WITS UNIVERSITY 100 1922 2022

SOUTHERN CENTRE FOR INEQUALITY STUDIES

Thinking about the 2022 budget policy statement

October 2022

Summary of main points

- Short-term improvement in the fiscal position on the back of nominal boom
- Real economic stagnation points to continued fiscal weaknesses in future
- Spending growth has been curtailed since the pandemic and government plans for a larger consolidation next year
- Consolidation to be continued over the medium-term with falling real per capita spending on core services, salaries rising below CPI and employment levels likely to be forced down further
- Higher rates of inflation ease the debt constraint and makes real consolidation easier to achieve
- Aggressive fiscal consolidation path appears to stabilize debt, but
  - Spending trajectory implausible
  - Revenue outlook optimistic
  - Major risks not included in baseline
- With slightly different and more plausible assumptions, fiscal targets set out in MTBPS are not achieved
- MTBPS points to further weakening of fiscal institutions

Spending uncertainties

- No policy direction indicated in MTBPS on a range of choices that are critical for fiscal planning
- Government pay assumptions
  - 2022: Unilateral implementation of current offer
  - 2023: Nominal pay cut – no provision for pay increase and withdrawal of R1000 cash gratuity
  - 2024: Wage bill grows more slowly than CPI projection (i.e. assumes further real wage cuts)
- Social grants
  - Covid SRD grant effectively funded as an “unallocated reserve”
  - Signalled cuts other grants to fund COVID SRD
- Public employment programmes (not mentioned, but Presidency has recently estimated a minimum budget of R15 billion rising to R24 billion over the MTEF)
- Eskom debt resolution impact on debt service costs and path of bailouts (no new information provided)
- GFIP maintenance delegated to Gauteng equitable share – putting further pressure on front-line service budgets and failing to resolve user-charges debacle

Weakening fiscal institutions

- Uncertainties about the path of expenditure and revenue mean that NT projections of the deficit and debt cannot be relied upon
- MTBPS losing credibility as a guide to future nominal spending path; increasing resort to special appropriations erodes in-year credibility of budget
- Partly a consequence of heightened economic uncertainty
- But the MTBPS also raises concerns about:
  - The credibility of the MTEF as an instrument for operational and fiscal planning
  - The danger of resort to opaque and misleading presentation of budget data (e.g. SRD grant depicted as unallocated reserve)
- Is the MTBPS a credible policy statement of the whole of government, or a negotiating proposal within government?
- Points to the need for a discussion on fiscal institutions that can effectively anchor social and economic expectations
  - Discussion is take place within treasury, but no clear path of public consultation
  - What is the relationship between collective bargaining and fiscal planning?
  - How will fiscal rules be designed to ensure broad ownership (i.e. beyond private-sector/bond-market assurance)

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Spending choices

To be welcomed …

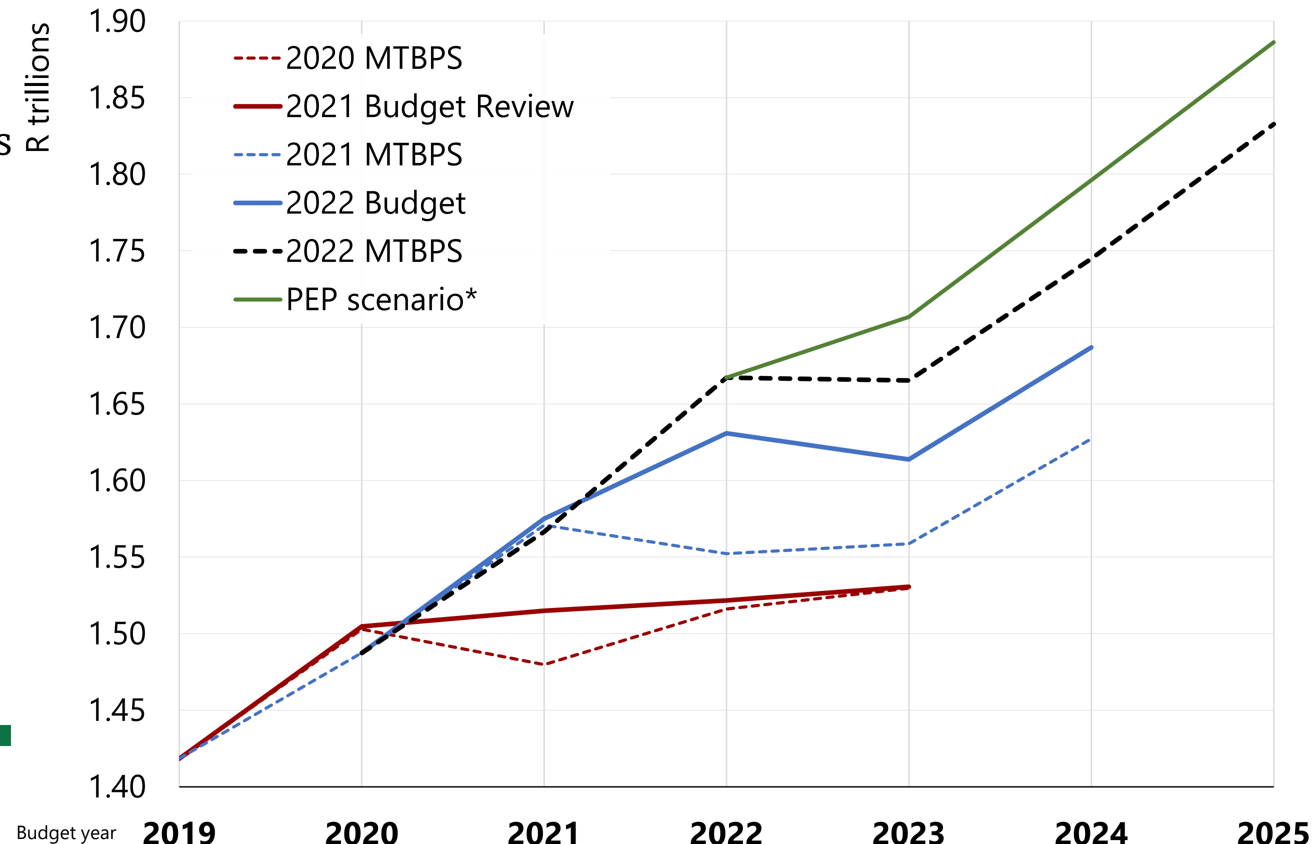
- The MTBPS reflects a strong improvement in the **current** fiscal position
- In the **current year** (i.e. the year of the 2022 Budget)
  - Fiscal buoyancy has been allocated largely to improving government's balance sheet
  - Government absorbs Sanral's liabilities and strengthens Transnet's income
- Over the medium-term, indicates **policy intentions** to strengthen the balance sheet further
  - Two thirds of the improvement allocated to reduced debt issuance
  - Intention to transfer a large share of Eskom's liabilities to the sovereign balance sheet
  - Inflation makes real spending cuts easier to achieve
- Government signals an **easing of cuts** to government consumption planned for 2023
  - Improved allocations across core public services
  - Easing the path of negotiation with government employees
  - Government determined to unilaterally implement its wage offer – could shift the burden of consolidation from headcounts to average pay

.... but

- The MTBPS provided no clear direction on key policy issues (e.g. Eskom, SRD grant, public employment programmes, user pays principle…)
- Reliance cannot be placed on the medium-term fiscal estimates:
  - The spending path is implausible
  - The revenue assumptions reflect a "best case scenario" where a cyclical uplift becomes permanent
- This points to a weakening of South Africa's fiscal institutions
- Despite easing the impact of the consolidation, a large contraction of government consumption is still planned for 2023. This will result in a further erosion of the value of core public services
- Beyond 2023, the MTBPS assumes that real resource allocation per capita will continue to fall, perhaps without end

Spending path: Consolidation eased

- The path of expenditure consolidation has been eased considerably, with government planning to add significant funds to frontline service departments next year and the year after
- MTBPS added large amounts to the spending path
  - 36 billion in 2022
  - R52 billion in 2023
  - R57 billion in 2024
- The spending ceilings tabled in successive MTBPS documents are no longer a good guide to budgets in subsequent years
- PEP scenario assumes:
  - Wage bill grows in line with CPI
  - Presidential Employment Stimulus continues with allocations in line with the Presidency 'minimum' estimates (R15.4bn (2023), R22.1bn (2024), R24.1bn (2025)
  - Covid-SRD grant continues, funded from "unallocated reserve"



Source data: National Treasury

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Spending slowdown continues

- Since the Covid19 pandemic in 2022, spending growth has significantly slowed (from 7% annual growth before the pandemic to 5.1% since the pandemic)
- In the period ahead, government is proposing an even tougher slowdown in spending growth
- The increase in CPI inflation makes consolidation easier to achieve

Nominal %-growth of core spending* and price inflation
Annual average over period

9%
8%
7%
6%
5%
4%
3%
2%
1%
0%

Core spending
Consumer price inflation
GDP inflation

2010-2015
2015-2019
2019-2022
2022-2025**

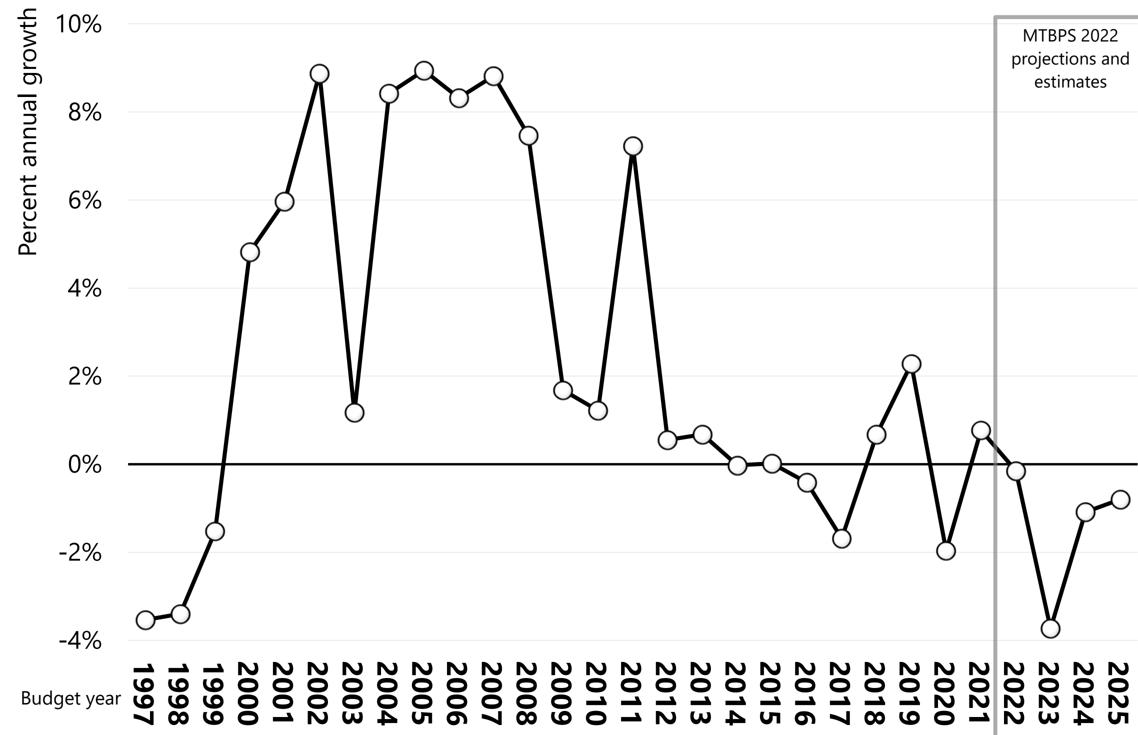
* Main budget non-interest spending less payments for financial assets, skills development levy and fuel-levy sharing with metros

** Based on NT/MTBPS 2022 projections and estimates

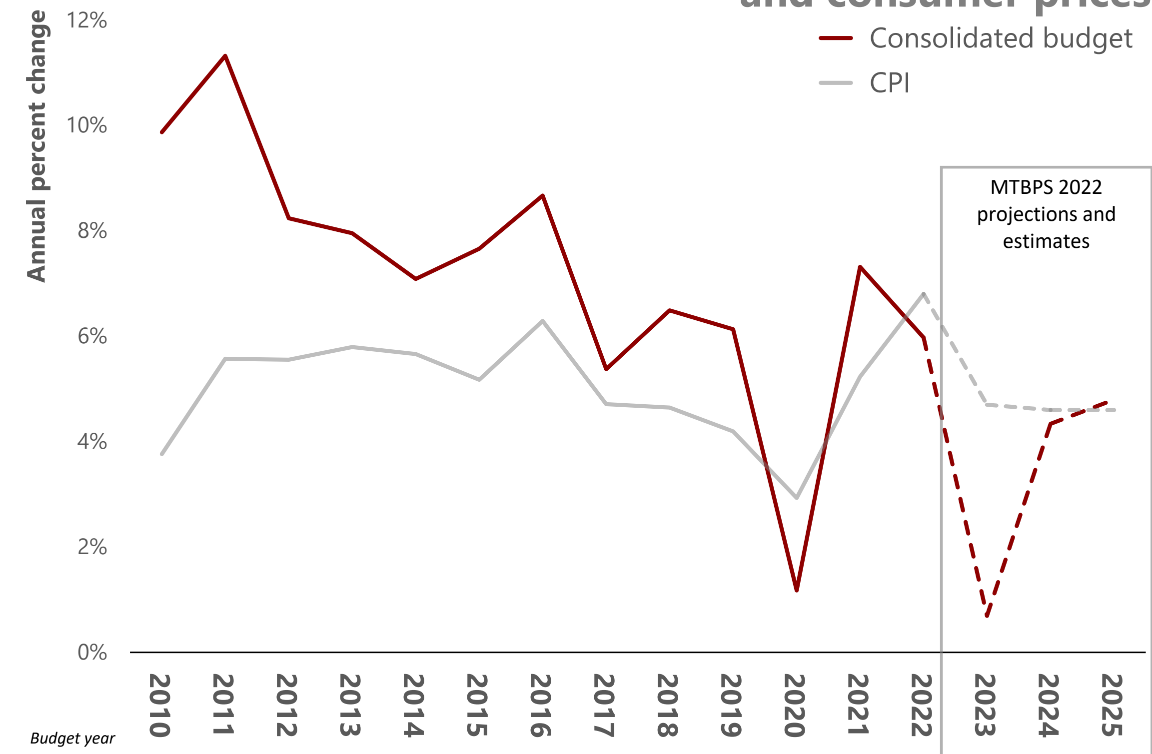
Source data: National Treasury

Large consolidation planned for next year

- Fiscal consolidation plans are strongly concentrated on 2023
- Main burden of consolidation on consumption spending i.e. mainly basic education, healthcare and criminal justice
- Additional resources to support headcount growth are only good intentions until next year's pay increases are known



* Main budget non-interest spending less payments for financial assets, skills development levy and fuel-levy sharing with metros



Source data: National Treasury, SARB, StatsSA

Spending per capita to continue falling

- Claims that fiscal consolidation will “end” after next years cuts are not borne out by treasury’s spending estimates
- Beyond 2023, the MTBPS assumes that real resource allocation per capita will continue to fall, perhaps without end

Real core spending* per capita

Constant 2022 R'000

27
26
25
24
23
22
21
20

Budget year

2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025

Based on MTBPS 2022 projections and estimates

* Main budget non-interest spending less payments for financial assets, skills development levy and fuel-levy sharing with metros

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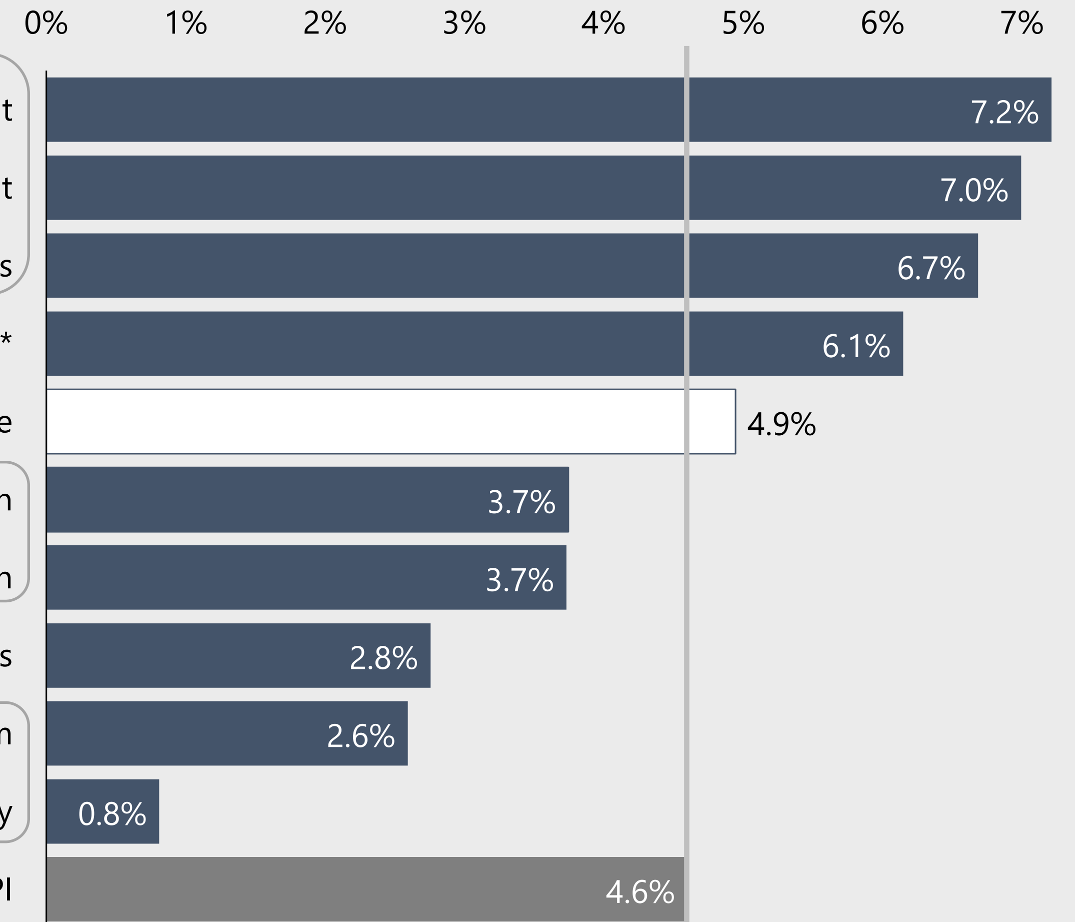
Source data: National Treasury, StatsSA

Spending priorities

1. Local government, infrastructure and university students
2. Health and education
3. Policing, justice and defence



* Assumes "unallocated reserve" is allocated for further extensions of COVID SRD grant

Social grants

- The MTBPS lays grounds for increased social protection budget
- The document recognizes that:
  - Employment recovery has lagged economic growth
  - Employment recovery has been slowest for low- and semi-skilled workers, while skilled workers have seen employment levels grow
  - Increased grants (including the COVID-SRD grant) has played a role in the recovery of household consumption levels
- But, the signal that child support grant and/or age old grant will be cut to fund new grants is a problem
- Policy ambiguity about a new grant for low-income workers and the unemployed
- Reflected in the budget, which assigns resources for continuation of the COVID-SRD grant, but calls these "unallocated reserve"

Other spending issues

- Rising pressure on healthcare budgets, reflected in accruals and medico-legal claims. Reforms proposed in the Liability Amendment Bill (which allow for the state to pay in instalments) are important
- Commendable that approximately 60% of the consolidated non-interest expenditure is allocated to the "social wage". Efficiency of the expenditure is increasingly becoming an issue and the spending reviews, and their implementation is good news.
- Some attention is given to climate change. The focus is on clean energy reforms, increased carbon taxes, and boosting the resilience of cities. More could be said about food security, loss of livelihoods.
- No specific mention of gender except to state there are increases in allocations to GCIS to undertake campaigns on GBV and femicide, anti-corruption and the economic recovery plan. National Treasury is yet to take questions of gender budgeting seriously

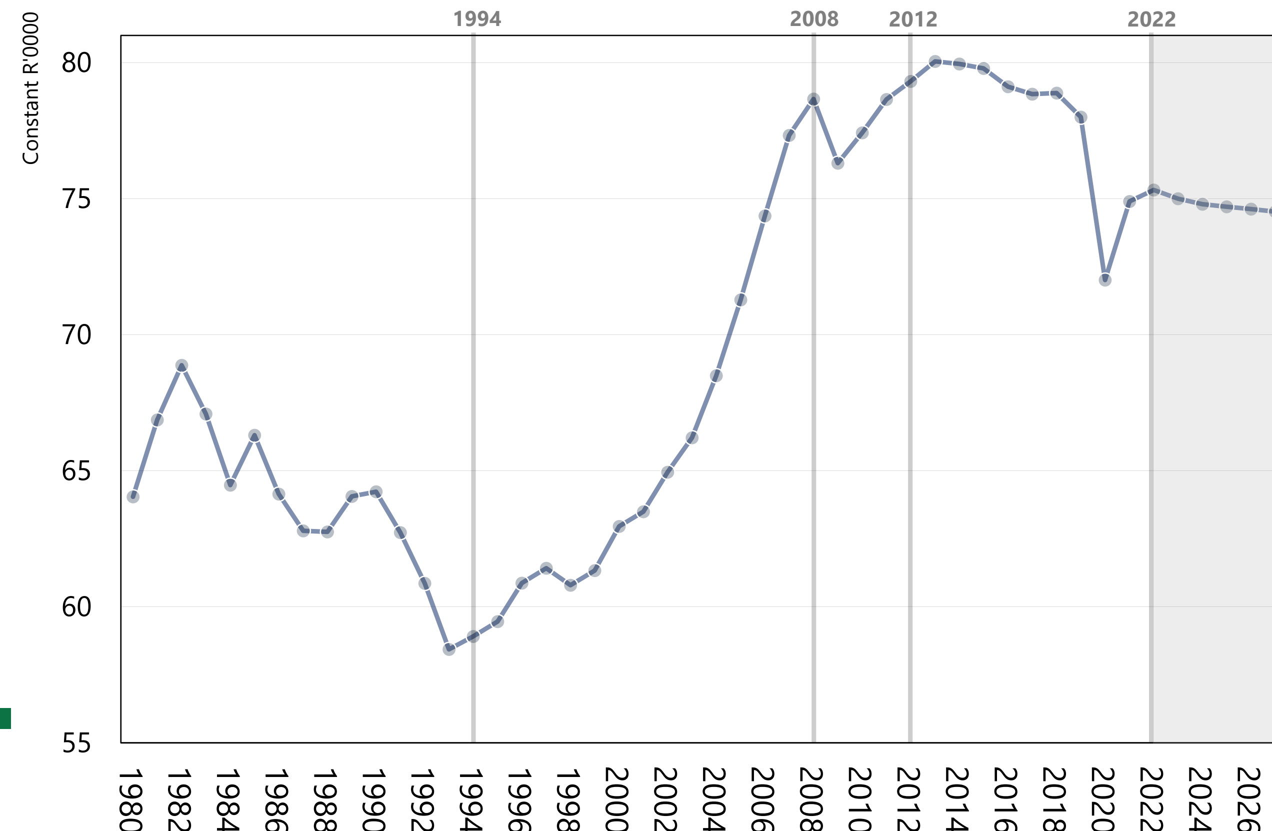
Macro-fiscal context

Nominal gains

- The combination of elevated commodity prices, rand depreciation and (unanticipated) higher domestic inflation is very good news for the fiscus
  - Raises nominal revenues
  - Improves debt metrics
  - Makes spending consolidation easier
- High global prices for South Africa's **commodity exports** boost mining sector profits and investment, spills over into manufacturing and finance, and raises the value of financial assets, improving balance sheets across the economy
- **Rand depreciation** further boosts to mining sector profits and raises the value of import taxes (VAT, customs and excise)
- **Inflation** boosts all government receipts and eases the burden on all debtors, including government

Real stagnation amid global storms

- Productivity stagnant
- Electricity supply constraint keeps potential output growth low
- Logistics, port and rail limit exports
- Skilled employment rebound, unskilled employment stagnation
- High interest rates and inflation put pressure on real disposable incomes (especially food and petrol/transport costs)
- Government's cost of long-term borrowing remains high
- Global outlook is uncertain, the IMF recently warning that "the worst is yet to come"



Source data: IMF, SARB

Treasury regards cyclical CIT boost as permanent

In year revenue performance a result of

- Higher profitability, earnings growth and bonus payments in the **financial sector**
- **Mining sector** contribution to CIT (and manufacturing) and PIT
- Post-covid recovery in **skilled employment** feed into PIT
- Rand depreciation + large import volumes: impact on customs duties and import VAT
- Elevated VAT refunds and fuel levy concessions

These conditions are unlikely to persist

Tax-to-GDP ratios for major taxes

Personal income tax
Value-added tax
Corporate income tax
All other taxes

MTBPS 2022 estimates and projections

Percent of GDP

10%
9%
8%
7%
6%
5%
4%
3%

Fiscal Year

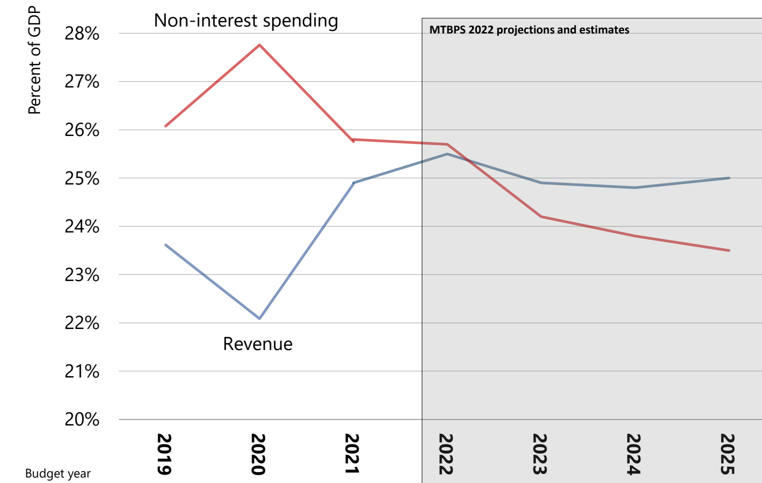
2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025

Source data: NT, SARB

Spending and revenue scenario

National Treasury Projection

Main budget revenue and non-interest spending

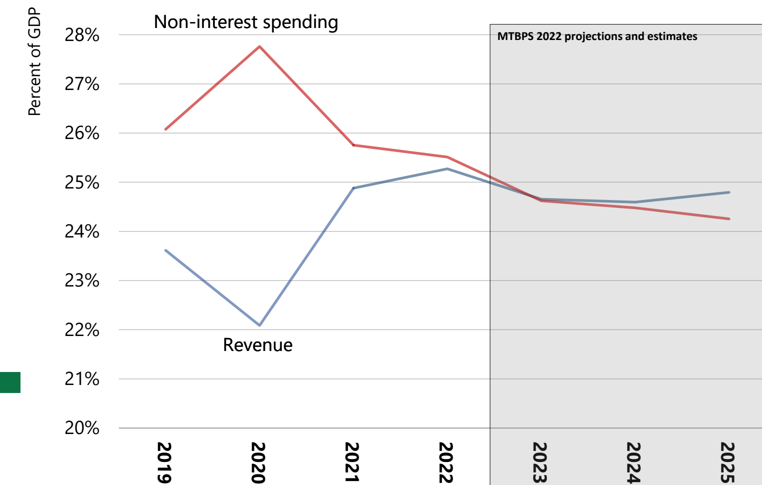


Assumptions in PEP alternate scenario

- Revenue
  - Uses IMF forecast of nominal GDP growth and NT revenue buoyancy
  - Revenue slightly lower as a share of GDP
- Spending
  - Assumes that compensation budget grows by CPI
  - Assumes public employment programmes implemented at Presidency minimum cost estimate
  - Eskom bailout adds to debt service costs, but reduces non-interest spending

Public Economy Project scenario

Main budget revenue and non-interest spending



Primary balance much weaker

- With small changes to revenue and expenditure trajectory, primary balance target looks doubtful

Primary balance (% of GDP)

Year	Outcome	MTBPS 2022 estimate	Alternative scenario
2014	-1.2%		
2015	-0.9%		
2016	-0.4%		
2017	-0.9%		
2018	-0.9%		
2019	-2.5%		
2020	-5.7%		
2021		-0.9%	
2022		-0.2%	
2023		0.7%	0.0%
2024		1.0%	0.1%
2025		1.5%	0.5%

Percent of GDP (axis: 2% to -6%)

Source data: National Treasury and Public Economy Project

Debt-to-GDP doesn't decline

- With small changes to revenue and expenditure trajectory, debt-to-GDP path does not stabilise
- Adding R200 billion Eskom debt in 2023 results in level-shift of ratio

PEP assumptions

- PEP primary balance assumption (on previous slide)
- R200 billion Eskom debt transferred to sovereign balance sheet in 2023

Debt-service costs continue to increase

Debt service costs (% of GDP)

Percent of GDP

Budget year	NT/MTBPS2022 forecast	PEP alternate scenario
2010	2.1%	
2011	2.3%	
2012	2.4%	
2013	2.6%	
2014	2.7%	
2015	2.9%	
2016	3.0%	
2017	3.2%	
2018	3.4%	
2019	3.6%	
2020	4.1%	
2021	4.3%	
2022	4.6%	
2023	4.7%	5.0%
2024	4.7%	5.1%
2025	4.8%	5.3%

PEP assumptions

- PEP primary balance assumption (on previous slide)
- Eskom debt transfer adds to debt service costs

Source data: National Treasury, Public Economy Project

Summary and conclusions

- Nominal boom, real stagnation points to continued weaknesses in future
- Spending growth has fallen since the pandemic and government plans for a larger consolidation next year
- Continued over the medium-term with falling real per capita spending on core services, salaries rising below CPI and employment levels likely to be forced down further
- Aggressive fiscal consolidation path appears to stabilize debt, but
  - Spending trajectory implausible
  - Revenue outlook optimistic
  - Major risks not included in baseline
- Nevertheless, higher rates of inflation do ease the debt constraint and makes real consolidation easier to achieve
- MTBPS points to further weakening of fiscal institutions

About

Public Economy Project

- The Public Economy Project aims to build analytical capabilities on macro-fiscal policy and public economics to support deliberation and engagement between government, social partners, and civil society. The project is located within the Southern Centre for Inequality Studies (SCIS) at the University of the Witwatersrand.
- More about the project here: https://www.wits.ac.za/scis/research-projects/public-economy/

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