform is expected to reverse the declining trend in the performance our ports and ensure the economy benefits from increased efficiency, lower costs, new investment in port infrastructure and private sector competition.

# ANNEX: STRUCTURAL REFORMS ARE CRITICAL FOR GROWTH (CONT.)

**Transport (cont.)**

- Enabling third party access to rail will provide means for the state to access capital, capacity and private-sector expertise into the rail network. Beyond access revenue to be generated by Transnet, the economy will benefit from positive spill-overs of the anticipated investments as well as being able to increase capacity of the current rail network.
- There is potentially 58 million tons that could move from road to rail benefiting sectors such as agricultural commodities, metals and minerals, cars, containers, hazardous chemicals and liquid bulk. Indeed, private operators have already pronounced on investment commitments.

# ANNEX: FURTHER CONSIDERATIONS FOR EXCISE DUTIES ON BEER

- Excise taxation and pricing policies are important tools to control alcohol consumption and its related health and societal harms
- South Africa's alcohol excise duty rate structure using benchmarks was implemented in 2002 (revised in 2012), where tax burdens were as follows:-

| | Excise duties & VAT | VAT | Excise duties |
|---|---|---|---|
| Wine | 23% | 12.3% | 10.7% |
| clear beer | 33%; 35% | 12.3% | 20.7% ; 22.7% |
| spirits | 43%; 48% | 12.3% | 30.7% ; 35.7% |

- Alcohol excise duties were increased above inflation since 2002/03 to achieve and maintain the targeted tax burdens
- In Budget 2015, the focus moved to excise component and revised to 11, 23 and 36 per cent for wine, beer and spirits, respectively. This change necessitated further above inflation increases
- This was acknowledged by SAB/ABInBev in a presentation to NT in November 2018
- Targeted incidence has been exceeded in the last 2 financial years since the price increases on some of alcoholic beverages haven't kept pace with excise increases
- Policy position is to increase excise duties by expected inflation, *as a minimum*, on an annual basis



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# ANNEX: ADDITIONAL DETAIL ON THE HEALTH PROMOTION LEVY

- NDoH's Strategic Plan for the Prevention and Control of NCDs 2013 – 2017, and National Strategy for the Prevention and Control of Obesity 2015 – 2020, identified unhealthy diets, such as salt, sugar and saturated fat, as one of the four major risk factors for NCDs
- Taxes on unhealthy food (foods high in fats and sugar) identified as key policy intervention hence Health Promotion Levy was implemented in April 2018, on sugary beverages
- The objective was to reduce excessive sugar consumption and induce product reformulation
- Impacts of obesity reduction cannot be assessed in such a short period of time and require more interventions to change the food environment
- Most of the problems of cane-growers emanated before the HPL due to drought, cheap imports, high input costs, etc
- The presentation by DTIC at Portfolio Committee on Trade and Industry on 4 Sept 2019 titled "Status on matters relating to the Sugar Industry" indicates:-
  - *South Africa's share of SACU local market shrunk from 1.6 to 1.2 million tonnes – the lowest since 1983*
  - *Area under cane has shrunk by 60 000 hectares from 430 000 ha in 2000 to 360 000 ha – loss 2% per annum – the lowest since 1983*
  - *Increase in imports of sugar hence request for import tariff protection*
  - *Shrinking slowly – 10 year crop – farmers stop investing or switch; and marginal growers going out of business.*

| tons | Actual | | |
|---|---|---|---|
| | 2016/17 | 2017/18 | 2018/19 |
| **SACU Market Demand** | **2 314 779** | **2 093 452** | **1 857 991** |
| % reduction in demand year-on year | | -9.6% | -11.2% |
| Eswatini* | 379 083 | 390 000 | 410 000 |
| Duty Paid Foreign Imports** | 283 582 | 519 231 | 196 782 |
| SADC Quota** | 9 114 | 5 922 | 23 500 |
| SA Producers' Sales*** | 1 643 000 | 1 178 299 | 1 227 709 |

* estimates are based on SARS import statistics and information from the Eswatini Sugar Association website
** SARS statistics
*** Actual sales by South African millers



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