Thinking about the 2022 budget policy statement

October 2022

Summary of main points

1. Short-term improvement in the fiscal position on the back of a nominal boom, but real economic stagnation means continued fiscal weakness ahead
2. Government slowed down spending growth in the wake of the pandemic. A much larger slowdown is planned for 2023
3. There is no “end of consolidation” in the fiscal framework, it continues for the full three years of the MTEF as indicated by falling real per capita spending on core services
4. Employment levels in health, education and criminal justice will be forced down further unless real reductions in government pay are executed for another three years (or if spending is increased substantially)
5. Aggressive fiscal consolidation path appears to stabilize debt, but
   – The spending trajectory is implausible, and “spending ceiling” is unreliable as forward guidance
   – The revenue outlook is optimistic
   – Major risks are not included in the baseline
6. With slightly different assumptions, fiscal targets set out in MTBPS are not achieved
7. The lack of reliability of key budget metrics points to a deterioration in the quality of the medium-term policy framework, and raises questions about fiscal institutions

Spending uncertainties

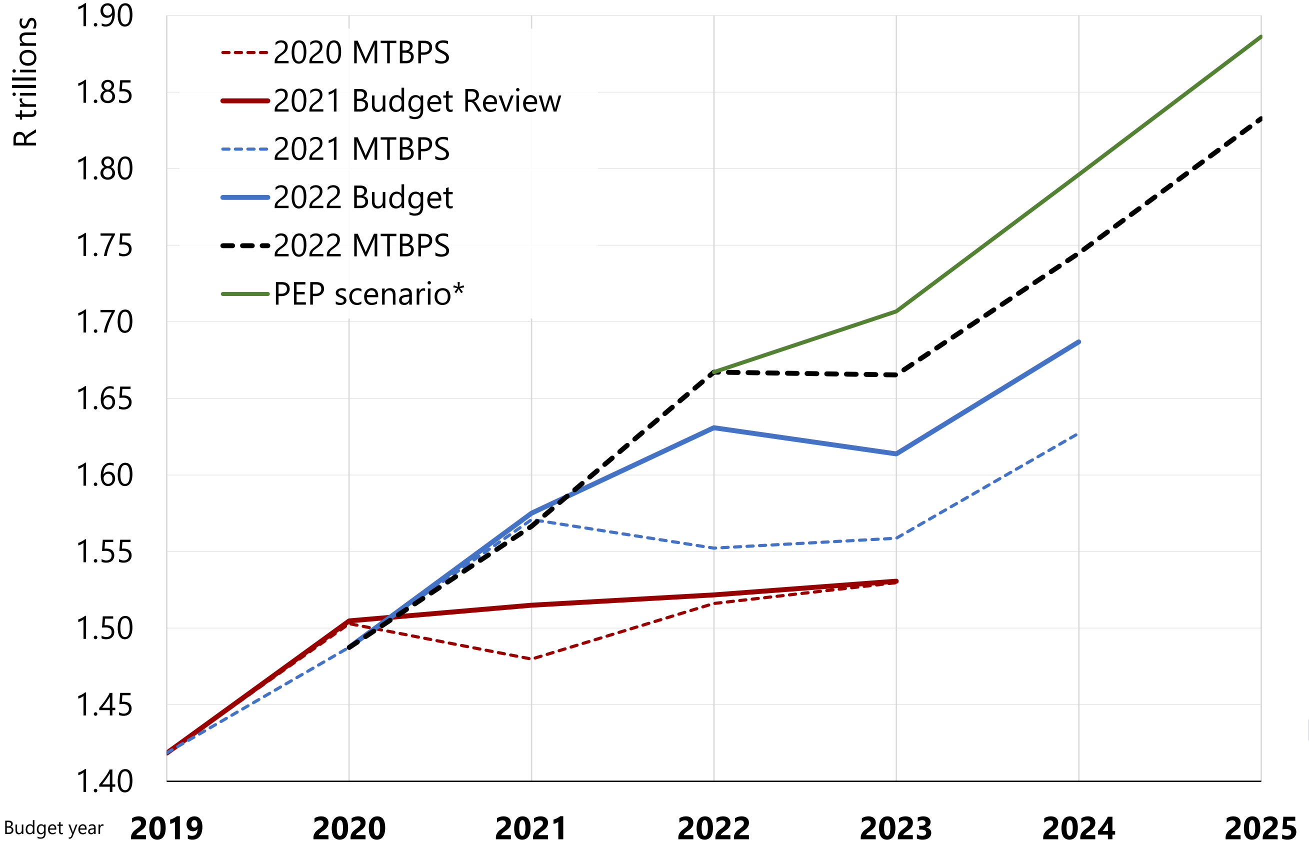
- No policy direction indicated in MTBPS on a range of choices that are critical for fiscal planning:
- *Government pay assumptions*
  - 2022: Unilateral implementation of current offer
  - 2023: Nominal pay cut – no provision for pay increase and withdrawal of R1000 cash gratuity
  - 2024: Wage bill grows more slowly than CPI projection (i.e. further real wage cuts)
- *Social grants*
  - Covid SRD grant effectively funded as an "unallocated reserve"
  - Signalled cuts other grants to fund COVID SRD: will government go through with this?
- *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

Spending path: Consolidation eased

- The path of expenditure consolidation has been eased considerably, with government planning to add significant funds
  - R36 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”

Nominal spending ceiling in successive budget documents
R trillions



Source data: National Treasury

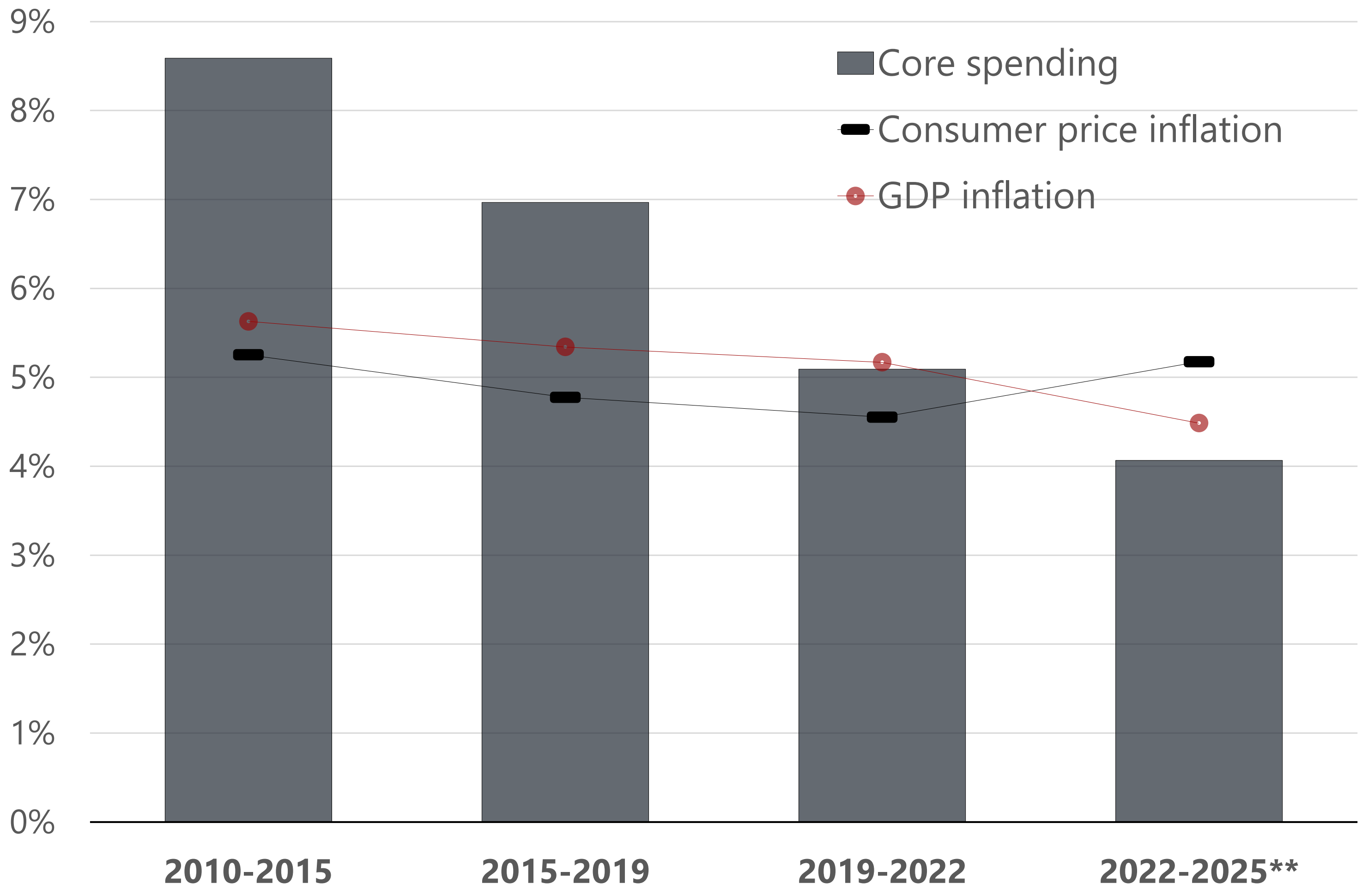
Spending slowdown continues

- 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
- The increase in CPI inflation makes spending cuts easier to implement (inflation does part of the heavy lifting)

* 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

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

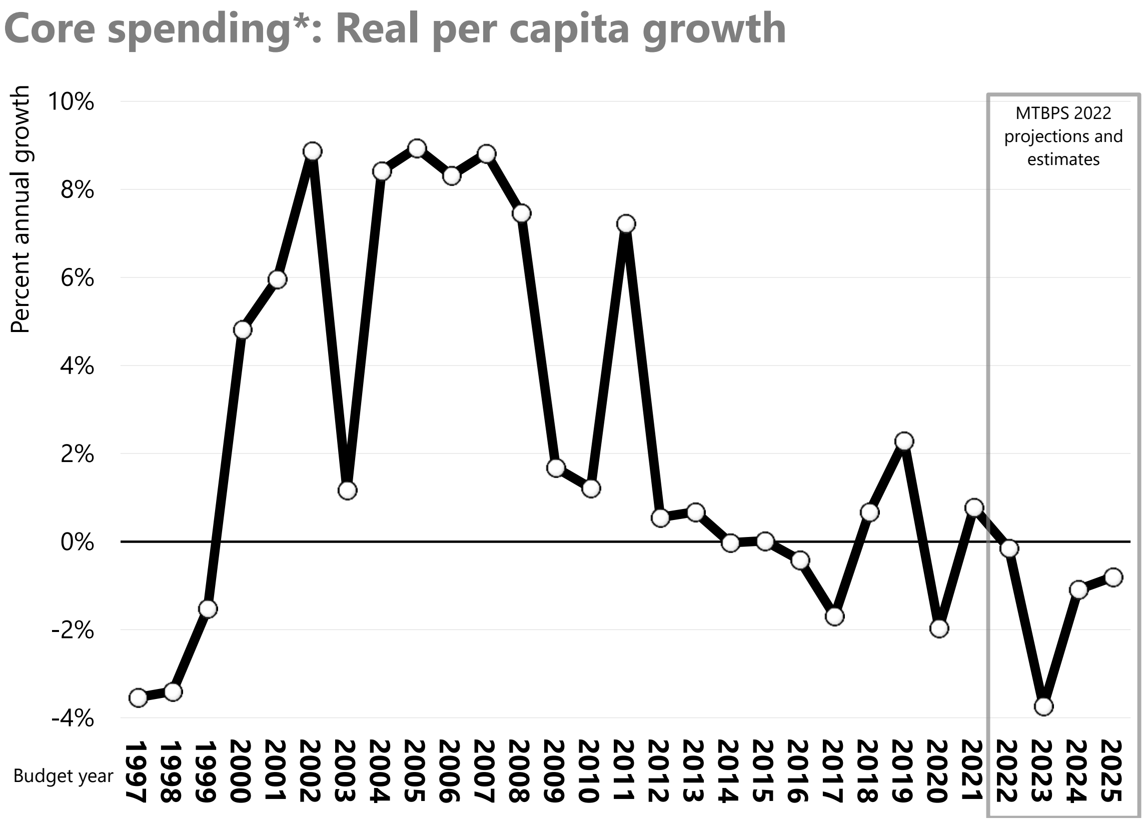


Source data: National Treasury

Large consolidation planned for 2023

Very large contraction in 2023, followed by further declines in real per capita spending

Main burden of consolidation on consumption spending i.e. mainly basic education, healthcare and criminal justice



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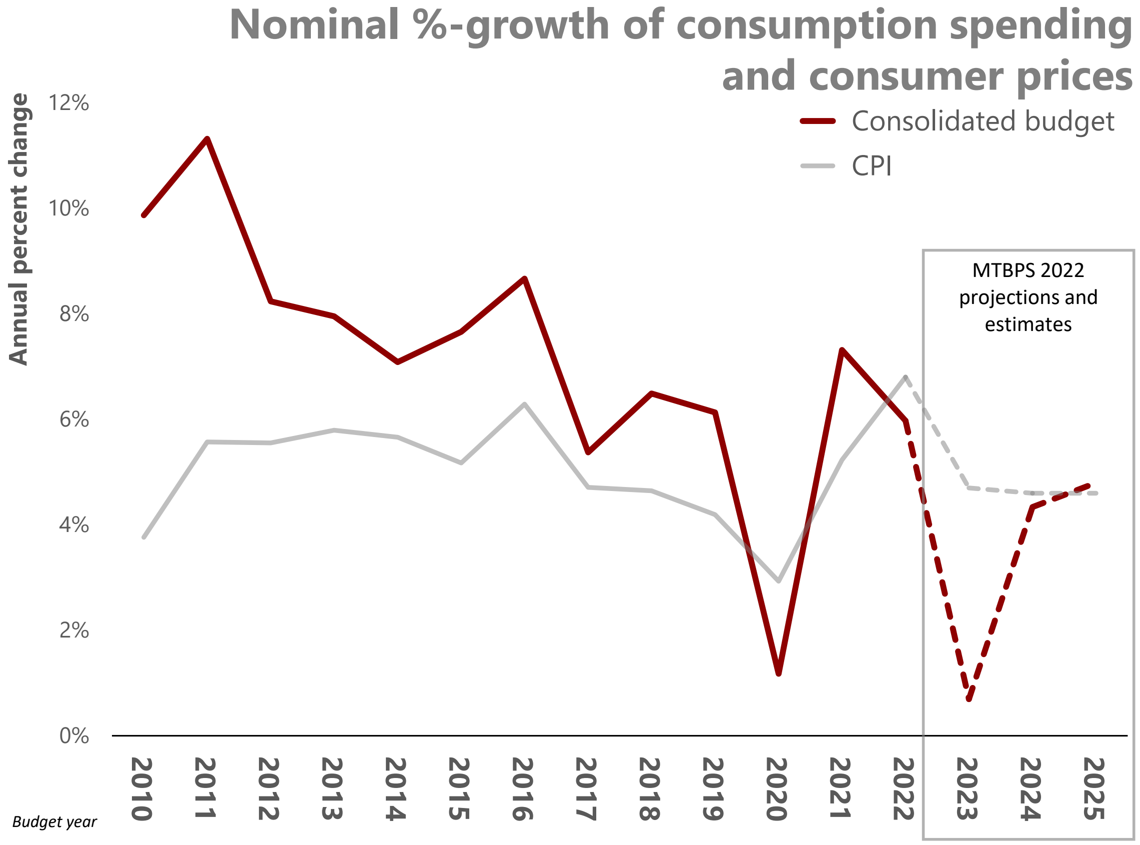
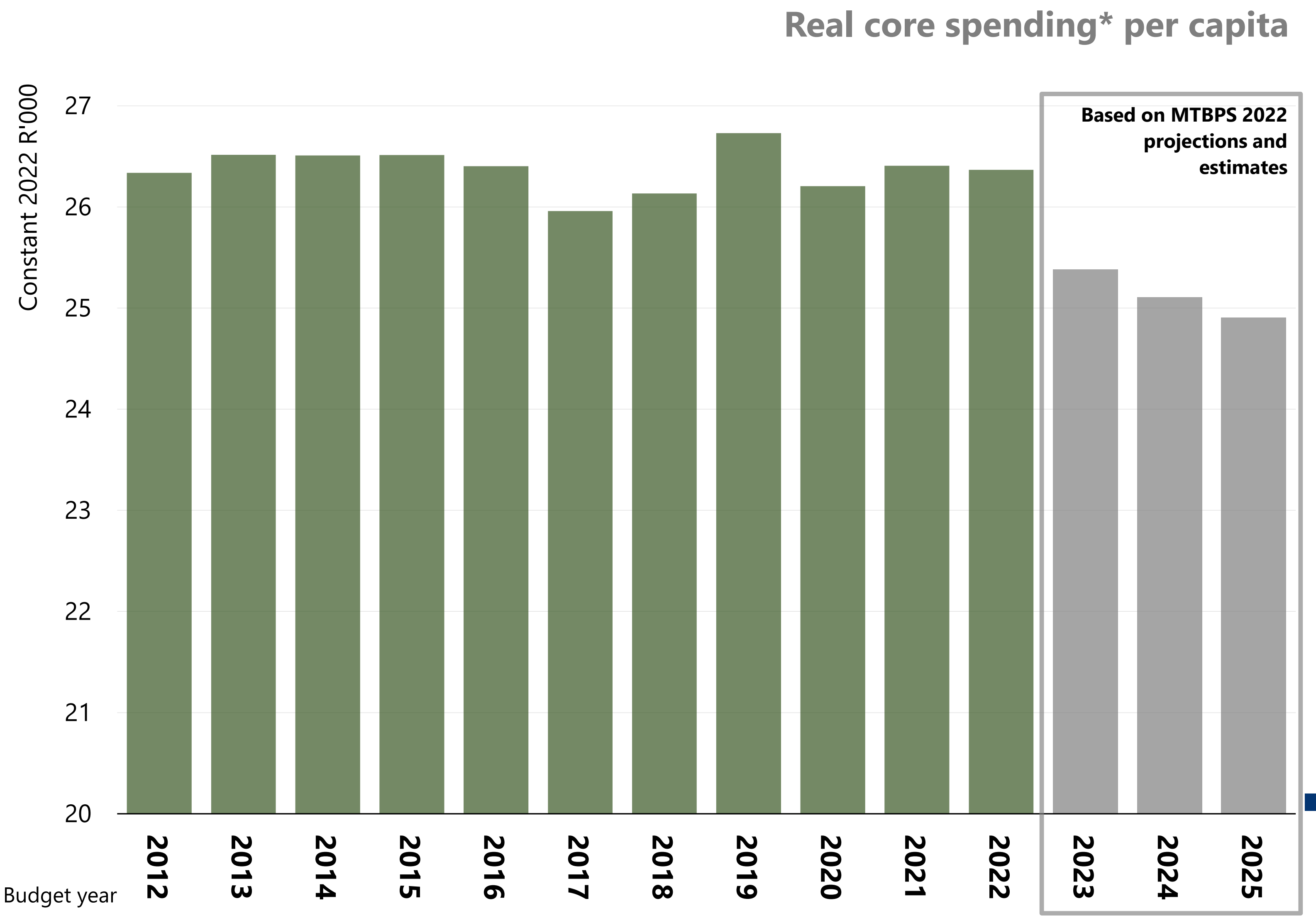


Source data: National Treasury, SARB, StatsSA

Spending per capita to continue falling

- Claims that fiscal consolidation will "end" after next years cuts are not borne out by spending estimates
- Beyond 2023, the MTBPS assumes that real resource allocation per capita will continue to fall



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

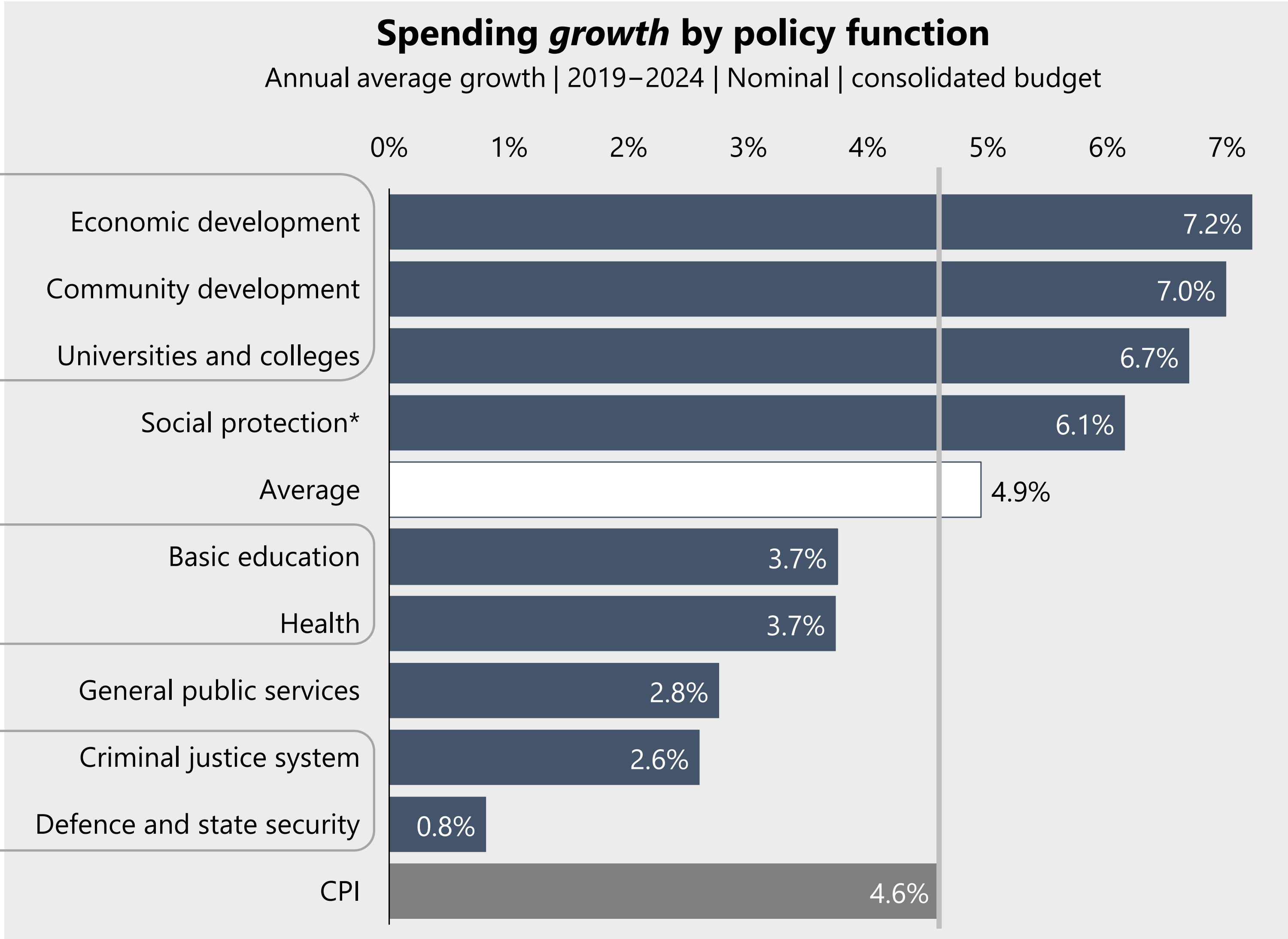
Source data: National Treasury, StatsSA

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, and is unlikely to be supported within cabinet
- Policy ambiguity about a new grant for low-income workers and the unemployed
- Policy uncertainty reflected in presentation of spending estimates, 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

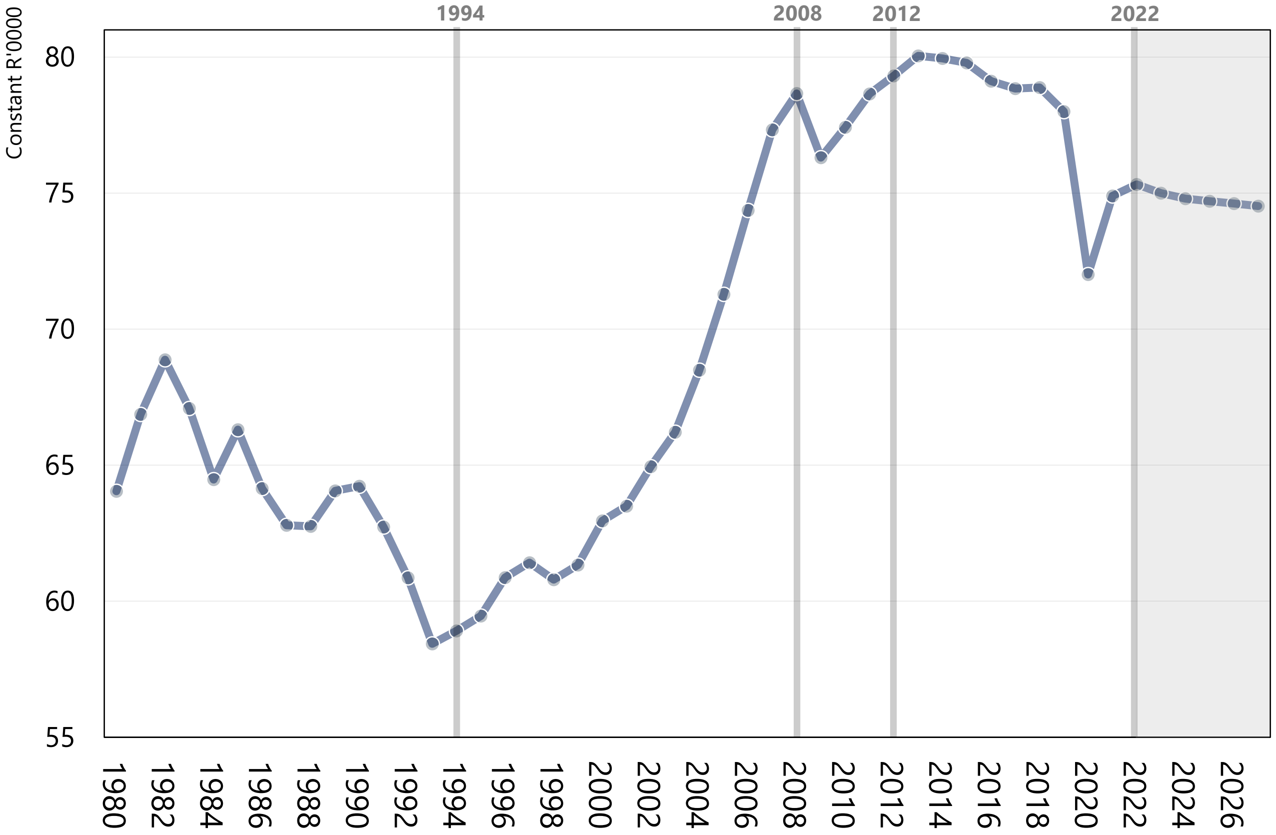
Nominal gains

- 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"

South Africa: GDP per capita in constant rand



Source data: IMF, SARB

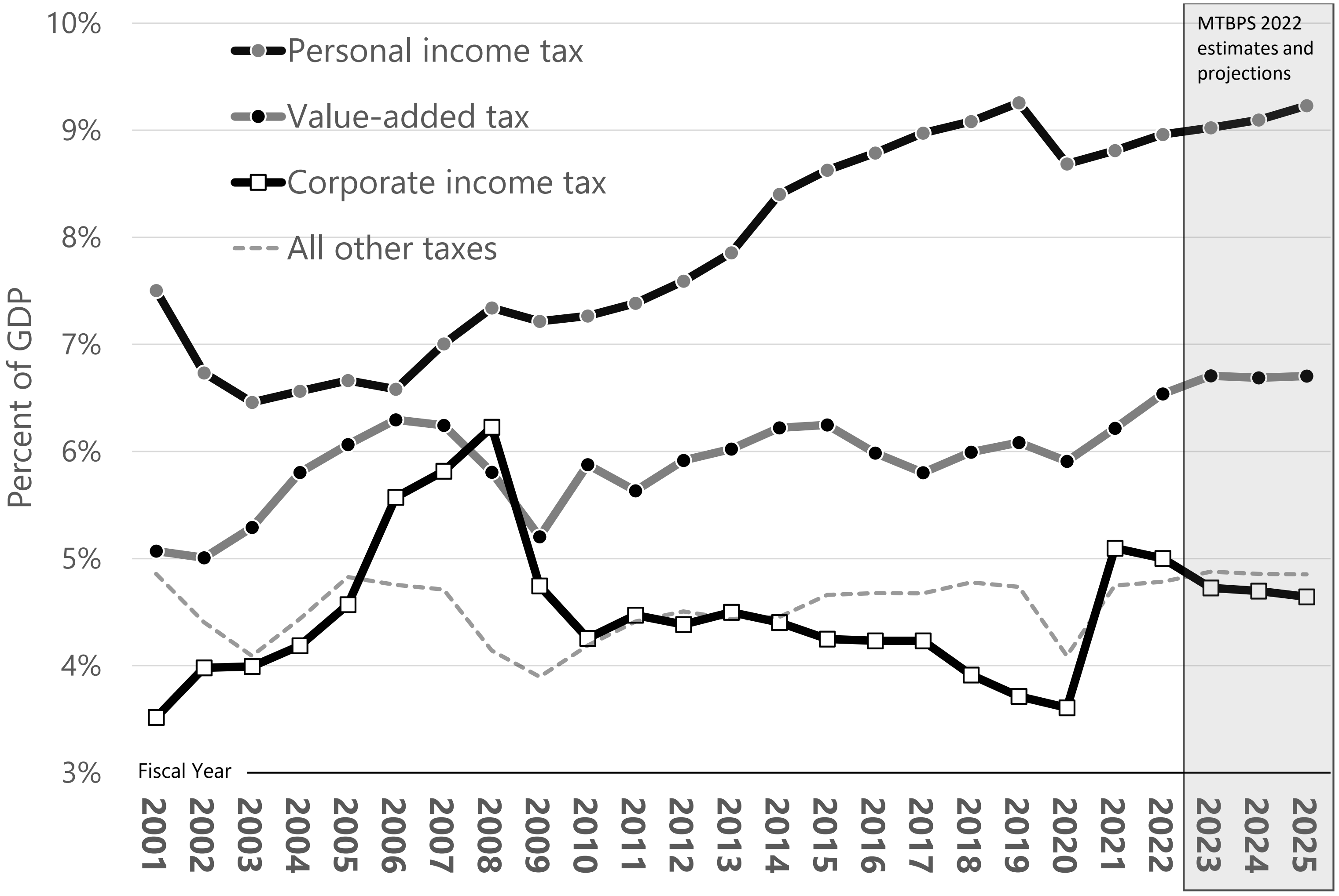
Treasury regards cyclical CIT boost as permanent

In-year good revenue performance:

- 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



Source data: NT, SARB

Spending and revenue scenario

Assumptions in PEP alternate scenario

Revenue

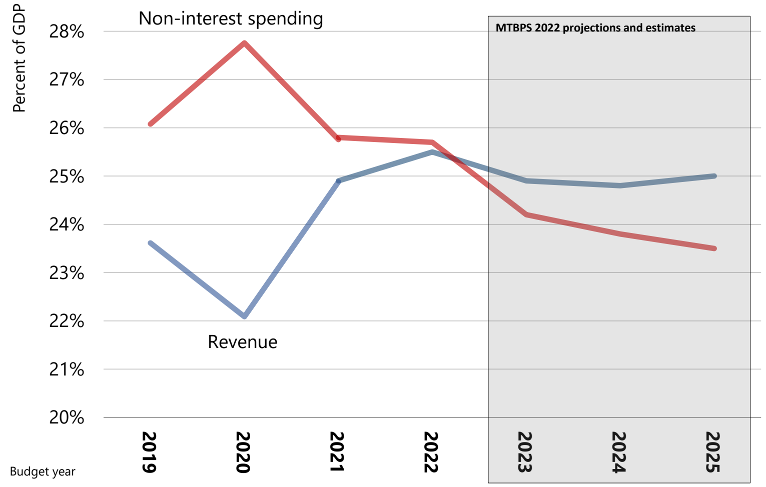
- Uses IMF forecast of nominal GDP growth and NT revenue buoyancy
- Revenue slightly lower as a share of GDP

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

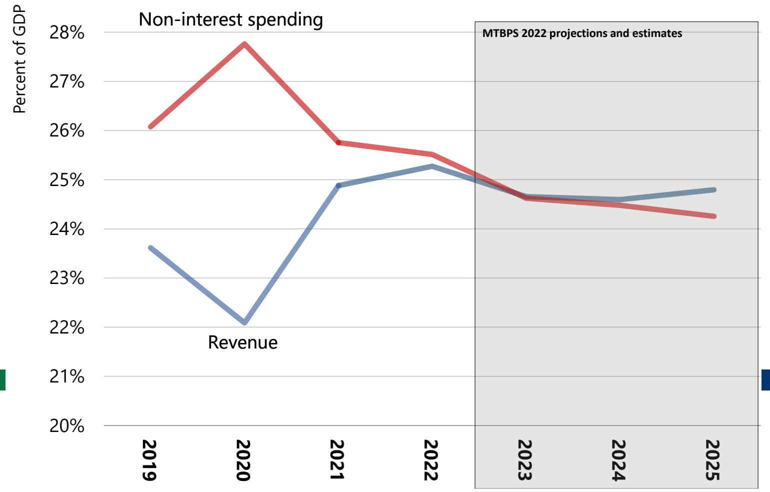
National Treasury Projection

Main budget revenue and non-interest spending



Public Economy Project scenario

Main budget revenue and non-interest spending



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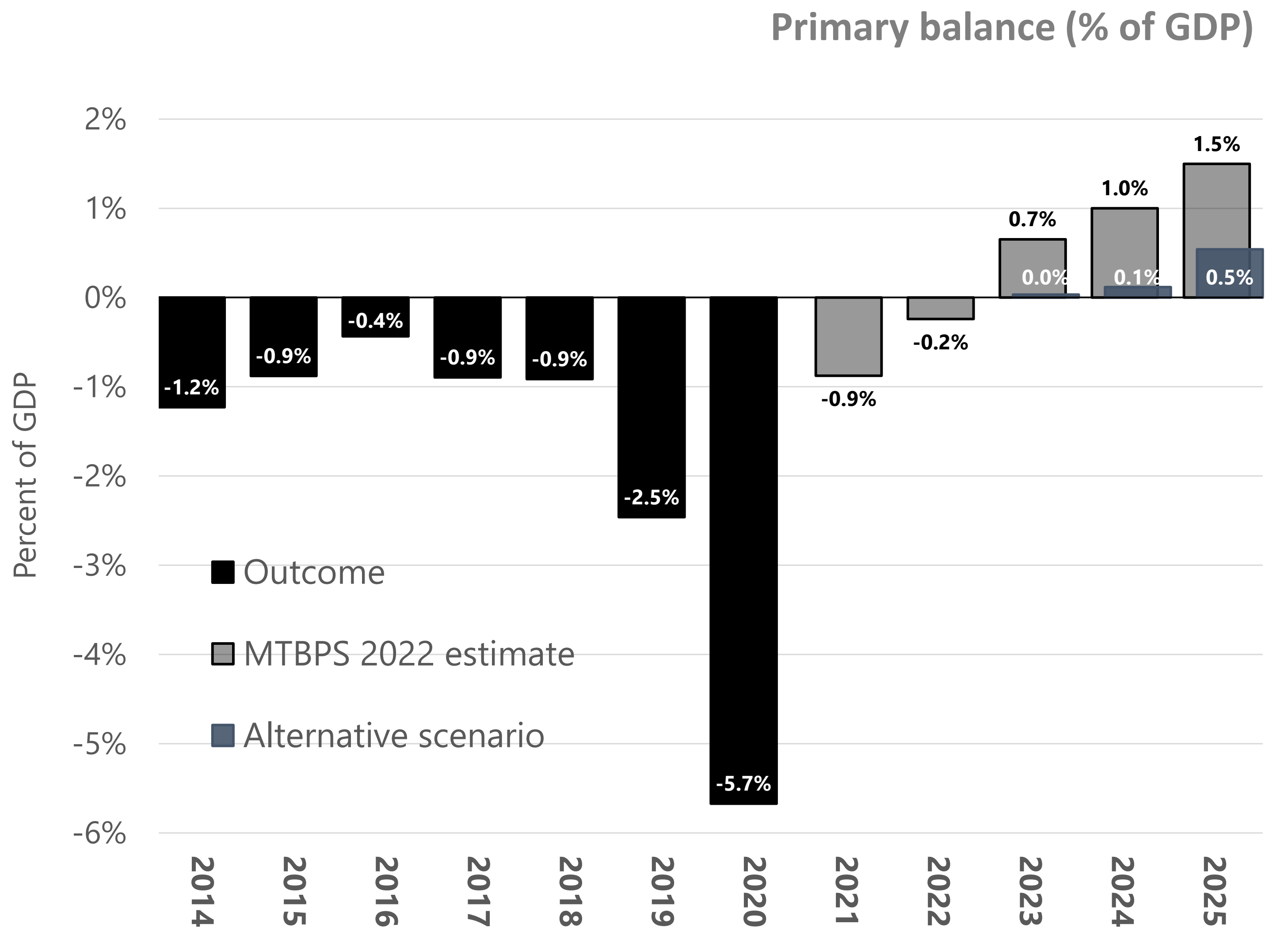
Primary balance could be elusive

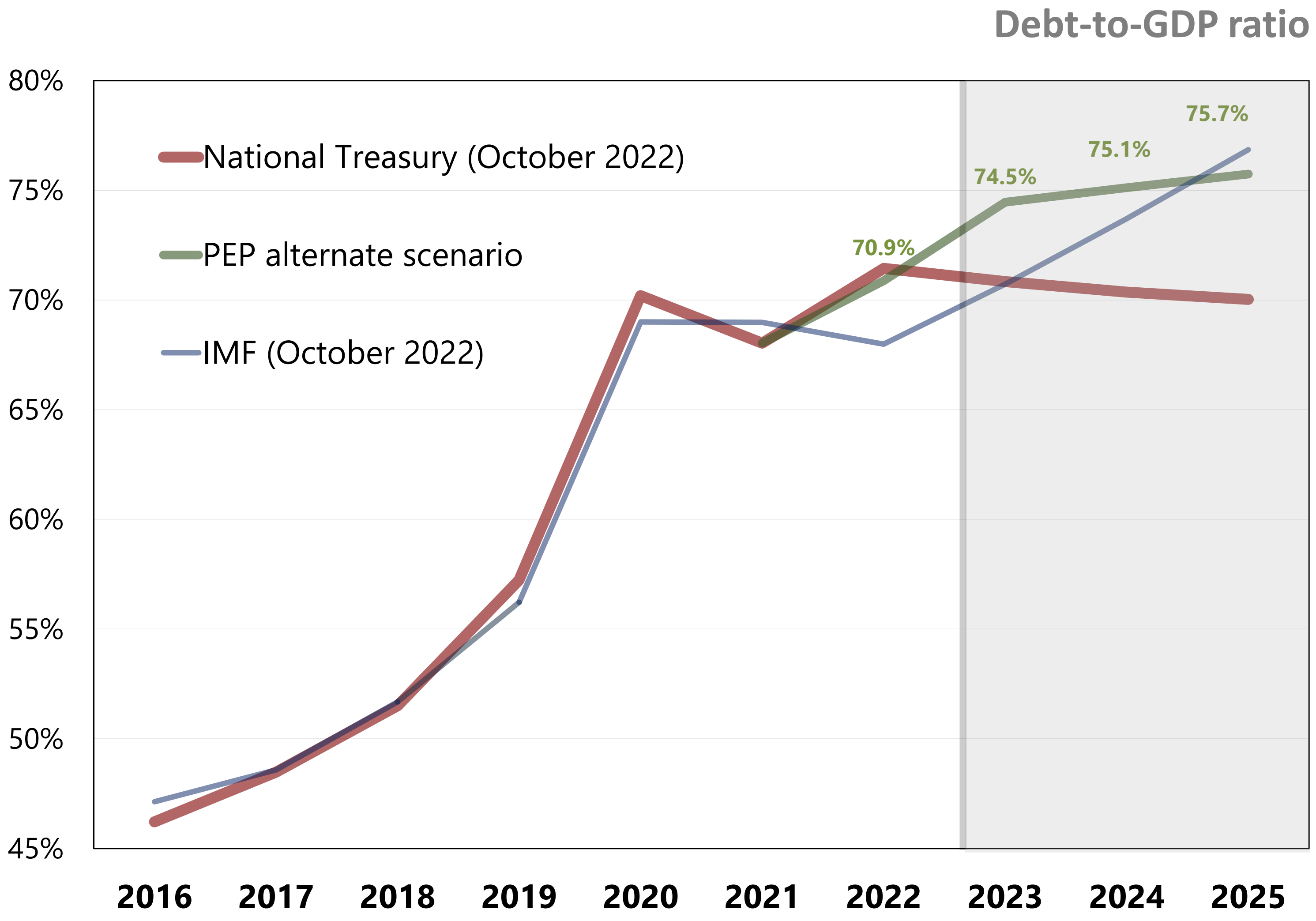
- With small changes to revenue and expenditure trajectory, primary balance target looks doubtful



Source data: National Treasury and Public Economy Project

Debt-to-GDP ratio may not 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

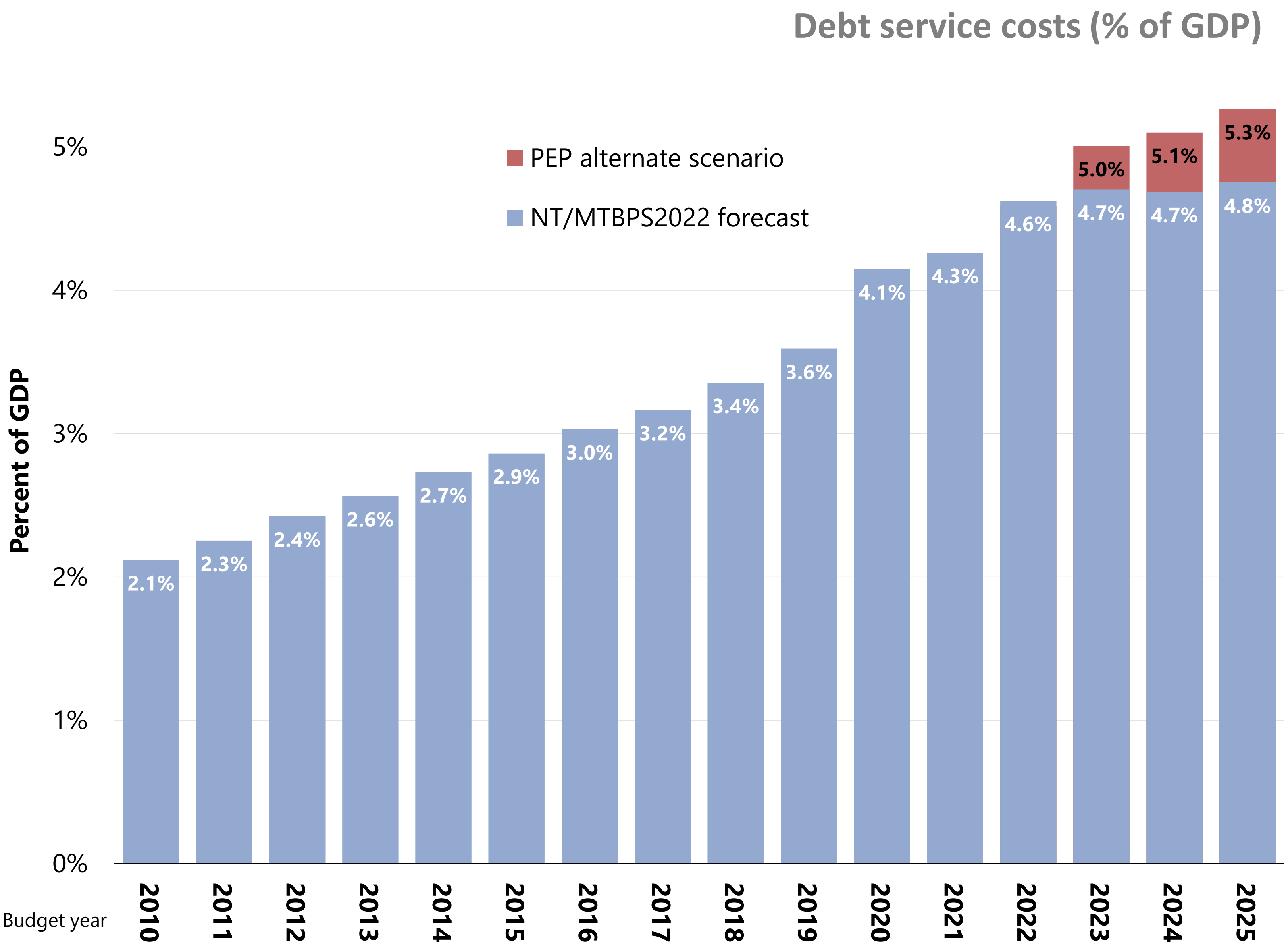


PEP assumptions

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

Source data: IMF, National Treasury, Public Economy Project

Debt-service costs may continue to increase



PEP assumptions

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

Source data: National Treasury, Public Economy Project

Need to guard against the weakening of fiscal institutions

- The budget policy statement should be a credible guide to Cabinet's real spending intentions in the years ahead. This is important for effective planning and operations within government. It is also important for the quality of democratic deliberation implied by the constitution.
- Heightened economic volatility and uncertainty are reason to tolerate larger errors in medium term forecasting.
- However, fiscal projections rest on the credibility of the expenditure estimates, which are under the direct control of authorities, yet:
  - The spending ceilings tabled in successive MTBPS documents are no longer a good guide to subsequent budgets
  - Large unallocated reserves obscure government's true policy intensions
  - Frequent resort to "special appropriations" weakens the authority of the main appropriation (i.e. the annual budget)
  - The decision to not include expected improvements in remuneration over the MTEF make forward estimates unreliable
  - Claims that the MTBPS adds resources to support more employment in core public services are unreliable until next year's pay increases are known
  - Projections of the deficit and debt based on unreliable spending estimates are themselves unreliable, obscuring measurement of the true fiscal stance.
- All this points to an overall deterioration in the quality of forward guidance provided by the budget policy statement

Need for public deliberation on fiscal institutions

- Emerging weaknesses in the medium-term budget framework suggests the need for a discussion on fiscal institutions
- Fiscal institutions should aim to
  - Ensure broad democratic deliberation on fiscal and budget choices
  - Effectively anchor social and economic expectations
  - Restore a solid basis for government planning and operations
  - Define a new relationship between collective bargaining and fiscal planning
- Discussion is taking place within treasury on “fiscal rules”, but greater public consultation and deliberation is needed.
- Numerical rules are likely to fail unless rooted in a strong consensus about fiscal policy. Need to strengthen institutions, not focus narrowly on rules
- The National Treasury’s macroeconomic policy review should be tabled in Parliament

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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