# Briefing Note:  PBO Fiscal Framework Summary:

## Policy Priorities

The 2023 Budget is framed by the three policy objectives set out in the 2022 MTBPS, which are to:

- Reduce the budget deficit and stabilise debt as a percentage of GDP
- Support economic growth by maintaining a prudent/careful fiscal stance, directing resources towards infrastructure, and fighting crime and corruption
- Reduce fiscal and economic risks, including through the Eskom debt-free arrangement
- The pursuit of higher growth in the 2023 Budget remains anchored on three pillars:
- Ensuring a stable macroeconomic framework to create a conducive environment for savings, investment and growth
- Implementing growth-enhancing reforms in key sectors, particularly in energy and transport
- Strengthening the capacity of the state to deliver quality public services, invest in infrastructure and fight crime and corruption

## Funding Priorities

Additional allocations within budget functional groups since the 2022 MTEF baseline mainly includes funding for:

- Social Development: Mainly for Covid-SRD grant and increase in social grant values
- Learning and Culture: Mainly for Education infrastructure grant and the school nutrition programme
- Health: Increase in Provincial Equitable Share of which R7 830.9 million is for CoE
- Economic Development: Mainly for Communication, SA connect phase 2, SANP, SA Radio Astronomy Observatory, SA National Space Agency and Provincial road maintenance
- Peace and Security: Defence: R3 068.6 million, Home Affairs for the border management authority, Police: R3 118.8 million mainly for COE,
- Community Development: Local Government Equitable Share R2 459.7 million, Water and Sanitation for Regional bulk infrastructure R1 300 million
- General Public Service: Refurbishment of Parliament R1 000 million

## Global outlook

Global growth forecasts have improved in early 2023 but there is much uncertainty. There is heightened global concern about the interrelatedness and cumulative impact of several serious risks risks. The 2023 Global Risk Report of the World Economic Forum refers to the interaction of present and future risks with compounding effects that they refer to as a "polycrisis". The WEF mentions energy supply crisis, food supply crisis, inflation crisis and cost of living crisis as examples of serious risks. The cumulative effects of crises have affected developing countries, including South Africa. The high likelihood of more crises points to greater hardships ahead.

In 2023, the UN Secretary General advocated for developing country governments to embark on "bold, targeted and timely" fiscal expansion and support from developed countries to support their recovery and stimulus. However, the South African government continues austerity with the 2023 budget, which follows the same failed fiscal consolidation path of the past decade. Fiscal consolidation has affected government's role in supporting aggregate economic demand and constrained growth, investment and employment. Lower growth over the decade caused a higher debt to GDP ratio.

Fiscal consolidation efforts continued at the height of the Covid-19 pandemic. The austerity mindset meant that South African households have been facing higher levels of unemployment, poverty and inequality. These households have become less resilient and more vulnerable to serious, interrelated global and domestic risks. These risks can cause sudden large-scale economic damage. The July 2021 social unrest was a symptom of the cumulative impact of pre-existing economic hardships in South Africa and the economic impact of the pandemic.

## The economic impact of the 2023 Budget

The National Treasury's (NT) projections of GDP growth over the MTEF illustrates how fiscal consolidation hinders GDP growth. Projected government consumption expenditure, which is expected to decline by an average of 0.6 per cent annually over the MTEF, will make a negative contribution to forecast GDP growth. The NT's forecast for positive GDP growth over the MTEF depends on recovery in investment. However, the NT's investment projections have consistently been too high and again seem unjustifiably high in the 2023 Budget. The NT projects investment to grow at an average of nearly 3 per cent over the MTEF mainly driven by private sector energy projects. The NT hopes these energy projects will ease the energy constraint, improve overall business sentiment and stimulate fixed investment. However, SA's fixed investment track record has been poor since the global financial crisis of 2008. We do not expect private investment levels to improve much over the medium term because the structural reforms proposed by the NT do not fundamentally address the deeper structural challenges that hamper investment & growth in the economy. The extraordinarily high levels of unemployment, poverty and inequality, market concentration, financialisation and misallocation of capital, inadequate state capacity to deliver infrastructure projects and the negative impact of continued fiscal consolidation all point toward continued poor investment and economic growth.

For the economy to grow, household consumption, which contributes about 60 per cent of GDP, has to grow but household demand and associated investments are expected to remain low. More government spending, particularly to support struggling households, service delivery and upgrading of services infrastructure could boost aggregate demand and form part of a developmental strategy for structural transformation of the economy.

## The fiscal policy framework: A primary budget surplus but at what cost

The 2023 Budget maintains government's long-standing fiscal consolidation stance through reducing government consumption spending. It pursues a primary fiscal surplus that the government is unlikely to achieve in the current fiscal year and over the MTEF. According to the NT, this "critical policy stance" to stabilise debt improves market sentiment. But, it hurts the real economy, erodes the state's capacity to deliver services and risks higher debt. It means fewer resources for teachers, doctors, nurses and police to serve a growing population. The risks to the credibility of the fiscal policy framework listed by the NT far outweigh the potentially dangerous and destructive socio-economic risk of not adequately investing in society

## Government Revenue

The gross tax revenue collection estimates are R10.3 billion higher than the MTBPS 2022 estimates, and R93.7 billion more than the Budget 2022 estimates. Government projects an average growth rate of 6.5 per cent in gross tax revenue over the medium term.

Budget 2023 proposes R13 billion in tax relief which disproportionately benefits middle and upper-income households. A 4.9 per cent increase is adjusted to the personal income tax bracket which which largely benefits middle and upper-income earners. The non-adjustment to the fuel levy and the Road Accident Fund (RAF) will provide significant relief in the context of high inflation and an exacerbated cost of living crisis. Since rich people spend so much more on consumption relative to poor people, they again benefit more than everyone else. The extension of RAF to food manufacturers and the extension of the general fuel levy relief will ease potential price pressures on households.

Approximately 69 per cent of the proposed tax relief is from renewable energy incentives. Studies show that clean energy subsidies disproportionately go to higher-income and wealthier people. The bottom 50 per cent of the South African population has negative wealth, which the NT acknowledged its response to the public hearings. Similarly, with businesses, it is likely that the businesses with greater access to capital will be able to take greater advantage of the incentive than small and micro businesses. It must be asked whether government should be incurring substantial expenditure to persuade consumers who would have chosen to spend on renewable energy anyway? How else could government have utilised this expenditure to support the majority in their pursuit energy security? In addition, NT states that the incentive cap for households is due to limited fiscal space. However, there is no limit for businesses, which is contradictory.

Fiscal policy is an important tool for the redistribution of income and wealth, that becomes even more important when there is extreme structural inequality. Revenue is expected to exceed non-interest expenditure, yet at the same time there will be declines in per capita spending. Fiscal consolidation has significant distributional impacts which the PBO has continuously highlighted. It threatens to deepen inequality and erode the fiscal legitimacy of the state.

## State Owned Enterprises (SOEs) and public finances

Budget 2023 shows that the contingent liabilities have increased above a R1 trillion in 2019/20 and are set to decline to R904.1 billion in 2025/26. The total amount of approved guarantees to public institutions is expected to decrease by R81.4 billion to R478.5 billion by 31 March 2023 whilst, the total exposure is expected to increase by about R800 million to R396.1 billion. The Eskom guarantee is projected to decline by R118.9 billion by the end of 2025/26 and its exposure increased as the utility drew down on its guarantees and Eskom accounts for 85.3 per cent of total exposure.

Many state-owned companies remain unable to adequately fund their operations and debt obligations, and are even less able to optimally invest in infrastructure. There is much frustration and concern about corruption, inefficiency, large debts and contingent liabilities, and bailouts of state owned enterprises (SOEs). Poor performance and inefficiencies of SOEs have real economic and quality of life implications for households and businesses. With regard to the two largest SOEs, the Budget 2023 says; i) Eskom remains reliant on continued state support to operate and meet its financial commitments, and ii) in terms of Transnet, a reliable, cost-effective and safe freight system, port and rail infrastructure requires large-scale investment following historical underinvestment.

As listed under Schedule 2 of the Public Finance Management Act (1999) major public entities are required to operate as sustainable profit-generating businesses that borrow on the strength of their balance sheets. The National Treasury is concerned that debt and bailouts of SOEs pose risks to the fiscal framework. Thus, the National Treasury have been developing a new framework for managing bailouts to SOEs to reduce fiscal risks and promote long-overdue reforms. These developments raise important questions, particularly in light of concerns of the negative implications of an austerity mindset on broader socio-economic outcomes. Should the term credible be applied to a fiscal policy framework that may be biased toward achieving a surplus and debt reduction in the short-term even if that fiscal framework means that government does not provide enough resources for key SOEs to avoid large-scale economic damage in the short-term and long-term viability?