South Africa's 2022-budget:

Presentation to a joint sitting of the Parliamentary Standing and Select Committees on Finance

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Presentation by the Fiscal Cliff Study Group:

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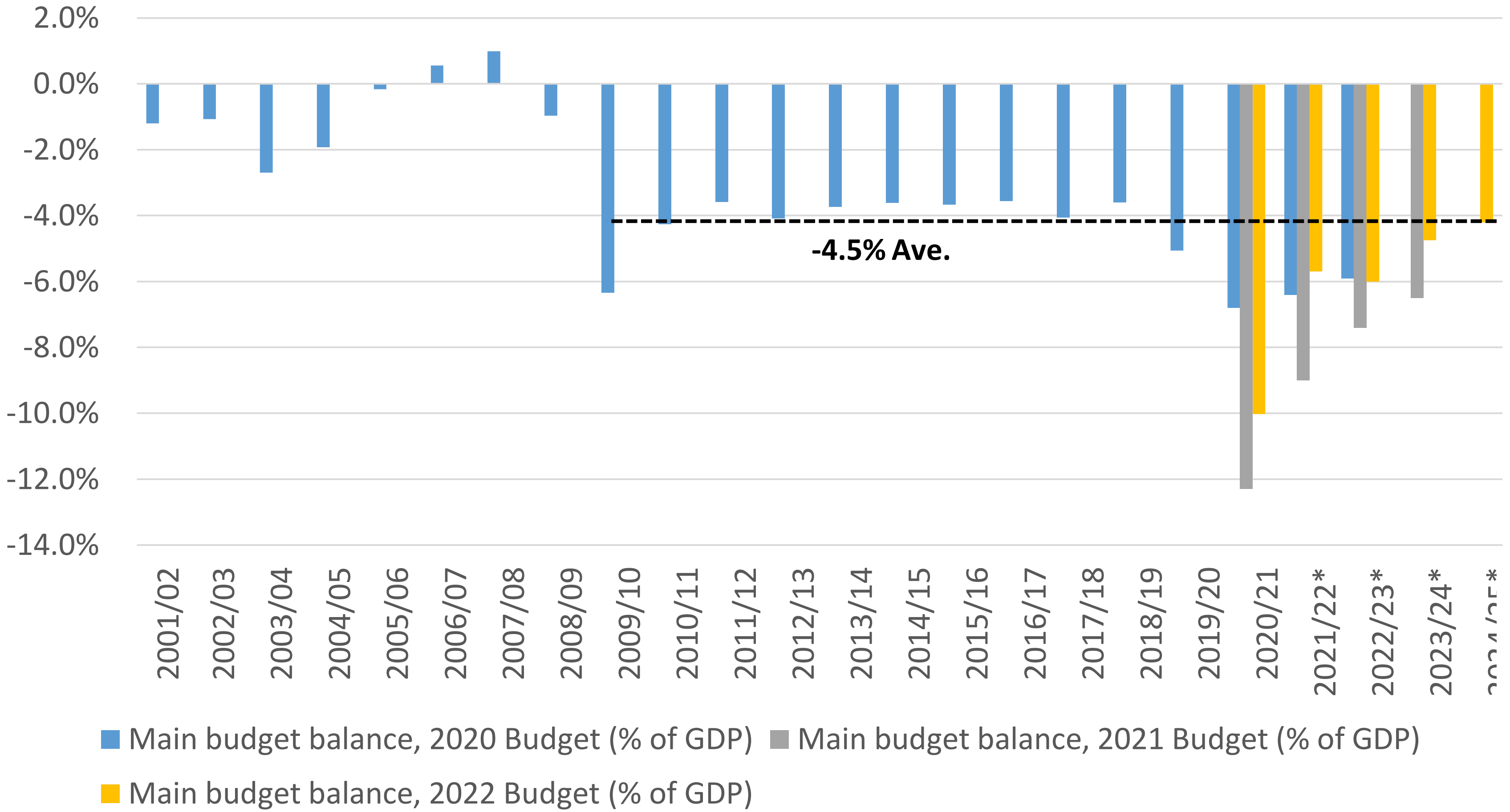
Overview of Presentation

- No budget austerity in 15 fiscal years
- Public-sector institutions
- Civil service remuneration
- Decline in SA’s potential growth rate
- Fiscal cliff update
- Recommendations

No budget austerity in 15 fiscal years



*Treasury forecasts (various National Budgets)

Source: SARB, Treasury

No budget austerity in 15 fiscal years

- South Africa has been running historically large deficits (4.5% GDP average) during the last decade.
- The budget deficit of 10% of GDP in 2020/21 one of largest on record.
- Expenditure (3.2%*) and debt (9.5%*) continue to rise
- Social grant beneficiaries to increase by more than a million over the medium term; special grant extended for another year
- All of this is evidence of a <u>highly expansionary fiscal stance</u>
- Reality is that SA has reached its <u>fiscal cliff/ fiscal limit</u>; thus making it *appear* as if measures (similar to austerity) is being implemented

*Average annual rise over medium term, as per 2022 National Budget
<u>Source</u>: thebalance.com, 2021 Budget Review

Public-sector institutions

- ‘Companies listed in Schedule 2 of the Public Finance Management Act (1999), referred to as major public entities, are **intended to operate as sustainable businesses** that **generate profits** and can **borrow on the strength of their own balance sheets**. These companies have **extensive borrowing powers compared with other public entities’**.

- 2022 Budget:
  - In 2021/22, state-owned companies made limited progress in their reforms
  - Over the past 12 months, a number of state-owned companies have missed their capital investment and loan disbursement targets
  - Investors have increasingly expressed an unwillingness to extend capital to such entities without government guarantees

- High time that the ‘extensive borrowing powers’ are ‘normalised’

- Better (more detailed) reporting on SOE’s will be welcomed as South Africa seems to be turning into the ‘Republic of SOE’s’

Source: 2022 Budget Review, Chapter 8: 91-92

Civil service remuneration

- The Fiscal Cliff Study Group (FCSG) has warned about unsustainable growth in civil service expenditure since 2013
- 'No general increase for civil servants' (February 2021 Budget)
- 2022 Budget notes that: *'(c)ompensation spending will increase from R665.1 billion in 2021/22 to R702 billion in 2024/25, at an* ***average annual rate of 1.8 per cent****'*
- *'No provision is made over the medium term for spending increases on compensation above this level. Departments are required to continue adhering to their compensation ceilings and, if needed, reduce personnel numbers to sustainable levels'*
- **Yet, compensation data from the 2022 Budget, indicates that various of the previous 'cuts' have simply been added back again to the latest figures…? (see next slide)**
- The whole budget rests on maintaining this budget position iro civil service remuneration: If this position slips, the budget falls apart

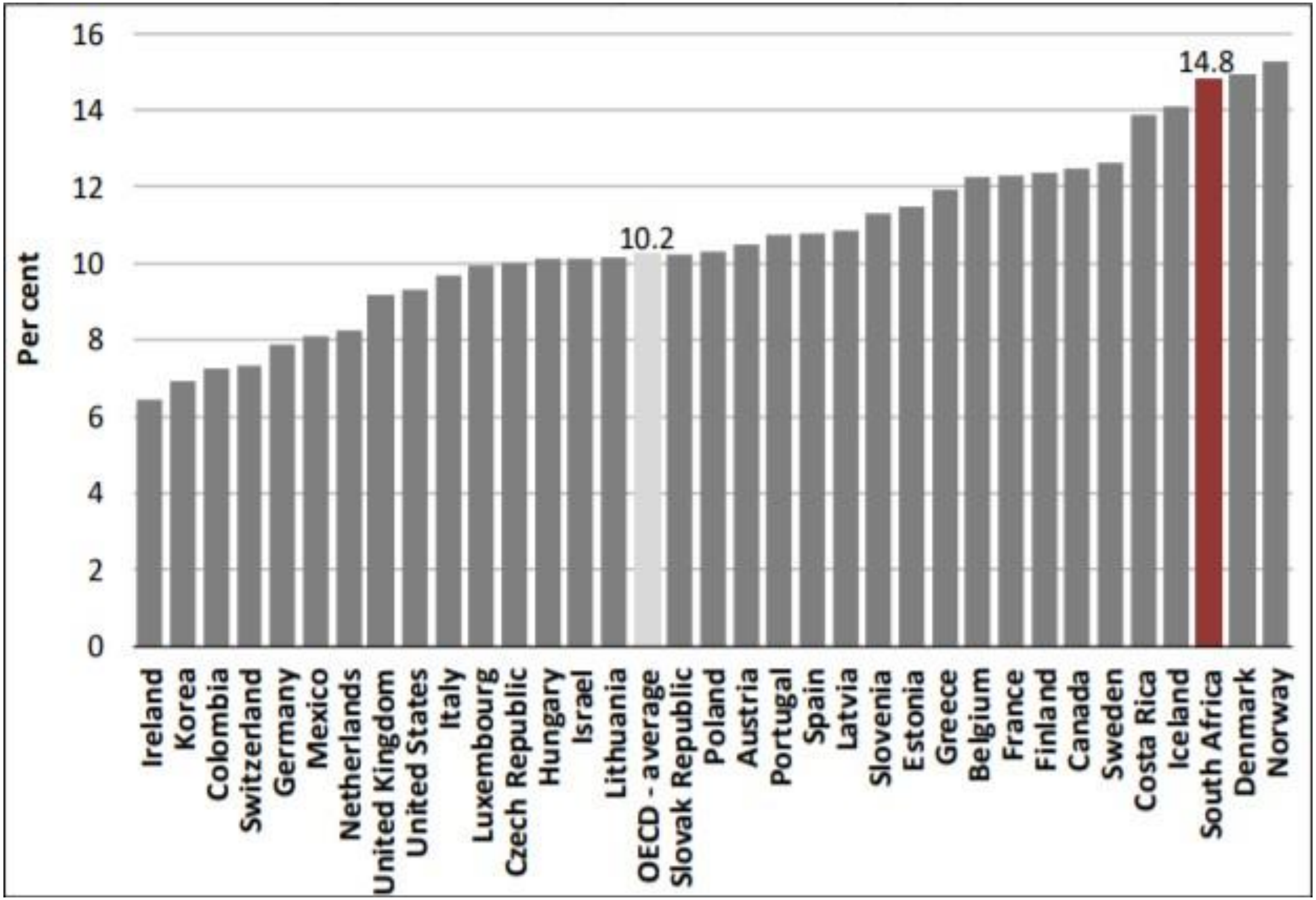
Source: 2022 Budget Review, Chapter 8: 91-92

Civil service remuneration

R,bn	2020/21	2021/22	2022/23	2023/24	Average annual nominal growth
2020 Budget	638.9	667.8	697.1	n/a	3.50%
2021 Budget	636.9	650.4	656	659.3	1.20%
Difference	-2.0	-17.4	-41.1	n/a	
2022 Budget	634.5	665	682.5	675	1.80%
Difference	-2.4	14.6	26.5	15.7	

Source: 2021 and 2020 Budgets, 2020 and 2019 MTBPS, Own calculations

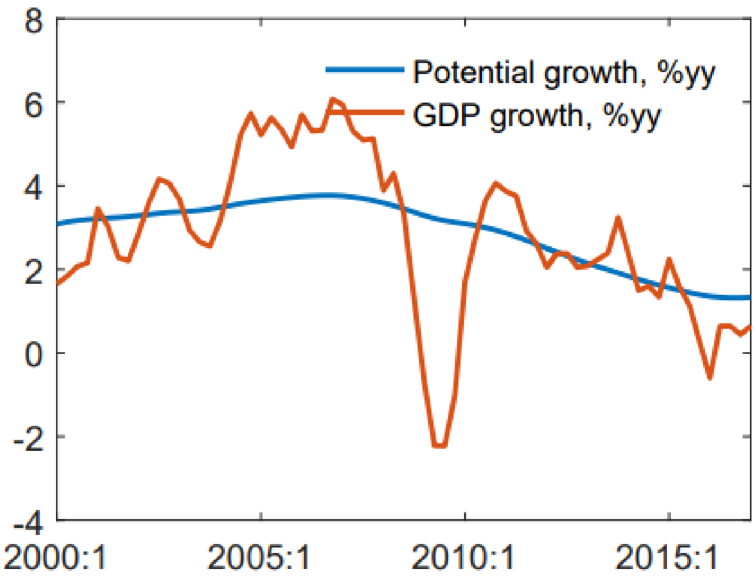
Civil service remuneration – as percent GDP



Source: 2021 Budget, Individual chapters 3: 31

Decline in SA’s potential growth rate

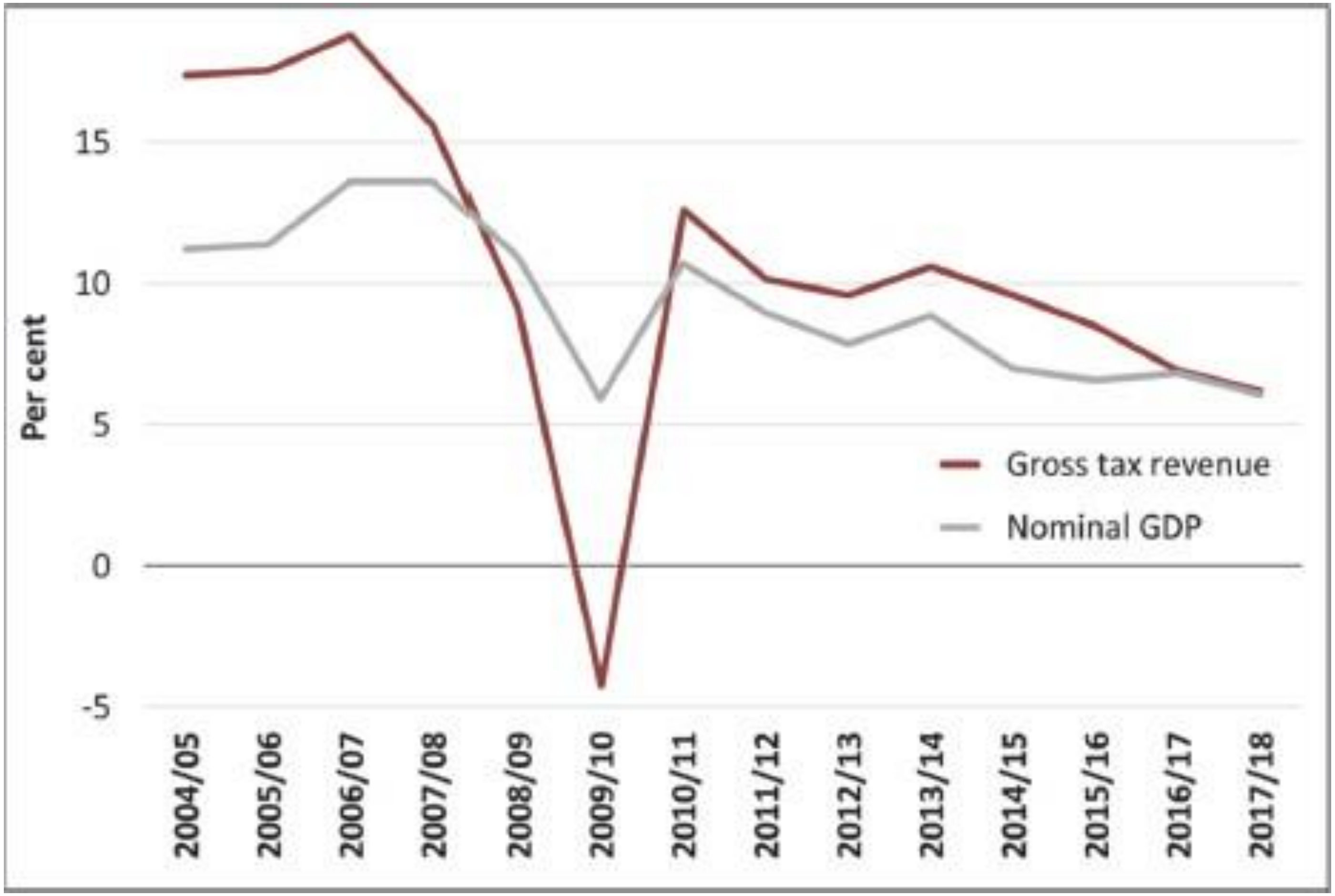
- South Africa’s potential growth has slowed significantly after reaching a peak in the mid2000s. Anvari, Ehlers, and Steinbach (2014) estimate that the country’s **potential growth declined from around 4% at its peak in the mid-2000s to around 2% after the global financial crisis**
- We find estimates of the **natural growth rate in the 1.9% - 2.3% range**. However, there is also evidence to suggest that the rate is under considerable downward pressure in the post-2010 period. The strongest decline is in the real sectors of the economy (Manufacturing, Mining), the greatest resilience in the service sectors (financial in particular)
- “Reaching lows of **1.1% by early 2017”**



Source: Botha, et al. 2019.; Fedderke, et al. 2016.

Why is this important…?

Government Revenue Correlates to GDP Growth



Source: 2017 MTBPS, Chapter 1:4

Fiscal cliff

- The fiscal cliff is the point where civil service remuneration, social assistance payments and debt-service costs will absorb all government revenue

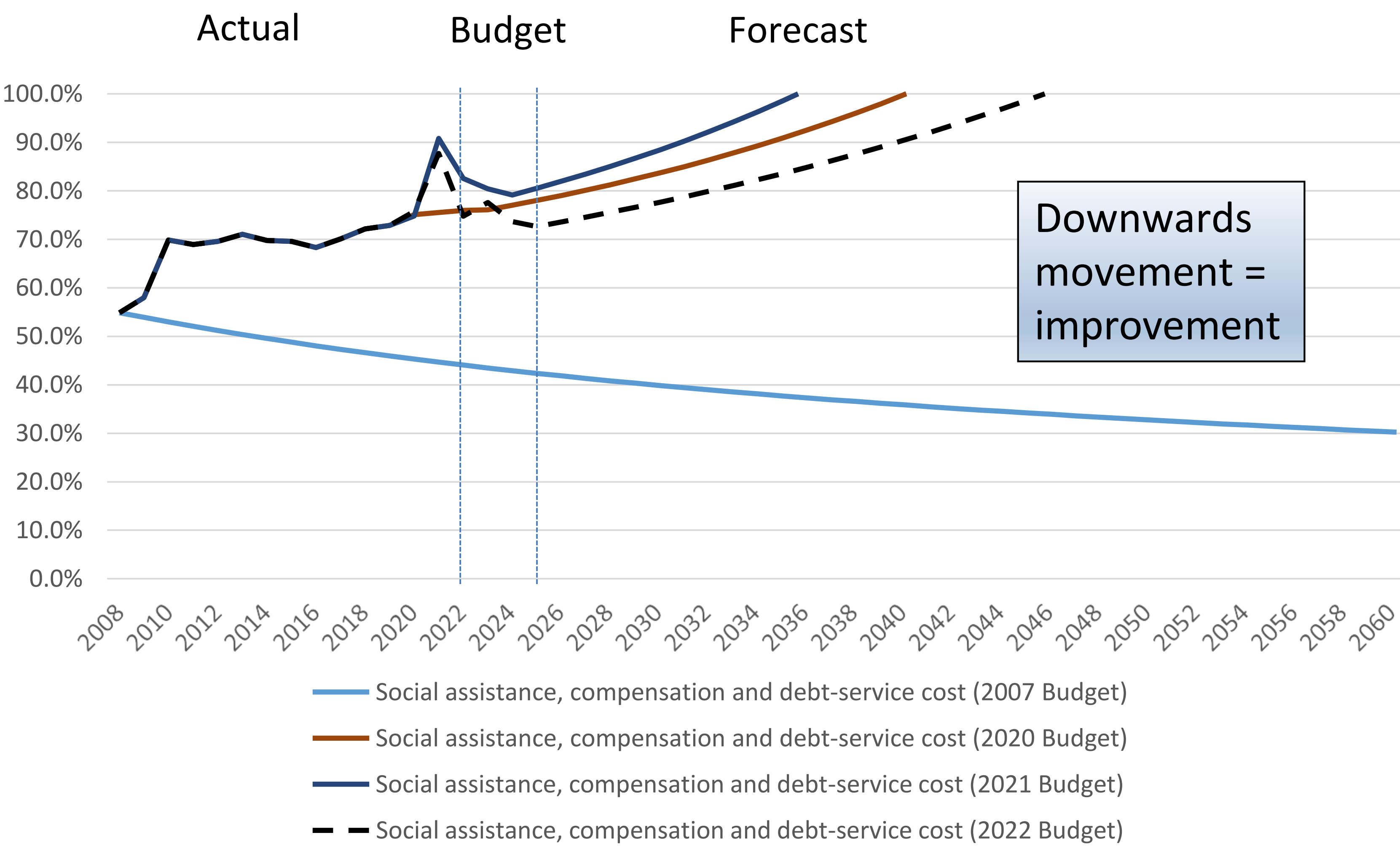
- Compensation of employees + social assistance payments + debt-service costs:
  - 55,0% of tax revenue in 2007/08
  - 75,5% of tax revenue in terms of February 2020 budget
  - > 100,0% of estimated tax revenue in terms of 2020 MTBPS
  - 91,0% of estimated tax revenue in terms of February 2021 budget
  - **74,7% of estimated tax revenue in terms of February 2022 budget**

Fiscal cliff: Projections for 2022/23 and beyond

Assumptions:

- **<u>Revenue</u>** recovery up to 2024/25 as per Budget. Thereafter growth of 6,6% per annum (average of 2007/08 to 2024/25)
- **<u>Civil service remuneration</u>** figures as per Budget until 2024/25. Thereafter average inflation plus 1 percentage point
- **<u>Debt-service costs</u>** figures as per Budget until 2024/25. Thereafter growth of 10,7% per annum (medium term average)
- **<u>Social assistance payments</u>** figures as per Budget until 2024/25. Thereafter to increase by average inflationplus 1 percentage point

Fiscal Cliff Barometer (2022 Budget)



*Graph intentionally limited to 100% of revenue

Vehicles manufactured in South Africa

- On previous occasions the FCSG repeatedly recommended that the central and provincial governments should only purchase vehicles manufactured in South Africa

- This was supported by the select and standing committees on finance

Taxpayers per income category, 2022/23

Taxable bracket	Registered individuals		Taxable income		Income tax payable before relief		Income tax relief after proposals		Income tax payable after proposals	
R thousand	**Number**	**%**	**R billion**	**%**	**R billion**	**%**	**R billion**	**%**	**R billion**	**%**
R0 - R91[1]	7 700 135	–	272.9	–						
R91 - R150	1 973 185	26.5	227.5	8.2	15.8	2.6	-1.2	8.7	14.6	2.5
R150 - R250	1 717 760	23.1	338.6	12.2	28.4	4.7	-1.6	12.0	26.8	4.6
R250 - R350	1 231 672	16.5	363.6	13.1	50.2	8.3	-1.9	14.2	48.3	8.2
R350 - R500	1 158 117	15.6	478.2	17.3	86.4	14.4	-2.8	20.5	83.6	14.2
R500 - R750	756 629	10.2	456.7	16.5	107.4	17.9	-2.8	20.5	104.6	17.8
R750 - R1 000	274 963	3.7	237.7	8.6	67.6	11.2	-1.3	9.7	66.3	11.3
R1 000 - R1 500	199 837	2.7	238.1	8.6	76.3	12.7	-1.0	7.3	75.3	12.8
R1 500 +	133 230	1.8	425.0	15.4	169.4	28.2	-1.0	7.1	168.4	28.7
Total	**7 445 393**	**100.0**	**2 765.3**	**100.0**	**601.4**	**100.0**	**-13.5**	**100.0**	**587.9**	**100.0**
Grand total	**15 145 528**		**3 038.2**		**601.4**		**-13.5**		**587.9**	

1. Registered individuals with taxable income below the income-tax threshold

<u>Source</u>: 2022 Budget, Individual chapters 4: 45

Taxpayers per income category, 2022/23

- During 2022/23 some 608 000 individual taxpayers (or 8,2 percent) fell into the top three income tax brackets (income of R750 000 or more per annum)

- These taxpayers alone contribute R284 billion:
  - 50.6 per cent of PIT, and
  - 20.0 per cent of total government revenue

- This leaves little room for further tax increases as this tax base can emigrate

Source: 2022 Budget, Individual chapters 4: 45

Recommendations

- The fiscal cliff barometer improved compared to the 2021 Budget, but continued vigilance is necessary as the shift is caused largely by the revenue ‘windfall’
- The severe impact of global shocks are highlighted by the sharp movements in the instrument
- The longer term outlook for the fiscal cliff barometer remains worrying as it is likely to trend in the wrong (upwards) direction

Recommendations

- Protect institutions that still function well, but:
  - Refrain from helping non-essential failed State-owned enterprises (SOEs); e.g., Alexkor, Denel, SA Express, SA Airways (importance of Council on SOEs)
  - Limit/reduce the remuneration and bonuses of executives at SOEs

- Spending limitations are inevitable, as South Africa did not have austerity budgets for the past decade

- Civil service wage restraint must be retained

Recommendations

- The FCSG reserves some scepticism regarding medium term forecasts
- In previous budgets the Minister's (repeatedly) warned about a looming "sovereign debt crisis". The 2022 speech notes that "the debt burden remains a matter of serious concern"
- Add to this the 'risks to the fiscal framework':
  - Slowing global and domestic growth
  - The public sector wage bill
  - SOE's
- The revenue windfall provided a short-term 'get out of jail free card' BUT the only real long term solution is sustainable economic growth; which will provide impetus for sustained rises in revenue.

Questions/Discussion

Selected references:

- Botha, et al. 2019. https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2018/8605/WP1802a.pdf
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- Mbeki, M, Rossouw, J, Joubert, F and Breytenbach, A. 2018. Fiscal Cliff Barometer. *New Agenda: South African Journal of Social and Economic Policy.* Volume 70. Third Quarter 2018.
- Rossouw, J., Joubert, S. J. en Breytenbach, A. 2016. Suid-Afrika se fiskale keuses gemodelleer: Afgrond of plato? *Tydskrif vir Geesteswetenskappe*, 56 (2-2): pp. 534-554.
- Rossouw, J, Joubert, S. J. en Breytenbach, A. 2014. Suid-Afrika se fiskale afgrond: 'n Blik op die aanwending van owerheidshulpbronne. *Tydskrif vir Geesteswetenskappe*, 54 (1): pp. 144-162.