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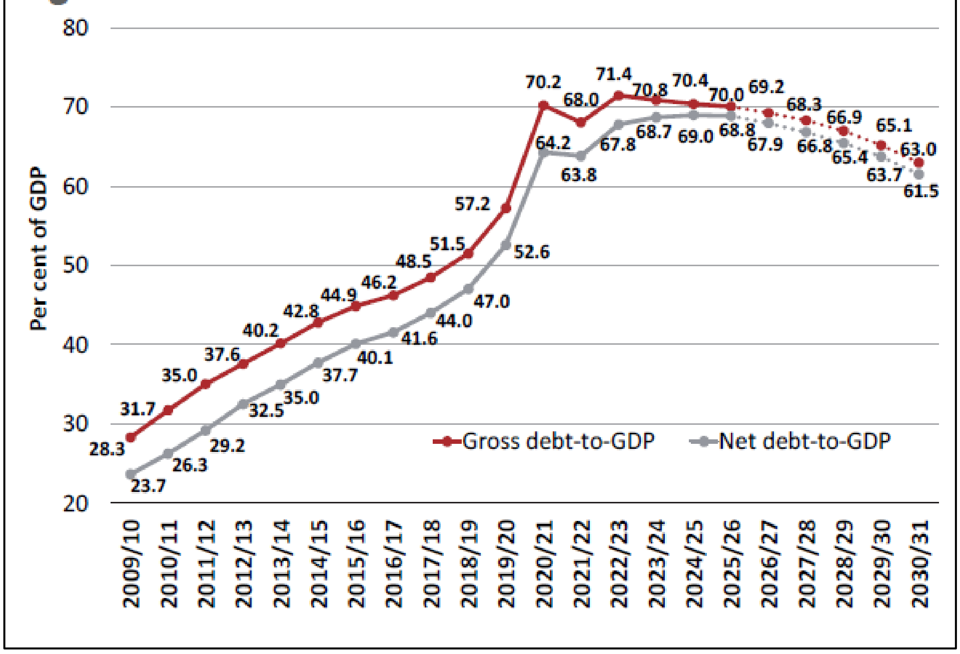
Media release

MediumTerm Budget Policy Statement – The good and the bad news

Sharon Smulders, Project Director: Tax Advocacy at the South African Institute of Chartered Accountants, shares the good and bad news from the MediumTerm Budget Policy Statement (MTBPS)

Johannesburg, 26 October 2022 – The **good news** stemming from the MediumTerm Budget Policy Statement (MTBPS) is that in 2023/24, South Africa is expected to achieve its first primary **budget surplus** in 15 years and this will be achieved with no new revenue enhancing measures from 2023/24 onwards. Further good news is that the gross debt is now projected to stabilise at 71.4% of GDP in 2022/23 – two years earlier and at a lower level than projected in the 2022 *Budget Review*.

Figure 1.4 Gross and net loan debt



However, the good news stops there, as from a consolidated budget balance perspective, there is still an overall **deficit**, but this will narrow from 4.9% of GDP in 2022/23 to 3.2% of GDP in 2025/26.

Table 3.6 Consolidated budget balance

R billion	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
		Outcome		Revised		Medium-term estimates	
Main budget	-345.1	-550.6	-323.1	-323.7	-286.1	-277.7	-260.7
Social security funds	11.9	-45.0	-5.8	-9.8	-6.8	-7.0	17.6
Public entities	39.6	34.9	28.8	3.5	1.4	-10.6	-18.9
Provinces	6.4	3.0	4.5	7.2	2.7	3.5	3.1
RDP Fund	-0.6	-0.5	-1.0	-0.2	-0.1	-0.0	–
Consolidated budget balance	**-287.8**	**-558.2**	**-296.7**	**-323.1**	**-288.9**	**-291.9**	**-259.0**
Percentage of GDP	*-5.1%*	*-10.0%*	*-4.7%*	*-4.9%*	*-4.1%*	*-3.9%*	*-3.2%*

Source: National Treasury

Furthermore, the single largest expense, debt service cost, is not in this projection of primary budget surplus. Debt service cost would have grown from R204bn (2020) to R380bn (2026) and that has a significant impact on the rest of the budget and South Africa's borrowing needs.

Revenue collection

Revenue collection has **exceeded projections** across most major tax categories. Compared with the 2022 Budget, the projected gross tax revenue estimate for 2022/23 has been revised up **by R83.5 billion** (R92.6 billion higher over the 2022 medium-term). The higher estimate is largely due to better-than-expected collections in the final quarter of 2021/22, upward revisions to near-term tax base growth projections and strong corporate income tax collections. National Treasury states the higher estimates partially reflect a permanent increase in revenue, most likely due to improvements in efficiencies at the South African Revenue Service (SARS).

SAICA however has some reservations as to how permanent these increases are. Much of the dividends tax increases and financial sector employees' tax increases were due to the last 2 years' COVID-19 provision reversals, not permanent increased financial performance. The downwards revision in projections for VAT also seems to align with the projected decline in GDP growth in the medium term.

Future estimated revenue projections are as follows:

Table 3.5 Main budget framework

R billion/percentage of GDP	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
		Outcome		Revised		Medium-term estimates	
Main budget revenue	**1 345.9**	**1 238.4**	**1 564.3**	**1 694.5**	**1 755.5**	**1 866.8**	**2 002.5**
	23.6%	*22.1%*	*24.9%*	*25.5%*	*24.9%*	*24.8%*	*25.0%*

SAICA raised its concerns in previous years with optimistic revenue and growth projections. These concerns have been realised this year again as real GDP is projected to grow by 1.9% in 2022, compared with 2.1% estimated in the 2022 Budget. National Treasury notes this concern and has warned in the MTBPS that there is significant uncertainty associated with these projections as revenue projections have changed rapidly before, during, and after the COVID-19 pandemic. National Treasury states that any significant downward revisions will place the current fiscal strategy under pressure.

How will the increase in revenue be used?

The use of the revenue overrun is extremely important, because our tax-to-GDP ratio is already far higher than it has been over the past decade. The MTBPS states that the tax-to-GDP ratio is expected to increase from 24.9% in 2021/22 to 25.3% in 2022/23 – breaching the 25% ceiling that Katz Commission recommended in its third report. A high tax-to-GDP ratio is not a problem where taxpayers are receiving good value for their money, however, this is not a reality currently in South Africa.

The MTBPS notes that in the current year, 65% of the additional revenue will be utilised to **narrow the budget deficit** and keep **debt stabilisation** on track. Allocations are then made to mitigate economic and fiscal risks associated with certain **state-owned entities** (Denel, the South African National Roads Agency Limited (SANRAL) and Transnet).

Overview of budgeted expenditure

Compared with the 2022 Budget estimates, government proposes a **net addition of R37 billion** to main budget non-interest spending in **2022/23**. Main budget non-interest expenditure will increase by a net **R52.4 billion** in 2023/24 and **R58.5 billion** in 2024/25 compared with the 2022 Budget. This includes the following proposed additions over the next two years:

- R66.9 billion for health, education and provision of free basic services by local government, and a **one-year extension of the COVID-19 social relief of distress grant**.
- R8.9 billion for safety and security.
- R11.3 billion for infrastructure investment, including rehabilitating damaged municipal infrastructure and refurbishing provincial roads.

Consolidated government spending is expected to increase from R2.21 trillion in 2022/23 to R2.48 trillion in 2025/26, **growing** by an annual average **rate of 4%.** The bulk of spending supports the social wage (health, education, local government free basic services, infrastructure, and safety and security). The spending increases are funded by the improved revenue estimates and an **expected drawdown** of the 2022 Budget **unallocated reserve** in 2023/24.

The **unallocated and contingency reserves** cushion the framework from fiscal risks that may materialise over the medium term. The unallocated reserve is increased by R11.3 billion to R41.3 billion in 2024/25. The contingency reserve has also been increased by R2 billion over the next two years. Whether these amounts are sufficient will remain to be seen, but seem to be conservative considering the damage caused by the riots and floods over the last two years. SAICA remains concerned that more than R80 billion per year is now being kept by National Government as conditional monies for various matters rather than outright allocations to enable recipients to properly plan and spend.

On 23 February 2022, Fitch Ratings noted that continuing **breaches of expenditure ceilings** points to difficulties in containing spending and it doubts that the National Treasury has the ability to contain government spending pressures. SAICA has also raised this concern with Parliament and it is evident that this concern continues to materialise as is seen from the table below.

Table C.3 Main budget expenditure ceiling[1]

R million	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
2020 MTBPS	1 418 408	1 502 867	1 479 709	1 516 052	1 529 585		
2021 Budget Review	1 418 399	1 504 656	1 514 934	1 521 721	1 530 664		
2021 MTBPS	1 418 456	1 487 388	1 570 890	1 552 268	1 558 725	1 627 154	
2022 Budget Review		1 487 399	1 575 002	1 630 905	1 613 671	1 686 932	
2022 MTBPS		**1 487 385**	**1 566 490**	**1 667 118**	**1 665 349**	**1 744 762**	**1 832 678**

1. The expenditure ceiling differs from main budget non-interest expenditure
Source: National Treasury

Compared with the 2022 Budget, the expenditure ceiling has increased by R51.7 billion in 2023/24 and R57.8 billion in 2024/25. What is of further concern, is that financial support for **Eskom is not included** in the expenditure ceiling **neither the wage increases in 2023/24** as the next wage negotiation process has not yet begun. Even a compromise with unions at about 7% will result in unbudgeted expenditure of more than R31 billion.

SAICA has asked Parliament if it finds it acceptable that there are consistent breaches of expenditure ceilings considering the debt levels as this undermines the credibility of the budget. No response has been received to date. No mention was made of zero-based budgeting either. National Treasury has, however, stated in the MTBPS that expenditure ceilings are too weak and it is considering various models/policy approaches to safeguard fiscal sustainability and limit excessive deficits, for example, debt ceiling, expenditure or revenue rule.

What is government doing about state-owned entities (SOEs)?

Eskom

Eskom is the biggest known risk to the economy and public finances as it does not generate sufficient revenues or control its costs. Financial support for Eskom amounts to R224.6 billion from 2019/20 until 2025/26. To ensure Eskom's long-term financial viability, **government plans to take over a portion of the entity's R400 billion debt**. How this will be done has not been specified in the MTBPS, other than the debt relief program specifics, including the selection of the relevant debt instruments and the method of effecting the relief, are still being finalised. The programme will include strict conditions that will be informed by an independent review of Eskom's operations. We will have to wait for the 2023 Budget Review to know more.

Other SOEs

Government is allocating **R30 billion** to **Denel**, the South African National Roads Agency Limited (**SANRAL**) and **Transnet** in the current year. SANRAL is allocated R23.7 billion to settle maturing debt and debt-related obligations. A total of R5.8 billion will be allocated to Transnet – half of which is shifted funds to repair infrastructure damaged by the recent floods, and half to repair and maintain freight rail locomotives. Denel will be allocated R204.7 million to reduce contingent liabilities arising from its weak financial position and R3.4 billion – if set conditions are met – to complete its turnaround plan.

The **Land Bank** remains in financial distress and the process to finalise a solution is ongoing. An amount of **R5 billion remains in the contingency reserve** in 2022/23 as part of the funding provided for the Land Bank in the previous budget. Conditions for the release of these funds have not yet been met.

Government, in the MTBPS, reiterated that it continues to enforce minimum criteria before guaranteeing the debt of SOEs. Over the past year, no guarantee requests that met the criteria were received. However, of further concern, is the admission in the MTBPS that the broader context of financial distress, weak governance and unsustainable operations in many of these companies remains unaddressed. No further solutions to these problems were proposed other than the Presidential State-Owned Enterprises Council that has developed a **draft framework to guide decisions on disposing of and retaining state-owned companies**. To complement this work, the National Treasury has begun developing a **SOEs funding framework**, which will be finalised in 2022/23. One wonders if South Africa has the finances to wait this long for decisions on the viability of these entities.

Greylisting

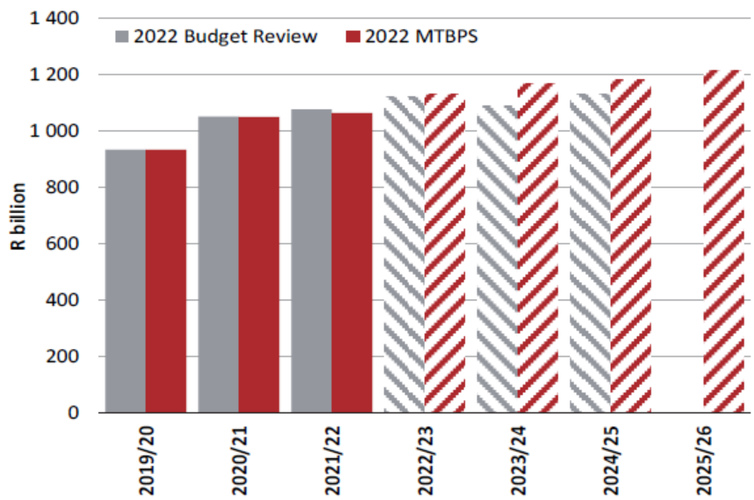
One of the matters highlighted by SAICA in its submission to Parliament in March 2022, was the economic and societal risks due to the lack of progress on interventions to address the findings of the Financial Action Task Force (FATF) and appropriations for law enforcement. South Africa was given 12 months to correct the deficiencies or risk being placed on the "grey list" from February 2023.

Most of the key recommendations dealt with challenges in our law enforcement and not necessarily our legal framework. In this regard, SAICA submitted that the financing of the SAPS needed to be reconsidered given the proposed medium-term budget cuts after inflation but even more importantly, the Minister needed to finance the needs of the National Prosecuting Agency to deal with corruption cases as a specific finding. The NPA Head, Adv. Shamila Batohi noted that the NPA needs at least another R1,7bn to be added to their current budget of R4,9 billion to prosecute corruption cases.

SAICA proposed that the Police VIP Unit budget, that is a budget for looking after South African politicians and dignitaries *inter alia*, be halved from R3,4 billion to R1,7 billion and that would secure the funding the **National Prosecuting Authority (NPA)** required. It would also demonstrate that the government and the Minister were willing to prioritise the budget to address more important needs. This did not happen, but the MTBPS notes that to improve the fight against corruption and advance the recommendations of the State Capture Commission, the **2023 Budget** will also **add to the budgets** of the NPA, the Special Investigating Unit, the Financial Intelligence Centre and the South African Revenue Service. These resources will help the institutions to identify sophisticated financial crimes, prosecute offenders, and recover money and assets that are the proceeds of fraud and corruption. As enforcement is the missing element to avoid greylisting and no real progress seems will happen in this regard, greylisting seems inevitable. The MTBPS does not seem to factor this in especially, as to debt service costs, GDP growth and revenue projections.

Public Service Compensation
The social wage, totalling R3.56 trillion over the next three years, will continue to take up the biggest share of the budget in support of poor households. From an economic classification perspective, **public-service compensation** is the **largest spending item**.

Figure 3.4 Social wage*



It is noted in the MTBPS that in order to avoid pre-empting the wage negotiation process, **no provisions have been made for wage increases in 2023/24** although increases will need to remain within the available fiscal resources so as not to compromise other spending priorities. The materialisation of risks such as a **public service wage agreement in excess of available resources** would mean reduced funding for other areas of expenditure over the MTEF period.

National Treasury is hoping to align negotiations and budgets, but this still has a long way to go, and until it does realise, the **budget is clearly understated** in this regard.

It has been admitted in the MTBPS that high average compensation levels are mainly responsible for South Africa's high public-sector wage bill rather than headcount growth. To address this, the Department of Public Service and Administration, working with the National Treasury and other national departments, is **reviewing remuneration policies across government**. The aim is for the public sector (excluding SOEs) to move towards a single remuneration framework in line with the principles of fair, equitable and sustainable remuneration. This will reduce current remuneration inequality for employees performing similar tasks in different spheres of government. No mention was made of performance indicators being linked to remuneration.

Infrastructure spending
Spending on buildings and fixed structures **will increase** from R66.7 billion in 2022/23 **to R112.5 billion** in 2025/26, at an annual average of 19% over the medium term. The 2023 Budget will propose funding to support project preparation – what exactly this means is not clear but National Treasury noted the lack of readiness of projects for current year and that these were thus taken out of budget but noted that over the medium term there are better quality projects and the 2023 Budget Review will include a list of projects and amounts allocated to each. SAICA has expressed reservations on these figures given that it has been previously disclosed that it includes repairs and maintenance and is not outright capital infrastructure expansion.

It was also noted that the Development Bank of Southern Africa, Infrastructure South Africa and the Government Technical Advisory Centre are scaling up efforts to **build a viable project pipeline**. These efforts are being strengthened by providing resources for project preparation. In addition, reforms are under way to reorganise and streamline functions for expedited planning and procurement for public-private partnerships and blended finance projects. **Public entities plan to invest** R145.8 billion in i**nfrastructure** over the MTEF period, including R85.3 billion in the **transport sector** and **R33.3 billion** in the **water sector**.

The South African National Roads Agency Limited will spend R61.8 billion to build new roads infrastructure and rehabilitate key transport routes serving the economy, mainly on the non-toll network, where over 85% of roads are beyond their design life. The Passenger Rail Agency of South Africa plans to spend R23.6 billion to rehabilitate vandalised and stolen rail infrastructure and to continue the modernisation programme, which includes renewing the fleet of rolling stock. The water boards will spend R27.7 billion over the MTEF period to provide bulk infrastructure. This includes the uMkhomazi water project and upgrading the capacity of various pipelines in the Rand Water service area, including the Zuikerbosch system.

Social grants
As mentioned above, the **temporary grant** will be **extended for one year** until March 2024. National Treasury noted that any permanent increase in expenditure, such as a new social grant, will need to be matched by permanent revenue increases or spending reductions elsewhere. National Treasury warned that given the large cost of extending this grant, increases to other social grants in 2023/24 will be slightly below inflation and other social welfare priorities may remain unaddressed.

Municipalities

By the end of the third quarter of 2021/22, 43 municipalities were experiencing financial and service delivery crises as defined in the Municipal Finance Management Act (2003). To date, interventions have been ineffective largely because of poor coordination among stakeholders, reluctance to address dysfunctional councils, ineffective monitoring and implementation of financial recovery plans, and incorrect application of the framework in section 139 of the Constitution.

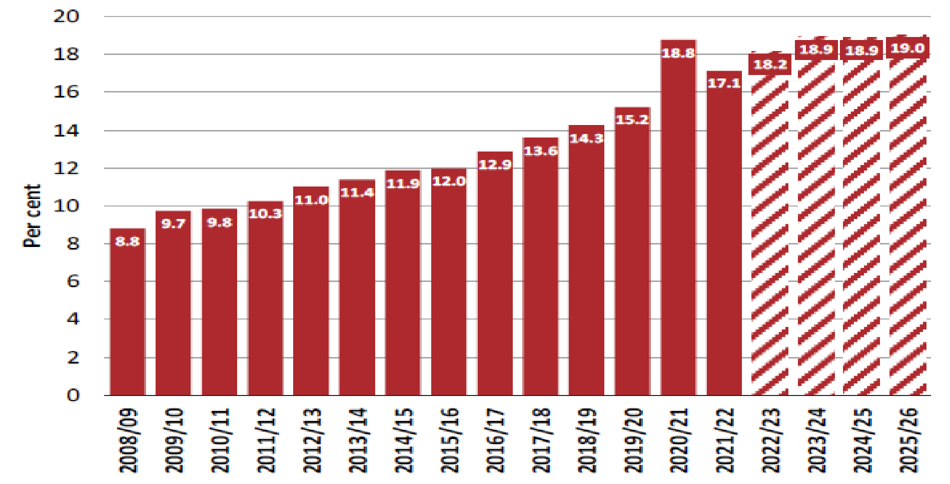
In response to municipalities' financial weakness, the National Treasury is working to **strengthen its early warning system** to improve oversight and timely assistance. An update on the progress will be provided in the 2023 Budget.

SACU payments
The SACU payment projections have been *revised higher* by **R13.2 billion** in 2023/24 and R19.4 billion in 2024/25. The revisions to SACU payments are mainly due to higher common revenue pool estimates than projected in the 2022 Budget Review.

Debt and interest costs
Despite the debt stabilisation in 2022/23, gross loan debt is expected to increase from R4.75 trillion in 2022/23 to R5.61 trillion in 2025/26. The key drivers of this increase remain the budget balance and fluctuations in the interest, inflation and exchange rates. Net loan debt (gross loan debt less cash balances) will, however, only stabilise in 2024/25 at 69% of GDP.

Debt-service costs will thus **continue to rise** over the medium term and are projected to peak as a proportion of revenue in 2025/26 as is seen below.

Figure 3.2 Debt-service costs as a share of main budget revenue



Unbudgeted expenditure
Unbudgeted items remain a significant risk to the credibility of the budget. SAICA noted these in its 2022 Budget Review and Appropriations Bill submissions and these included: SOEs contingent liabilities that are fast becoming government debt, financial support for municipalities that are in a precarious financial health situation, costs to fix the dilapidated water and sanitation infrastructure, costs needed to appoint 12 000 new police recruits as promised by the President in the 2022 SONA as inflation will erode the current increases given to the Police Department, contingent legal liabilities that history indicates will most

likely realise are mounting and potential underfunding of the long-term funding requirements of the GEPF.

It is noted in the MTBPS that provincial health departments continue to face a high level of medico-legal claims. The contingent liability associated with these claims – in other words, the potential loss incurred by the state if all claims are to be paid out – **increased** from R106.3 billion in 2020/21 **to R109 billion** in 2021/22, while payment of claims declined from R1.7 billion to R1 billion over the same period.

As mentioned earlier, Eskom's debt (and the impact on debt service costs) and the wage increases in 2023/24 have also not been included in the budget and this poses serious financial risks for the fiscus and affects the credibility of the MTBPS.

Conclusion

The risks to the fiscal outlook, which include further slowdowns in economic growth, higher public-service wage costs, contingent liabilities of state-owned companies and the introduction of unfunded spending programmes, remain real. The unbudgeted for expenses could result in a faster accumulation of debt and negatively affect the public finances.

A sustained improvement in growth and employment outcomes requires rapid and decisive implementation of economic reforms, supported by clear and stable macroeconomic framework – and improved state capacity. The MTBPS provides no rapid or decisive implementation reforms, rather lengthy high-level promises of processes and reviews.

As mentioned in SAICA's 2022 Budget submission, the main problem facing South Africa does not lie in the raising of financial resources, but rather how those financial resources are being applied and invested into the economy in order to generate the returns we require to achieve the desired outcomes. The urgency of monitoring and measurement of implementation success and accountability measures is lacking, and this does not bode well for avoiding the FATF grey listing which, should this occur, will have a substantial effect on the current MTBPS.

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