2020 MTBPS analysis

03 November 2020

Parliamentary Budget Office

PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

The Parliamentary Budget Office

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Outline

- Introduction
- Background
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- Policy framework and plans
- Revised fiscal framework and debt outlook, revenue and expenditure
- Fiscal consolidation and compensation of employees
- Revisions to 2020/21 non-interest expenditure
- Conclusion

Introduction

- The MTBPS is an update on the budget, and sets out government's priorities and budget allocation over the MTEF
- The MTBPS provides an update on government finances and the economic status of the country, such as:
  - The macroeconomic context
  - Changes to spending
  - Changes to revenue collection
- In terms of Money Bills and Related Matters Act 2009, Parliament in adopting revised fiscal framework should ensure that;
  - appropriate balance between revenue, expenditure and borrowing
  - debt levels and debt interest cost are reasonable
  - the cost of recurrent spending is not deferred to future generations
  - adequate provision for spending on infrastructure development, overall capital spending and maintenance
  - consider the short, medium and long term implications of the fiscal framework, division of revenue and national budget on the long-term growth potential of the economy and the development of the country
  - take into account all public revenue and expenditure, including extra-budgetary funds, and contingent liabilities

Background

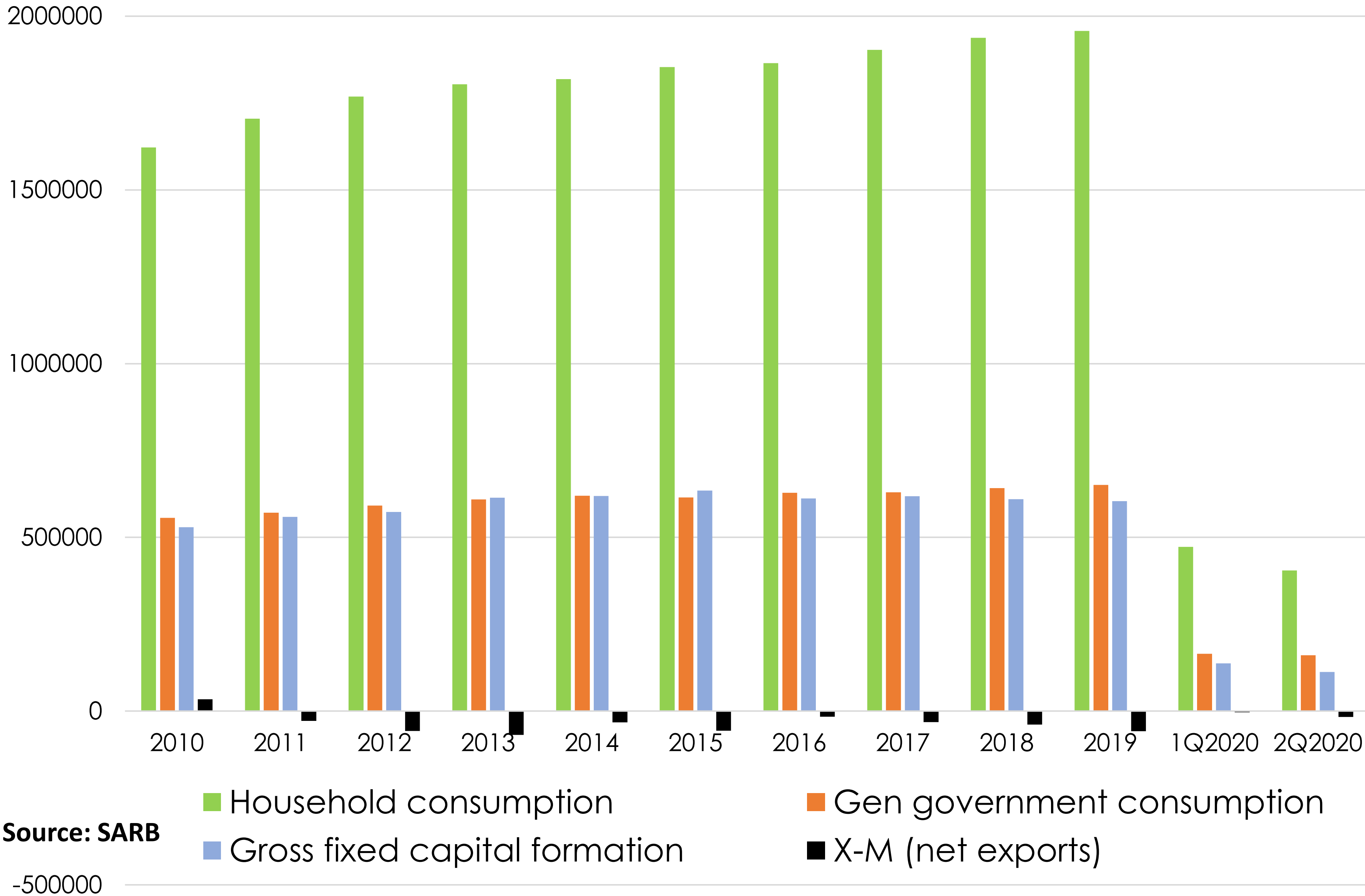
- Global Covid-19 infections continue to grow with many countries experiencing new waves of infection and implementing further lockdowns
- New waves creates huge uncertainty about implications for the global economy and when an economic recovery from Covid-19 will begin
- There is a global consensus that public sector action in the form of fiscal and monetary stimulus remains vital to avert further economic collapse
- The 2020 MTBPS proposes steps to reduce the fiscal deficit and stabilise the debt-to-GDP ratio over a five-year period. This will be done by:
  - Rebuilding the economy through the implementation of the Economic recovery plan
  - Improving the efficiency and composition of spending
- It is important to realise that the 2020 MTBPS' proposals are affected and dependent on uncertainties including;
  - Further negotiations related to public sector wage bill
  - Government is currently in discussion and performing performance reviews
  - Further reviews on conditional grants to provincial and local government sphere
- This presentation is providing some insight into:
  - The drivers of growth in the South African government
  - Possible blockages to growth
  - approved strategic priorities for funding
  - Changes to the fiscal framework is demonstrated with a main focus on debt and debt service cost
  - Main changes to the composition of expenditure and the revenue component of the fiscal framework

Macroeconomic overview and fiscal policy

The impact of fiscal consolidation

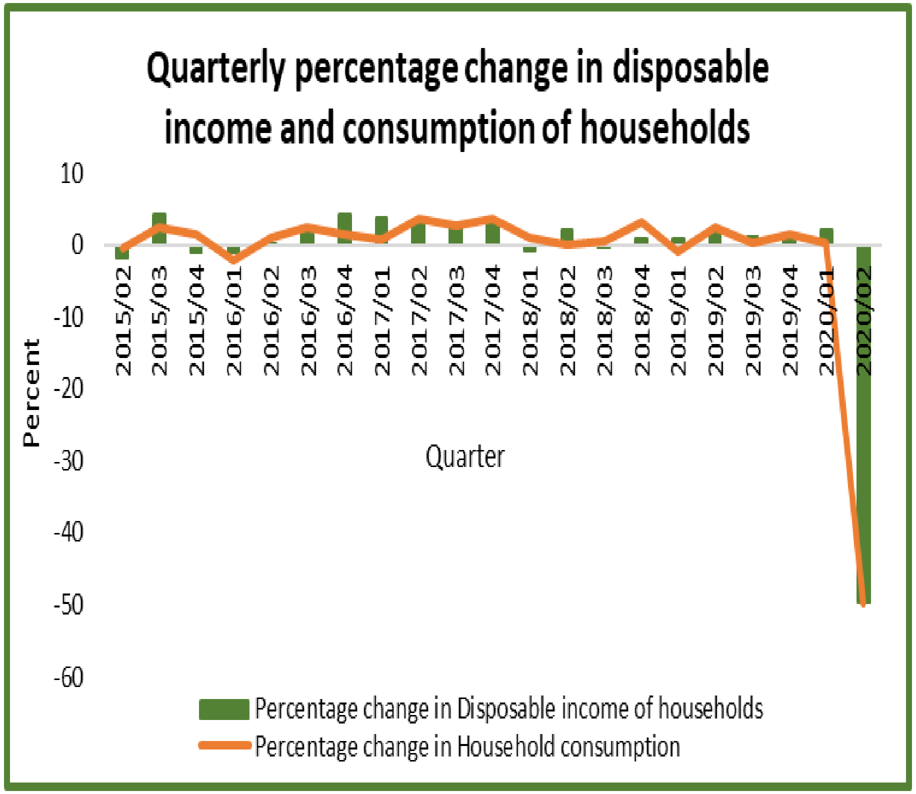
- Government fiscal objective is focused on quick rapid debt reduction
- The pandemic is not over and the crisis could well deepen
- Will spending cuts in critical developmental areas reverse socio-economic gains?
- Will these cuts will also affect the country's ability to respond to current and future health, environmental and other crises?
- During times of crises:
  - uncertainties are high and aggregate demand is weak, and
  - the private sector is generally unable to drive recovery and prefers to keep its assets liquid rather than sink it in fixed investments
- Expenditure cuts mean government is reducing the state's role in the economy at a time when it is critical for the state to step up
- The current state of the SA health system teaches us that plans to leverage private sector investments in critical areas of service infrastructure provision where social rather than profit motives should drive economic activity, could increase hardship and inequality

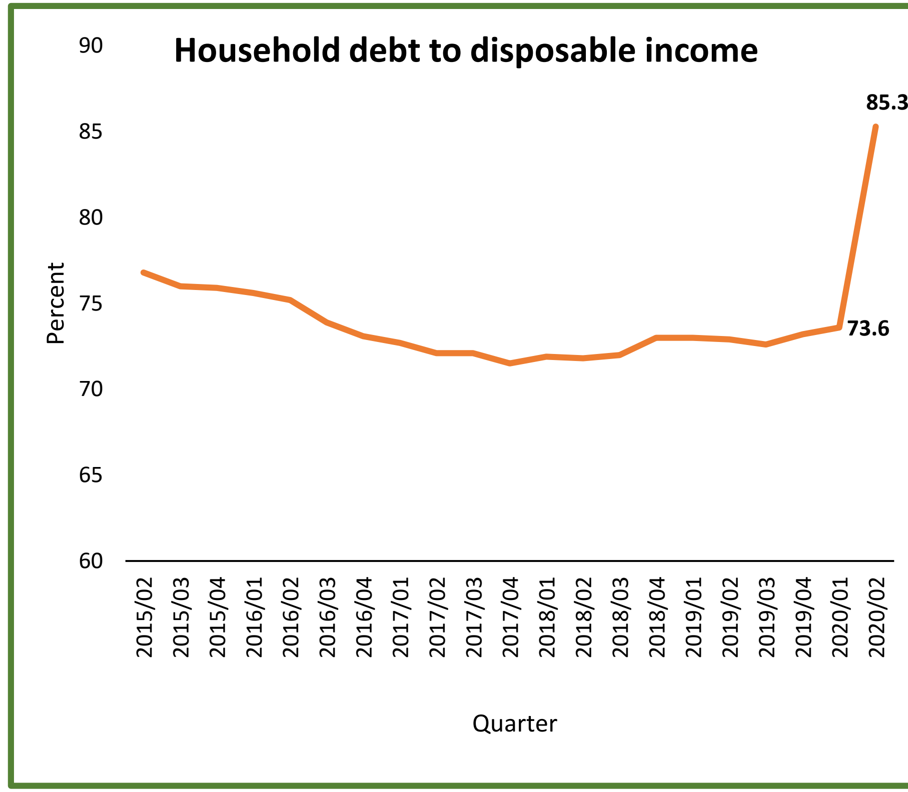
Components of GDP (Real 2010, Rmillions)



Source: SARB

Household income and debt

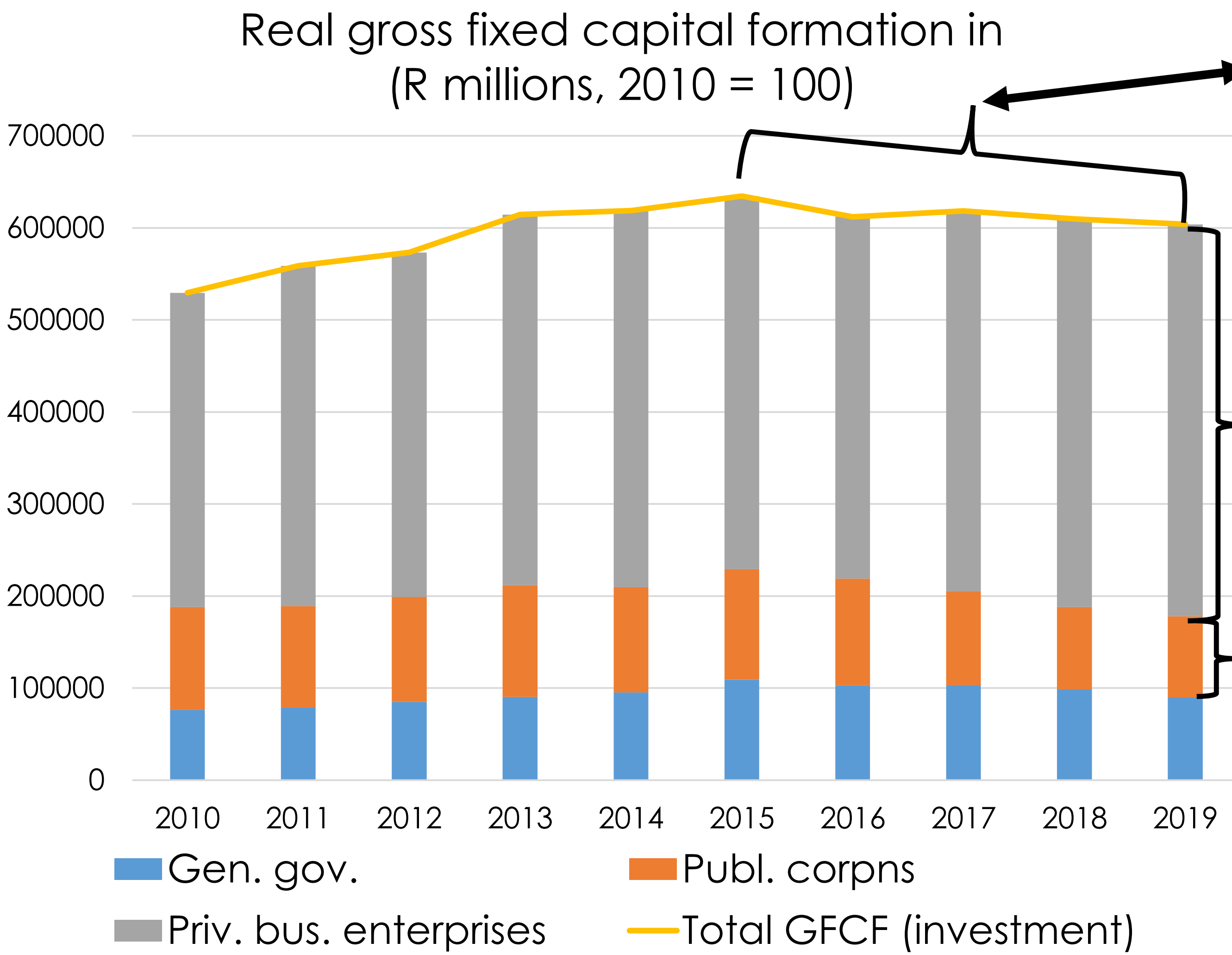




Source: StatsSA

- Aggregate demand will be under severe pressure as households consumption (which is about 60% of GDP) declines due to loss of income and increased household debt to disposable income levels

The reason for the decline in real total investment from 2016 to 2019 was the decline in public corp. investment



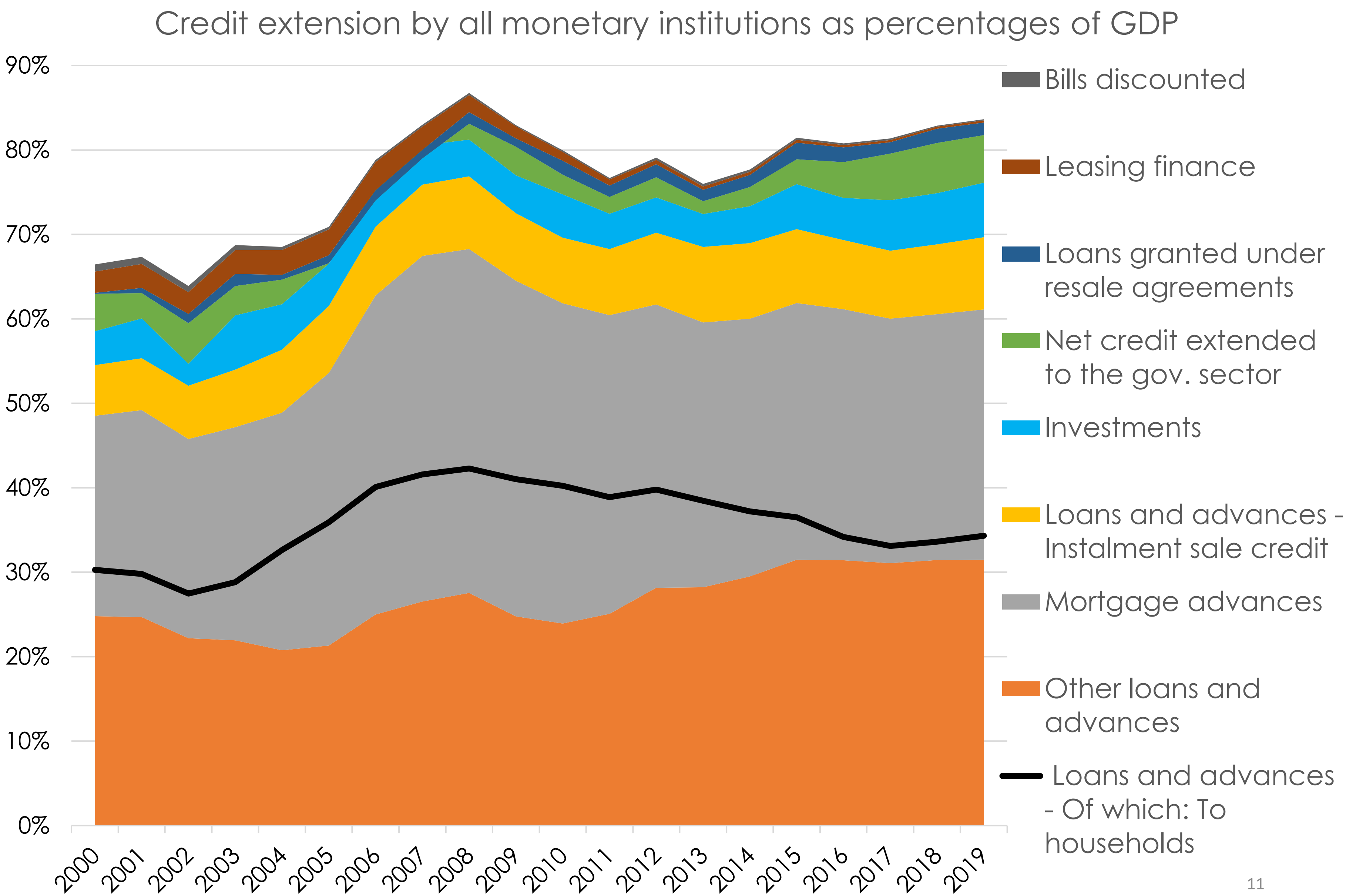
The decline in total inv. from 2015 to 2019 was around R31 bn

Priv. bus. Enterprise investment grew by R1 bn from 2015 to 2019

The decline in investment by public corpns from 2015 to 2019 was around R32 bn

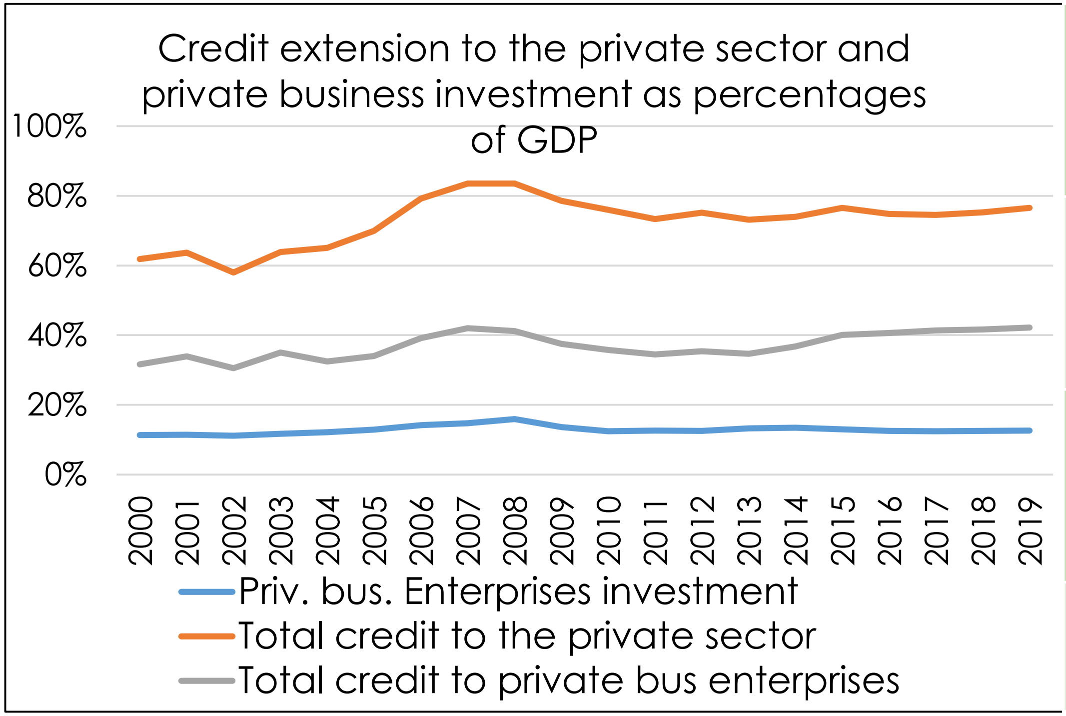
Source: SARB

Credit extension investment



Own calculations using SARB data

Private investment and credit

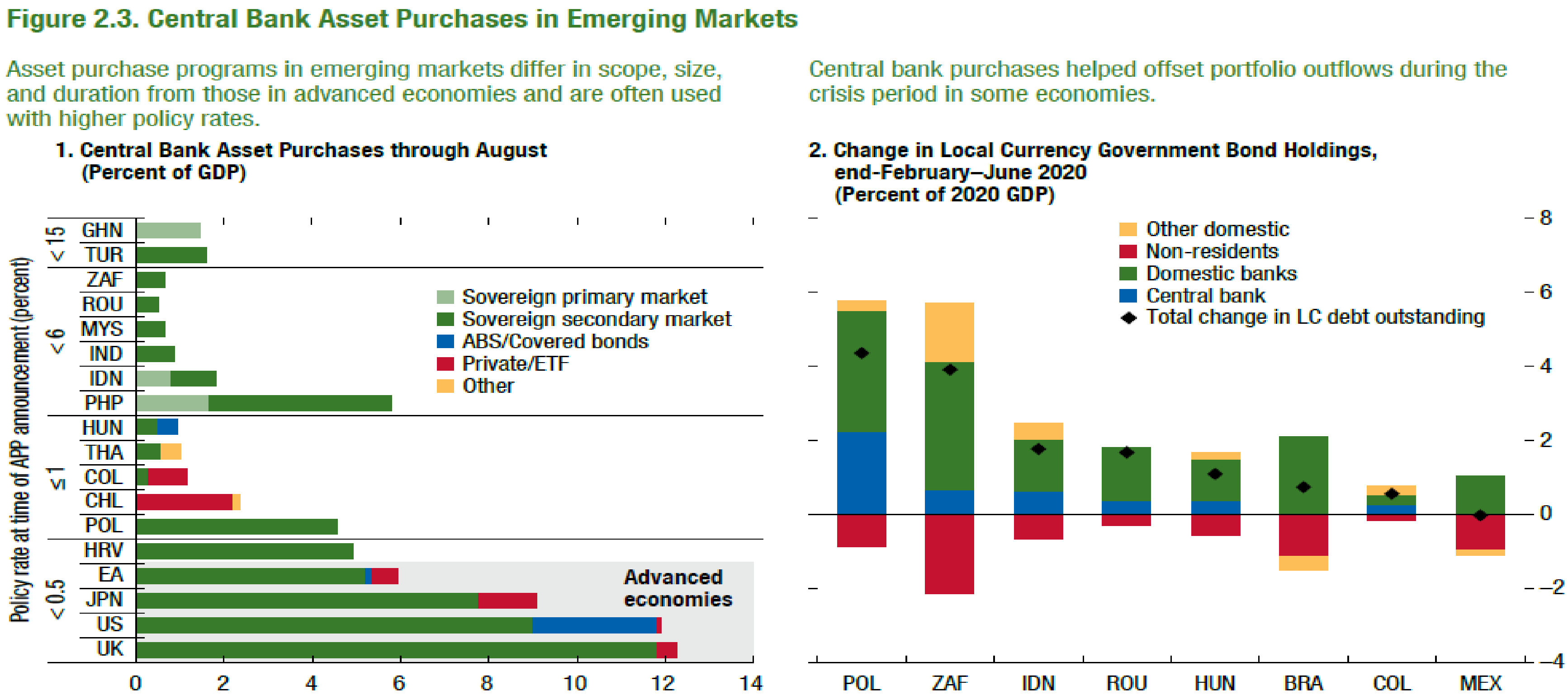


	2003 to 2008	2008 to 2013	2013 to 2019
Priv. business Enterprises investment	4.2%	-2.6%	-0.7%
Total credit to the private sector	19.7%	-10.4%	3.4%
Credit to private bus. enterprises	6.2%	-6.6%	7.6%

Own calculations using SARB data

- Total credit extended to the private sector as a percentage of GDP increased 2.4% from 2013 to 2019
- Total credit extended to private businesses as a percentage of GDP increased 7.6% from 2013 to 2019
- Gross fixed capital formation by private businesses decreased by 0.7%
- Government debt is not crowding out private borrowing for investment (nor is household debt)

SARB's purchase of sovereign bonds



Source: IMF, Oct. 2020 Financial Stability Report

- Central banks used QE to support financial stability and government spend
- These measures have reduced borrowing costs and risk
- The SARB's purchases of SA sovereign bonds were small to support financial liquidity but not gov. spending and debt
- SARB limited interest rates cuts in response to portfolio capital outflows
- SA Banks and residents bought government bonds. Non-residents sold.
- There is room for state entities such as the SARB and the GEPF to increase SA gvt bonds in their portfolios to reduce and lower risk on government debt

Policy framework and plans

Policy direction to inform budget proposals

2019-2024 MTSF Priorities	ERRP priority interventions
• A capable, ethical and developmental state • Economic transformation and job creation • Education, skills and health • Consolidating the social wage through reliable and quality basic services • Spatial integration, human settlements and local government • Social cohesion and safe communities • A better Africa and World	• Aggressive infrastructure investment • Strengthened informal sector • Localization through industrialization • Energy security • Support for tourism • Gender equality • Green economy interventions • Public employment programmes • Strengthening food security • Macro-economic interventions

Policy implementation over the medium term

Supplementary Budget Priorities	MTBPS Spending Priorities
• **Primary Health** o Government prioritised public health to save lives o Scaling up capacity in the public health system o Contracting of private hospitals to supplement public-sector capacity • **Social development** o Scaling up and maintaining social assistance interventions for distressed and vulnerable households o Reprioritising funding to prepare social facilities for safe reopening and service delivery o Funding of psychosocial services for people affected by the pandemic • **Peace and security** o Increased deployment of the police service and national defence force during the lockdown o Other departments required to reprioritise funding and roll out their own responses	• **Health** o Protection of service delivery in areas such as primary healthcare, immunisation, and HIV prevention and treatment o Significant restructuring of provincial health services, with a focus on efficiency • **Social development** o Extension of the special COVID-19 social relief of distress grant until 31 January '21 o R1 billion is allocated for food relief to vulnerable households o Responsibility for early childhood development transferred to the basic education • **Peace and security** o Priorities are to fight crime and ensure territorial integrity o Reprioritisation of funds to capacitate the Information Regulator o State capture commission: Additional R63 million • **Learning and culture** o Ensure that planned infrastructure projects are delivered in time and within budget o Basic education committed to improving educational outcomes • **Community development** o Review of programmes related to the provision of mass housing, public transport standards and the levels of free basic services o Introduction of the informal settlements upgrading partnership grant in 2021 for provinces and metropolitan municipalities • **Economic development** o Prioritise finalising of outstanding restitution claims o Supporting resettled farmers o Government and the tourism sector will collaborate to maintain tourism assets • **General public services** o DPSA: reprioritise funds for personnel expenditure reviews in national, provincial and local government, public entities and SOCs over the next two years o DPE: reprioritise funds to support the Presidential State-Owned Enterprises Council, an advisory body to assist with strengthening state-owned companies

Improving efficiency and composition of spending

South Africa's public spending levels are not matched by high levels of quality or efficiency in the services delivered

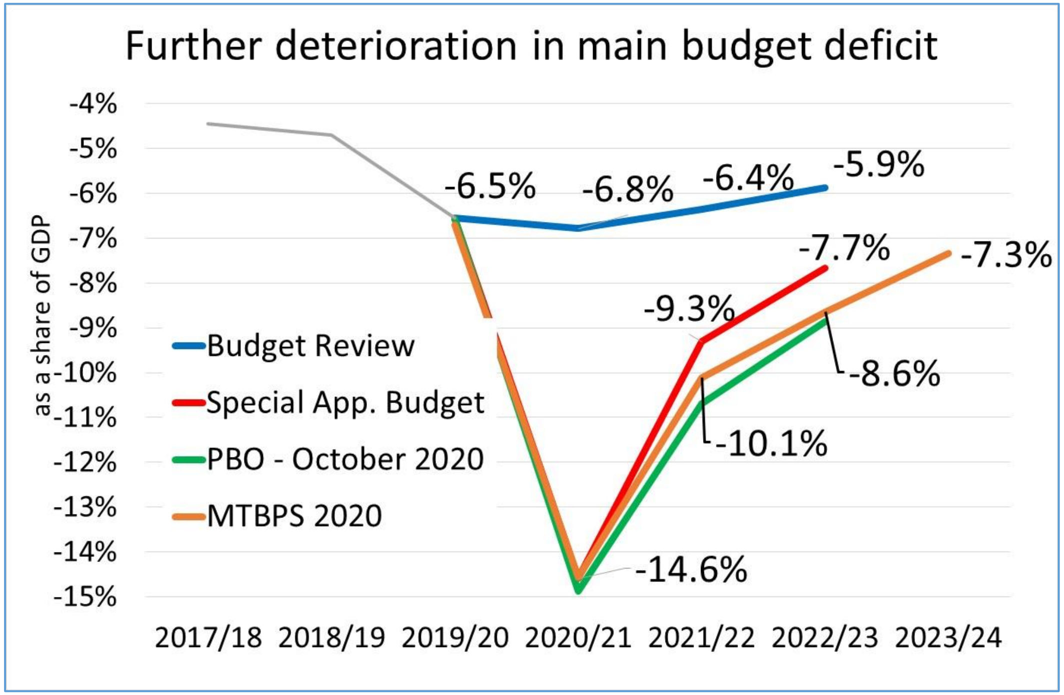
- Government acknowledge that proper implementation of the programme performance budgeting system is necessary
- Preliminary findings on spending reviews, which forms part of the budget system, indicate that:
  - Many policies are designed and adopted without considering their total costs and affordability
  - Multiple institutions share overlapping responsibilities or mandates, leading to duplication of work
  - In several high-spending procurement areas, including information and communications technology, and infrastructure, it appears that government is overpaying for goods and services
  - The spending reviews will be used to inform baseline allocations in the 2022 MTEF period
- Other analysis shows:
  - Shortcomings in the quality of data to determine efficiency
  - Policies, such as NHI and the district model depends on outstanding interventions
- Current year revision based on Covid-19 fiscal impact, support to SOEs and Local government
- Revisions to the MTEF based on stabilizing debt and reducing the budget balance

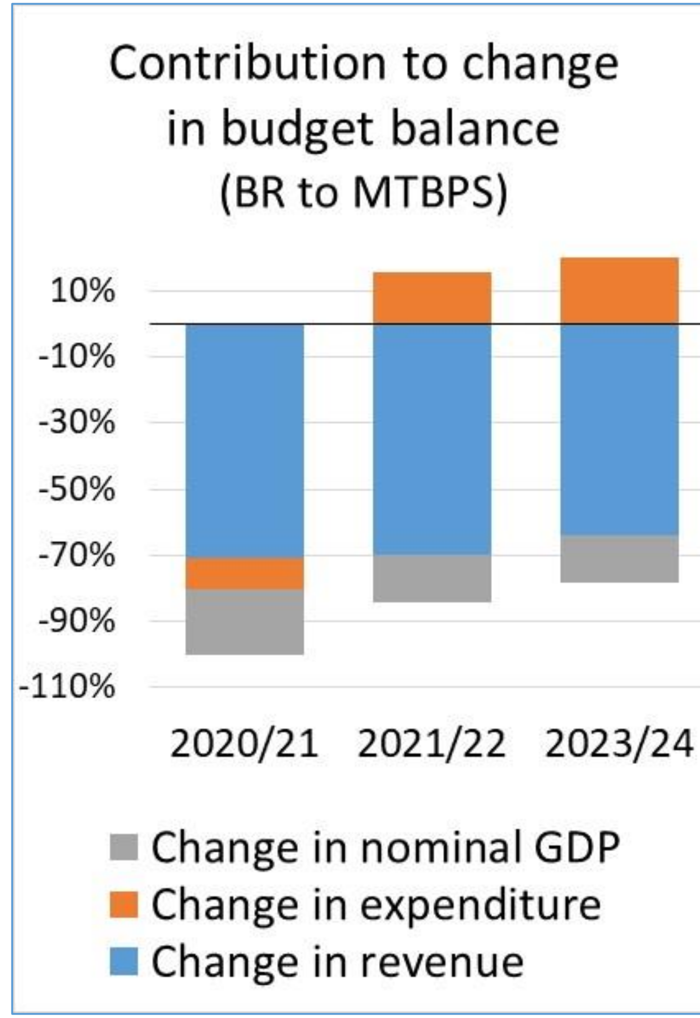
Basis for revisions to the medium-term expenditure framework

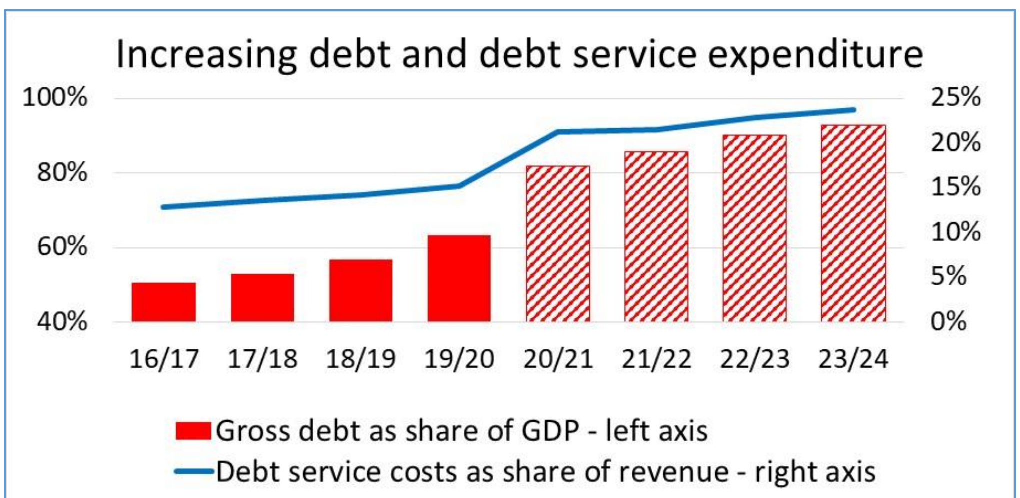
- Based on stabilising debt-to-GDP ratio:
  - Reducing non-interest spending, mainly compensation of employees
- To ensure sustainability, high-level policy discussions are still needed on:
  - The number and size of departments, ministries and public entities in national and provincial governments.
  - Management of the functions assigned to the three spheres of government.
  - Containing the public-service wage bill.
  - The approaches to providing financial support to students in post-school education.
  - The subsidy mix for urban transport systems.
  - The structure of the human settlements delivery programme.
  - Measures to strengthen the social protection system for the most vulnerable.

Revised fiscal framework and debt outlook, revenue and expenditure

Fiscal Framework outlook

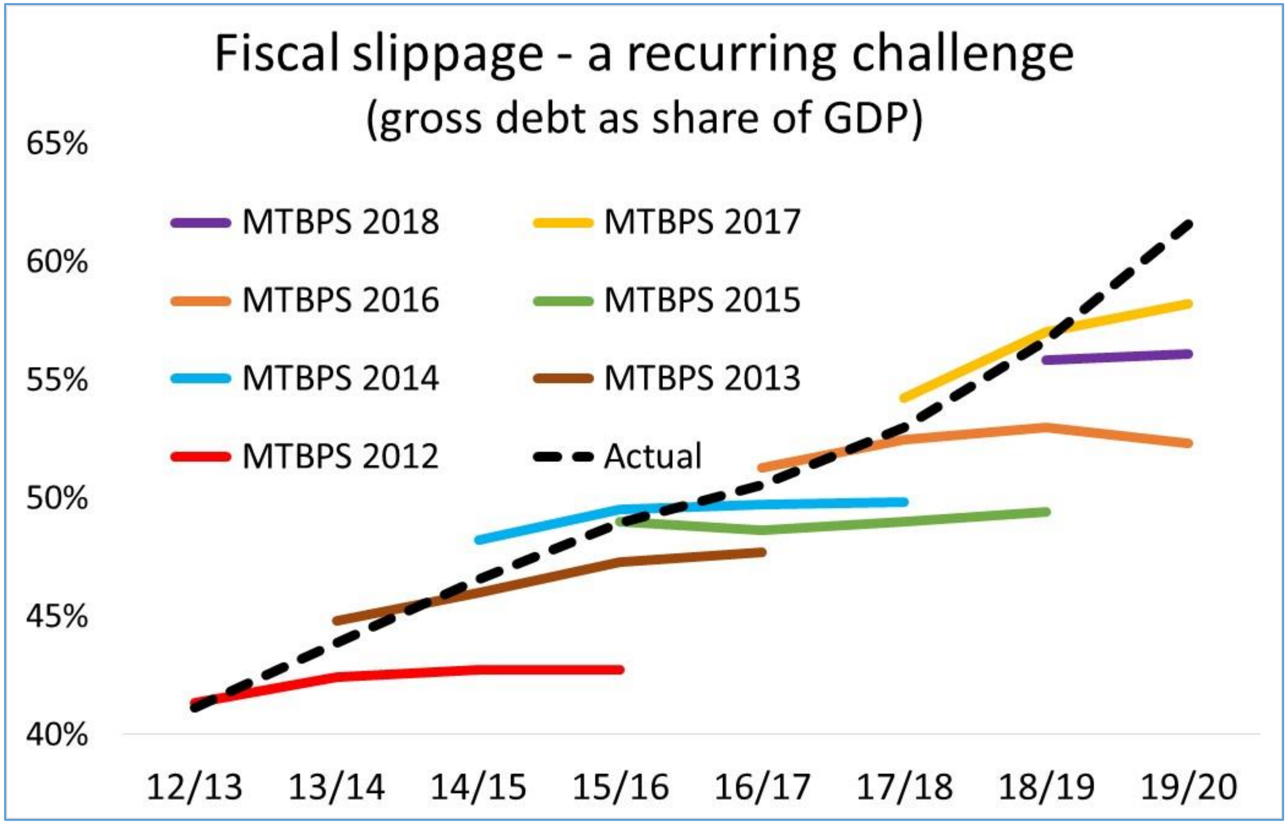






Data: Stats SA, National Treasury, PBO

Fiscal framework – credibility and risks



- Fiscal slippage is a continuous challenge affecting credibility
- Higher indebtedness and borrowing has increased cost of further slippage
- Implications of budget reductions for service delivery and growth
- Risk from a weaker economic recovery
- Risk from wage-bill pressures
- Risk from further expenditure pressures

Revenue discussions

Revenue collection and other updates

- Further downward revision on gross tax revenue since the special adjustment by R 8.7 billion, making total revision since Feb 20 BR to R 312.8 billion
- The MTBPS calls for additional measures amounting to R40 billion over the medium term
- Some policy proposals in the MTBPS may worsen tax revenue collection if implemented, for example the impact on PIT and VAT of reduction in the public sector wage bill
- Non- policy factors (lockdown) to reduce revenue collections:
  - Reduction in consumption
  - Excessive corporate profitability during the lockdown
  - Loss of jobs due to economic lockdown expected to adversely to affect PIT collection
- Finalisation of tax gap study in Dec. 2020 (tax collected vs expected), for PIT, VAT and CIT
- Presidential 4IR Commission proposes implementation of digital tax for digital economy; (October 2020)

Compensation of employees and Personal Income Tax

- Reduction in COE to take into account potential impact that will have;
  - On service delivery
  - Government's policy to attract high skilled professionals
  - Overall unemployment rate
- Public sector workers account for a relatively larger portion of personal income tax(PIT) base because:
  - They comprise a larger share of the workforce
  - Their earnings tend to be higher than their counterparts in the private sector. Consequently, the PIT tax base is potentially more sensitive to public sector pay policy decisions or level of employment;
- In times of public spending growth, it is generally recognized that public sector tends to offer greater job security than the private sector, yielding a steady stream of PIT revenue
- However, in times of austerity, the tendency to impose policies directly aimed at reducing the public sector workforce size or capping pay can have a disproportionate effect on the PIT tax base

Expenditure discussion

Revisions to 2020/21 non-interest expenditure

	R million
Non-interest expenditure (2020 Budget Review)	**1 536 724**
2020 special adjustments budget (SAB) net additions	36 006
Revised non-interest expenditure (2020 SAB)	**1 572 731**
COVID-19 fiscal relief package allocations	**19 431**
Employment creation	12 634
Extension of special COVID-19 social relief of distress grant	6 797
Increases in allocations since 2020 SAB	**14 904**
South African Airways	10 500
Rollovers	1 602
Unforeseeable and unavoidable expenditure: Food relief	1 000
Self-financing	1 500
ICASA for the licensing process of high-demand spectrum	85
Land and Agricultural Development Bank of South Africa	74
South African Express Airways SOC Ltd	143
Resources used to fund adjustments since 2020 SAB	**(33 286)**
Net of provisional allocations for COVID-19 fiscal relief	(19 575)
Reductions to fund South African Airways allocation	(6 970)
Drawdowns, suspensions and projected underspending[2]	(6 740)
Other adjustments[3]	**(1 050)**
Revised non-interest expenditure (2020 MTBPS)	**1 572 731**

Declining capital expenditure

Capital expenditure by national vote, R'000 (April - September)			
	Revised budget	**Actual**	**%**
2017/18	15 213 399	5 016 485	33,0
2018/19	14 296 771	5 016 485	35,1
2019/20	15 424 153	3 911 657	25,4
2020/21	15 484 983	3 493 071	22,6

- In the 2020 MTBPS, the minister noted that there is a sharp drop in public infrastructure investment
- It is mostly driven by declines in spending by state-owned companies.
- Between 2016/17 and 2019/20, total public infrastructure spending fell from R250 billion to R183 billion, or from 5.7 to 4 per cent of GDP.
- Over the decade, the government will aim to protect funding for infrastructure investment

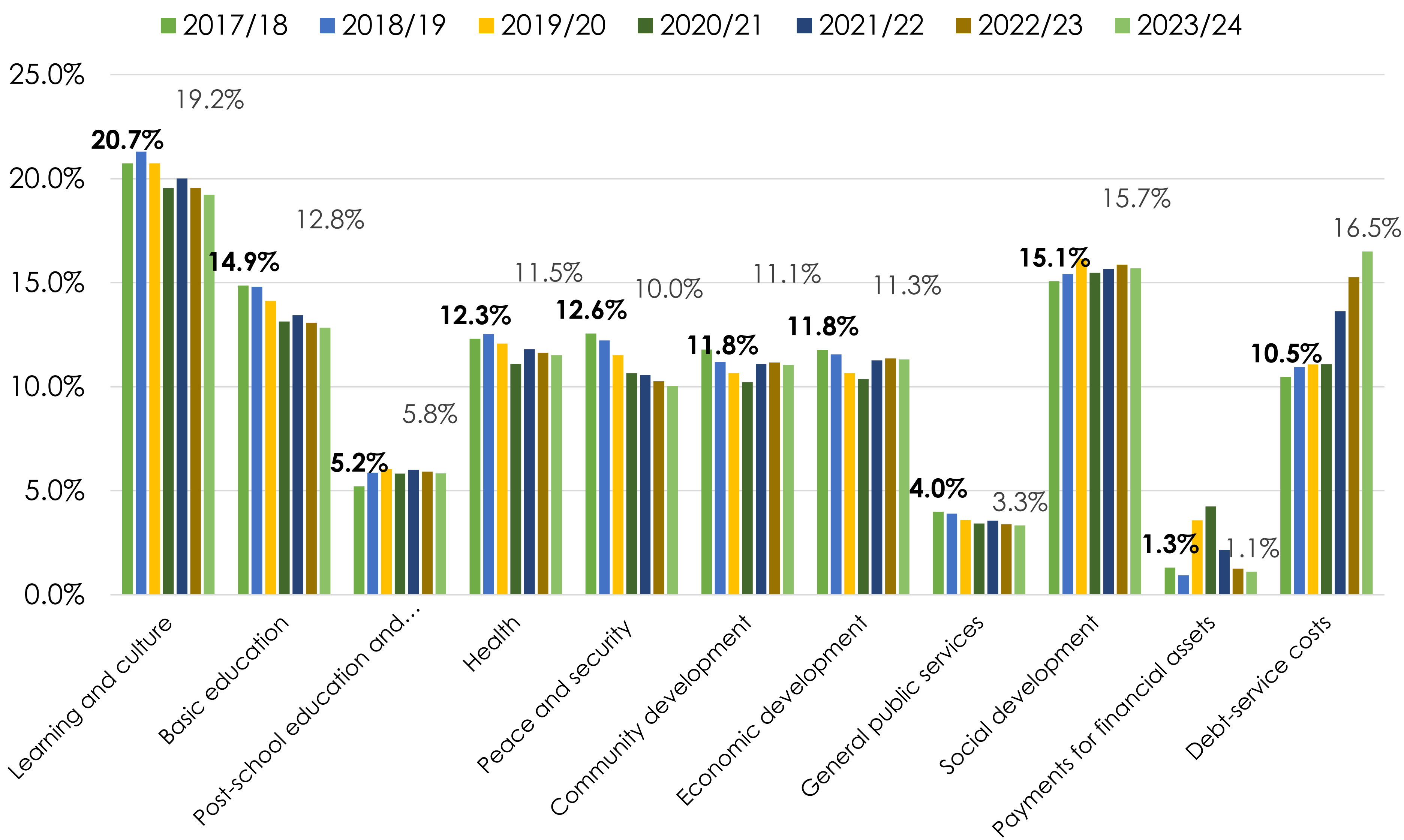
Revisions to 2020/21 consolidated expenditure

Compensation accounts for about half of the total reduction:

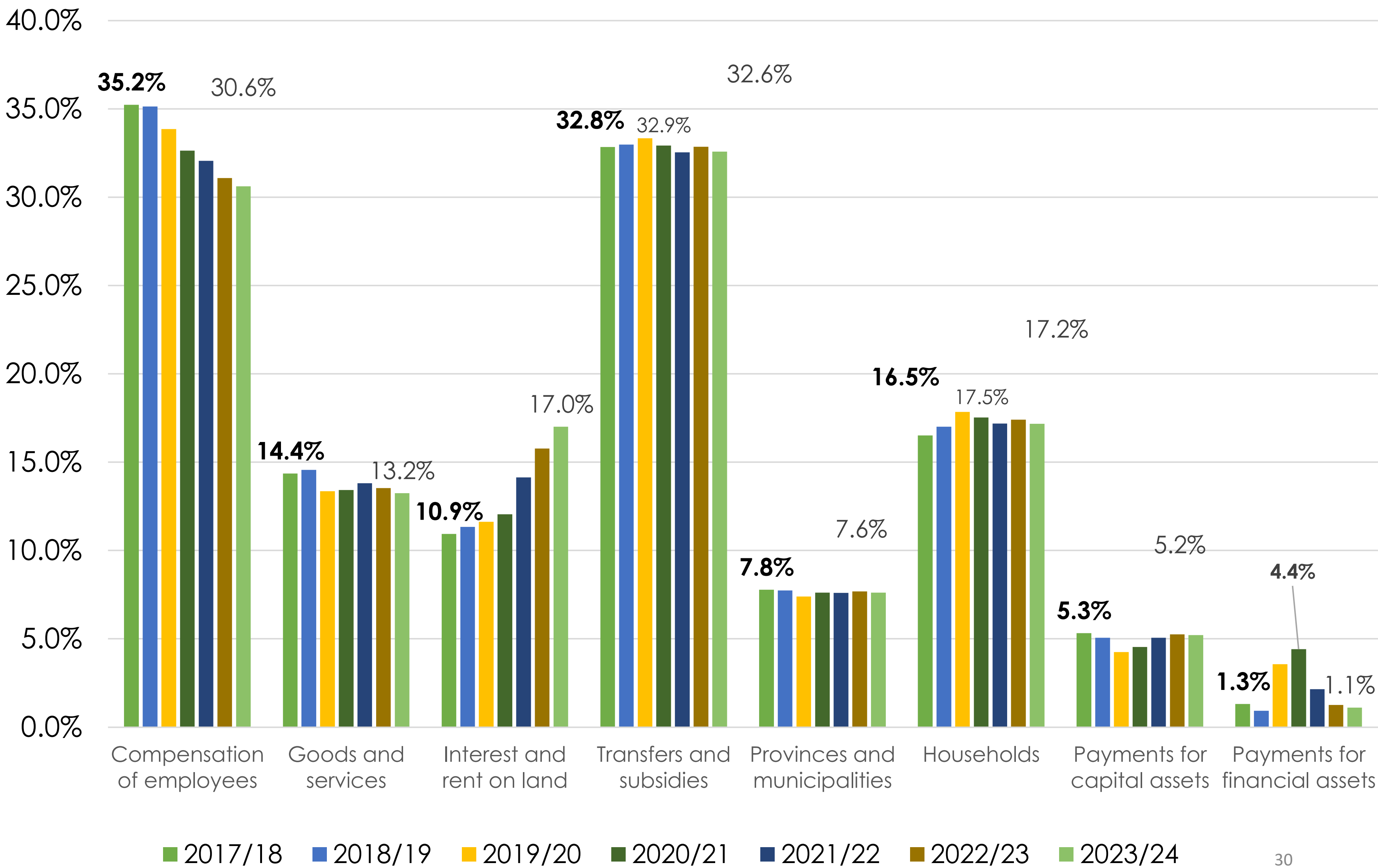
- Health (- R8 987 million + R393 million for outreach team leaders)
- Learning and culture (- R14 007 million + R6 999 million for assistance in public schools)
- Peace and security (- R9 185 million)

R billion	2019/20 Outcome	2020/21 Revised[2]	2020/21 Change from previous year	2021/22 Revised	2021/22 Change from previous year
Current payments	**1 087.7**	**1 138.3**	**4.6%**	**1 196.2**	**5.1%**
Compensation of employees	626.1	639.3	2.1%	639.1	0.0%
Debt-service costs	*204.8*	*225.9*	*10.3%*	*271.8*	*20.3%*
Transfers and subsidies	**616.4**	**644.7**	**4.6%**	**648.6**	**0.6%**
Provinces and municipalities	136.6	149.3	9.2%	151.5	1.5%
Households	329.8	343.4	4.1%	342.5	-0.3%
Payments for capital assets	**78.6**	**88.9**	**13.1%**	**100.8**	**13.4%**
Payments for financial assets	**66.0**	**86.5**	**0.3**	**42.9**	**-50.5%**
Total	**1 848.8**	**1 958.4**	**5.9%**	**1 988.5**	**1.5%**
Consolidated expenditure	**1 848.8**	**1 958.4**	**5.9%**	**1 993.5**	**1.8%**
Consolidated expenditure including June 2020 budget adjustments	**1 848.8**	**2 037.8**	**10.2%**	**1 993.5**	**-2.2%**

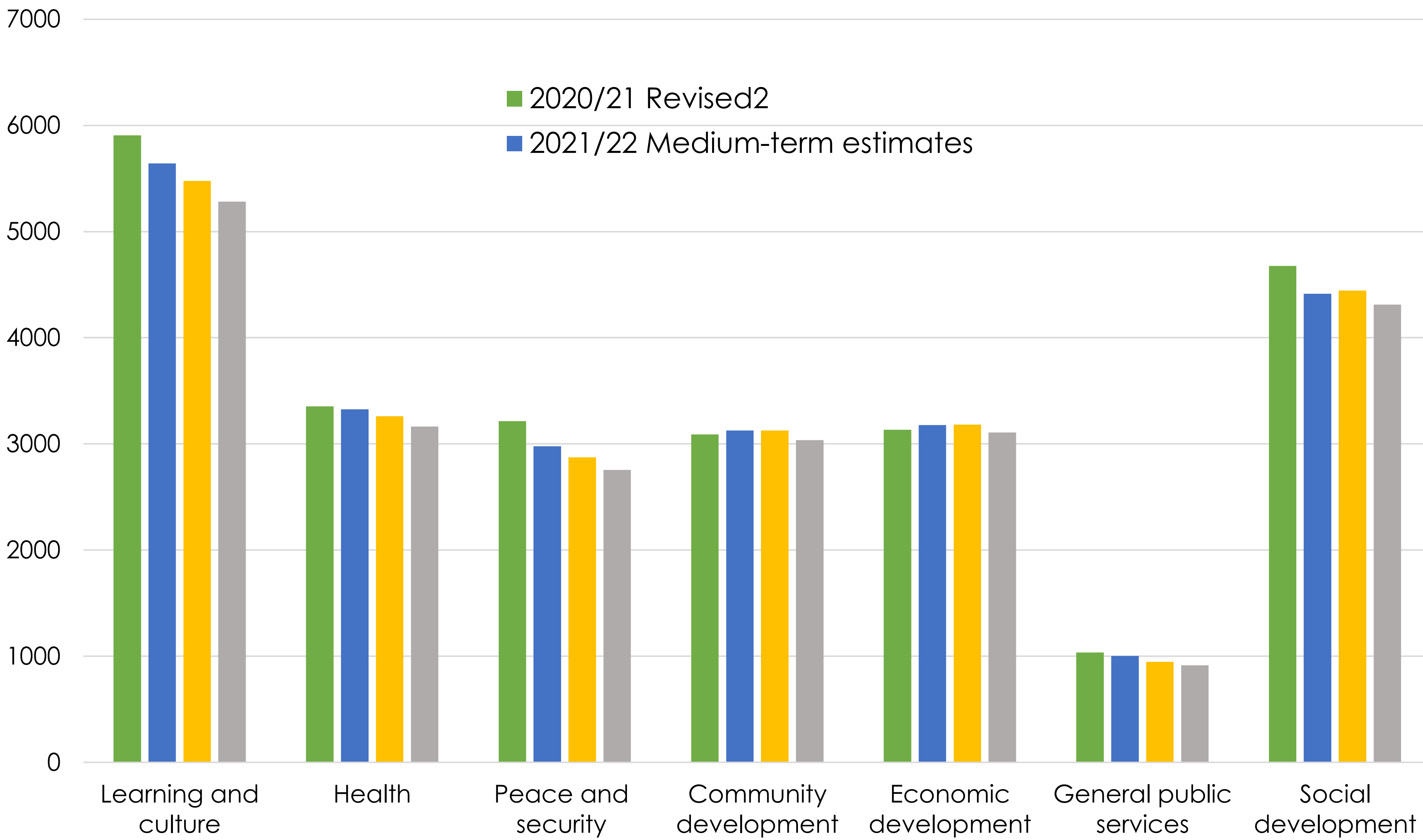
Changes to the proportions allocated per budget functions



Changes to the proportions allocated per economic function

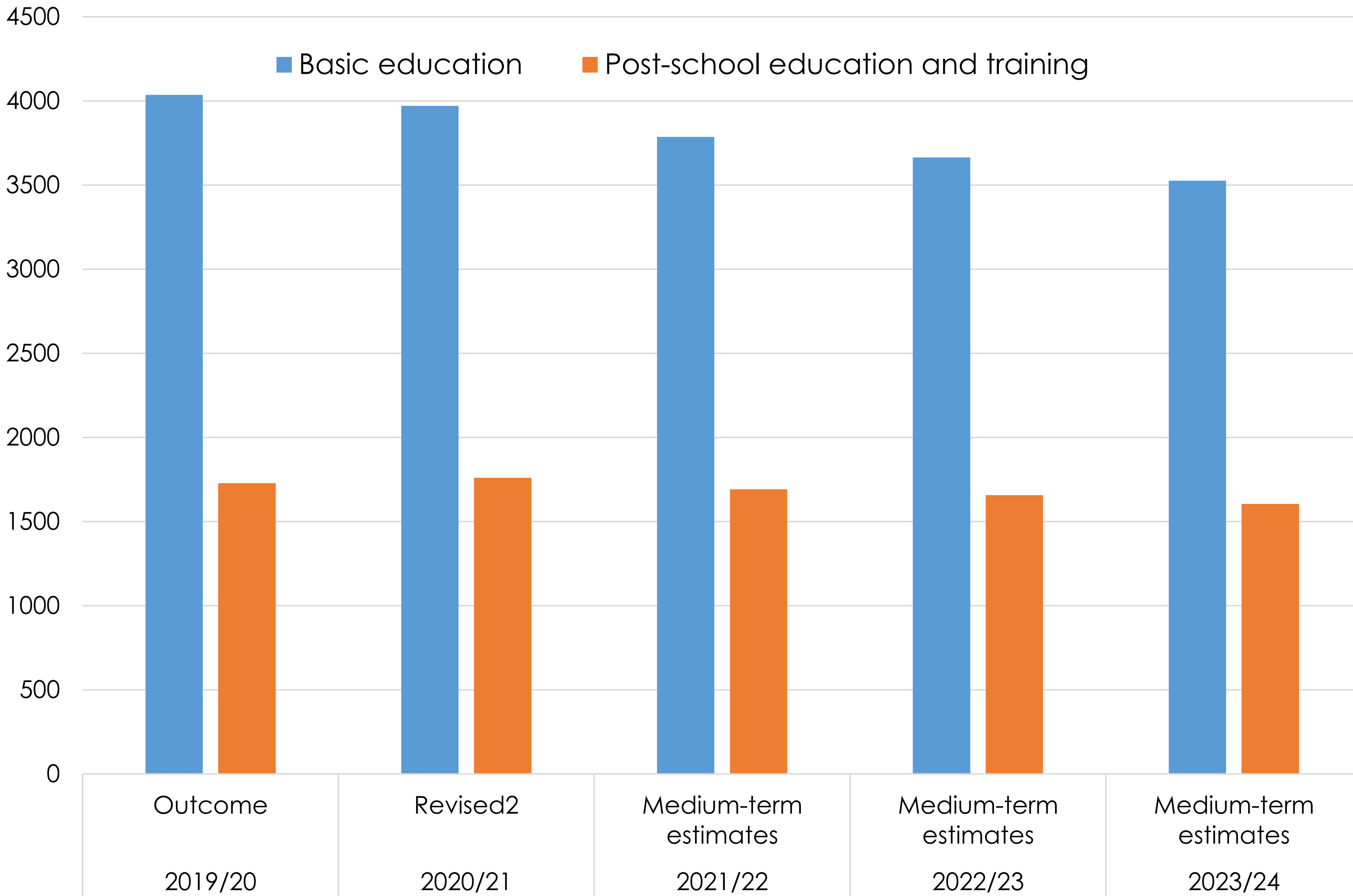


Real per capital expenditure per function group



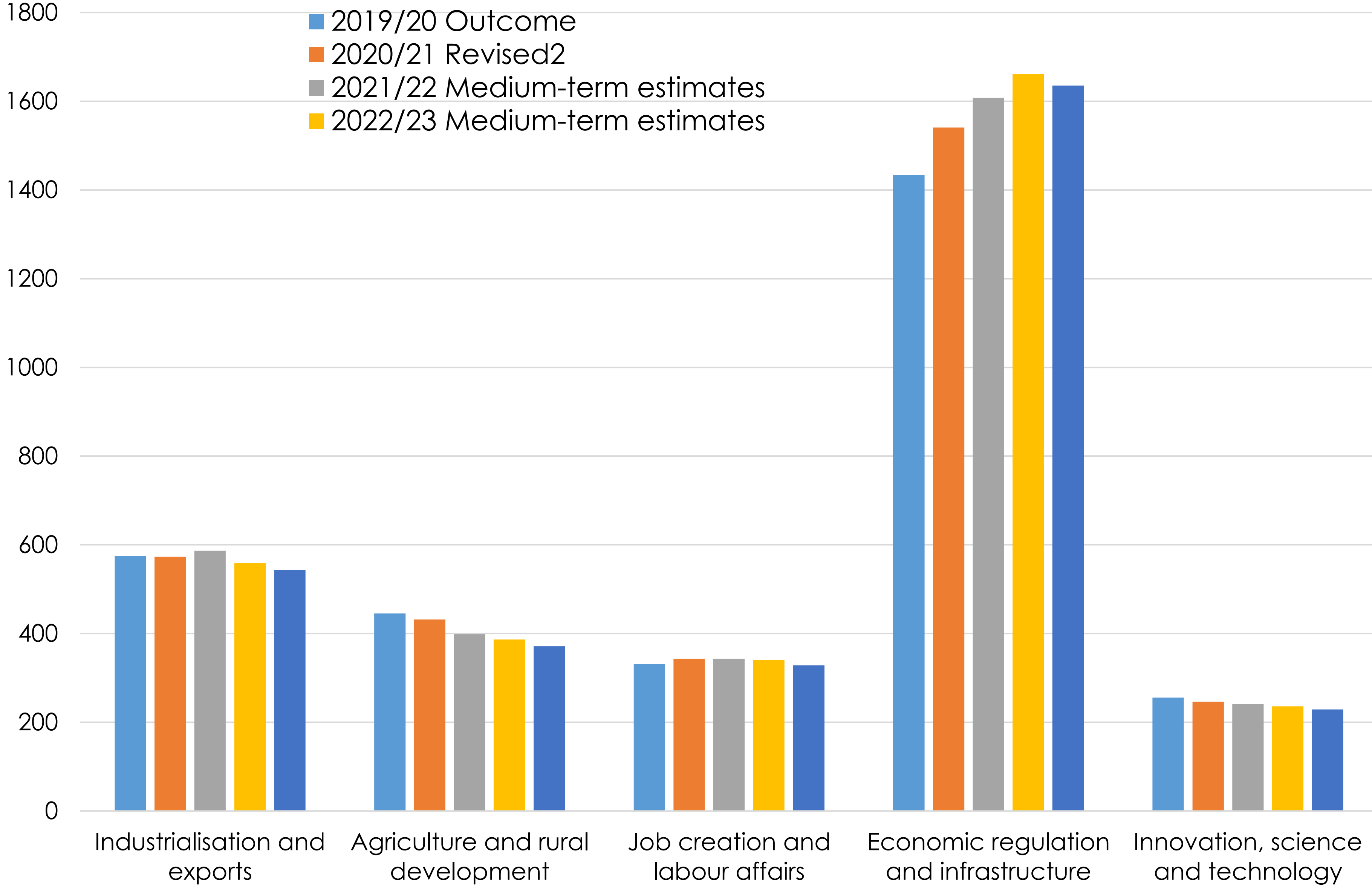
Source: Own calculations using National Treasury data

Real per capita expenditure on education



Source: Own calculations using National Treasury data

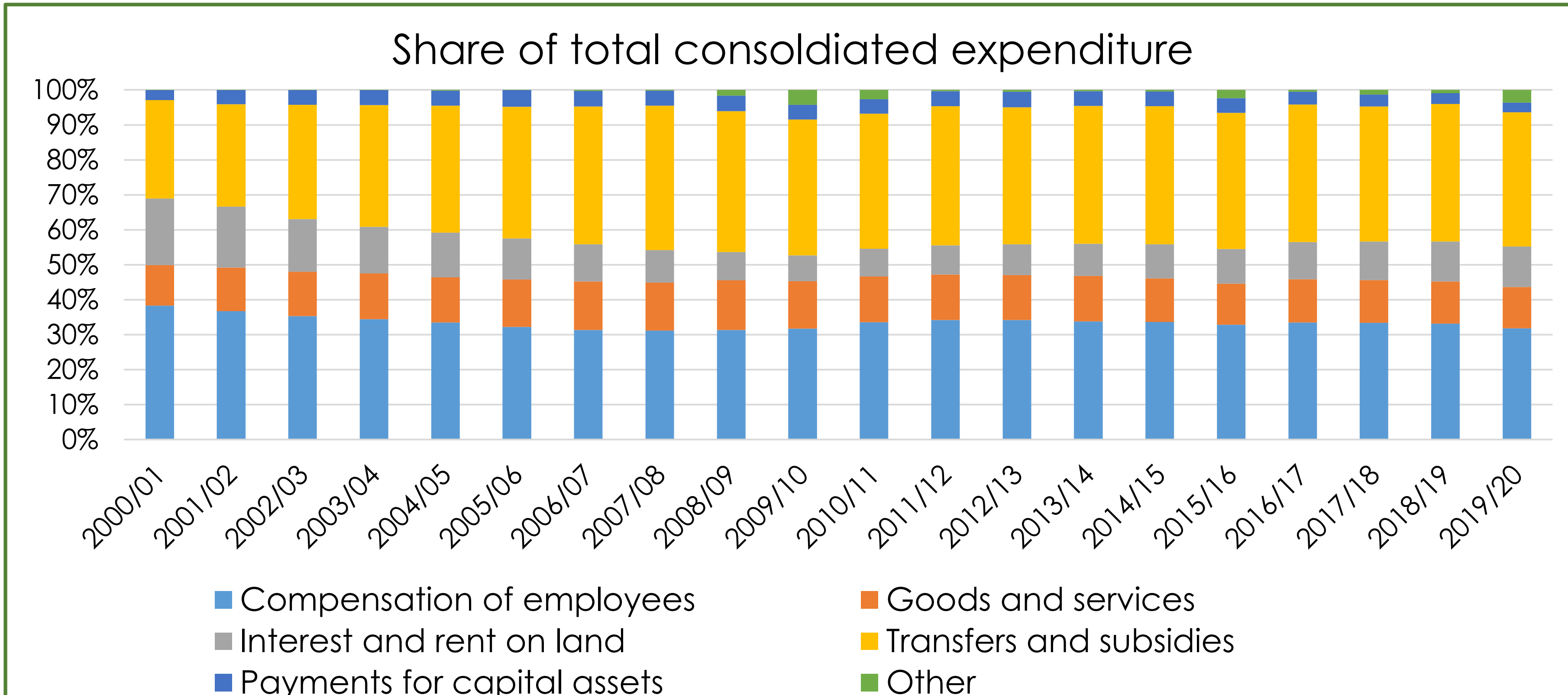
Real per capita expenditure on economic development



Source: Own calculations using National Treasury data

Fiscal Consolidation and the implications of the downward pressure on the Public Sector Wage Bill

- Large reductions in compensations of public employees is justified by the explanation that expenditure on compensation has increased.
- It is argued that increase in compensation crowds out investment expenditure.
- However, the share of compensation in total expenditure has declined from 38% in 2000/01 to 33.9% in 2019/20



Source: National Treasury

Fiscal Consolidation and the implications of the downward pressure on the Public Sector Wage Bill (contd.)

- Over the MTEF period, all departments will be required to control wages & headcounts.
- They will have to review and rationalise their organisational structures to minimise the effects on frontline services and ensure that they remain within their compensation expenditure ceilings. Much of the changes will take place at provincial departmental level which means they will have to source other means of financing their expenditure.

Reductions to compensation of employees

	2020/21	2021/22	2022/23	2023/24	Total
Function					
Community development	-632	-1636	-2294	-1545	-6107
Economic development	-1676	-4469	-6084	-4112	-16341
General public services	-1268	-4064	-5444	-3765	-14542
Health	-8987	-19147	-27388	-17202	**-72723**
Learning and culture	-14007	-30038	-42948	-27207	**-114199**
Peace and security	-9185	-21644	-2848	-18863	**-78541**
Social development	-760	-2190	-3065	-2116	-8132
Total	**-36515**	**-83187**	**-116071**	**-74811**	**-310585**

Source: National Treasury

- More than 80% of the total compensation reductions is in the learning and culture, health, and peace and security functions.
- These labour-intensive functions account for the majority of public personnel
- Reductions in compensation could strongly impact service delivery if public sector workers respond by leaving the public service and seek private employment.

Fiscal Consolidation and the implications of the downward pressure on the Public Sector Wage Bill (contd)

- Government proposes growth in the public-service wage bill of 1.8% in the current year and average annual growth of 0.8% over the 2021 MTEF period.
- To achieve these targets, which are proposed as essential for fiscal sustainability, government has not implemented the third year of the 2018 wage agreement. Furthermore, the Budget Guidelines propose a wage freeze for the next three years to support fiscal consolidation.
- Broad sweeping cuts to the public sector wage bill may lead to clashes with public sector unions, affecting the current wage agreement and upcoming wage talks.

Conclusions

- The ambitious goal in the MTBPS to quickly reduce public debt levels and achieve a primary surplus raises several questions:
  - How much weight should be given to the forecasts in the MTBPS given the uncertainty caused by the plethora of implementation risks and continued global spread of the pandemic?
  - Is it prudent to plan such large expenditure cuts during an ongoing health and economic crisis?
  - How will South Africa build resilience, particularly for the poor, to future possible health, climate and other crises?
  - How will the possibility of prolonged labour conflict in the public sector due to wage freezes affect performance of the public sector?
  - How much will unemployment increase and, other than 800 000 temporary jobs, where are the plans to reduce unemployment?
  - Will government's expenditure cuts and potential debt reduction lead to the expected rise in business confidence during the current crisis?
  - Is the plan to leverage infrastructure investment enough at a time when the private sector may be unwilling to make long-term investments?
  - Will infrastructure investment be enough to adequately deal with the collapse in aggregate demand?

Additional Slides

Foreign Direct Investment (FDI) trends

Table 1. Investment trends by type and region, 2020 Q1-Q3 *(Per cent change vs 2019)*

	Cross-border M&As	Greenfield projects*	International project finance**
World	-15	-37	-25
Developed economies	-21	-17	-19
Europe	-5	-17	-17
North America	-32	-25	-34
Developing economies	12	-49	-25
Africa	-44	-66	-49
Latin America and the Caribbean	-73	-53	-34
Asia	60	-42	8
Transition economies	84	-58	-46

Source: UNCTAD, cross-border M&A database (www.unctad.org/fdistatistics), information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for announced greenfield projects, and Refinitiv SA for announced cross-border project finance deals.

* The trend in greenfield projects refers to the first eight months of 2020.
** International project finance refers to (the trend in) the number of deals, as project values for the latest months are unavailable.

- African FDI is down 29% and sub-Saharan Africa down by 21% in first half 2020
- FDI flows to SA was up 24% due to MNC transfers to their subsidiaries in SA but not for green fields investment
  - Acquisition of Pioneer food by PepsiCo for US$1.8 billion also on the cards
- However, despite the pre-pandemic negotiated deals, the outlook for FDI to SA is affected by the bleak global and African economic outlook.
- The transfer to SA subsidiaries of MNCs during the pandemic may not be a positive sign but indicate stress related to poor aggregate demand in SA.

Financial deregulation and exchange control liberalisation

- There is an urgent need to consider the difference between long-term investment in to the economy and foreign short-term capital flows or "hot money
- Investors and speculators want different outcomes
  - Long-term productive investment seeks out macroeconomic stability and growth
  - Short-term hot money seeks out speculative opportunities for quick returns
  - Long-term productive investment builds the economy and create jobs
  - Hot money increases volatility and systemic risk in the financial sector and causes macroeconomic fragility
- Hot money diverts money from productive investment and employment creation:
  - Short-term inflows drive up financial asset prices. Potential investors invest in liquid financial assets rather than sinking money into longer-term productive investments
  - Increasing inflows of hot money create volatility, increases uncertainty and drives potential investors to look for short-term solutions to increase their returns
- Financial deregulation and exchange control liberalisation supports increased speculation and could create conditions that deter productive long-term investment
- Long-term productive investments are supported by policies that address low growth:
  - On the demand side there are extraordinary levels of inequality, mass structural unemployment and growing poverty
  - On the supply side there is need for economic restructuring to deepen and diversify the industrial base aided by structural reforms

The Infrastructure Fund

2019 MTBPS

- Announced Fund housed in DBSA
- To fast-track infrastructure projects and drawing on existing capacity;
  - the Presidential Infrastructure Coordinating Commission
  - the National Treasury,
  - GTAC and
  - the Independent Power Producers' Office.
- Collaboration with the private sector through BASA, ASISA and PPGI
- Set aside R100 billion over a decade
- Fund amounts are assumed at;
  - R18 billion over 2020/21 MTEF
  - R10 billion in 2024/25,
  - R12 billion in 2025/26,
  - R15 billion in 2026/27,
  - R20 billion in 2027/28 and
  - R24 billion in 2028/29

2020 ERRP

Aggressive infrastructure investment to:

- aggregate demand,
- assist in reviving the construction industry and
- contribute to employment creation

Establishment of Infrastructure South Africa (ISA)

- A central government agency responsible for coordinating and driving the infrastructure investment programme

Government to strengthen state capacity for infrastructure expansion through;

- Standard design for social infrastructure
- Designate the DBSA and Coega to be implementing agents for certain key projects where there are capacity constraints
- Reinforce the Municipal Infrastructure Support Unit as it is in the area of municipal infrastructure where there are the greatest capacity issues
- Improve coordination with provinces to introduce preparation capacity, whilst also working strengthen overall infrastructure capacity
- Allow greater allocation to project preparation and packaging