# Medium Term Budget Policy Statement 2019

Preview Document

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On Wednesday 29 October, Minister Tito Mboweni will deliver his second MTBPS, and his first of the new administration.

**His number one priority must be to present a credible plan to prevent a blow-out of the deficit and to stabilise the national debt. This is will require deep spending cuts.**

This must be the primary goal of the speech if the government is to retain (and hopefully, reclaim) credit worthiness and the credibility that is so central to attracting investment.

During the past year, the government has shown itself unable to make decisions. There has been much said about the real reforms needed for economic growth, with inconsequential action in achieving these reforms.

As a result, the economy is not growing nearly fast enough to make a dent on poverty and unemployment. We expect growth projections to be revised downwards again. This also means that revenue targets will be missed, as VAT and corporate receipts collapse.

There are now 10.2 million South Africans who are looking for work or who have given up looking for work, nearly 600 000 more than at this time last year. This too only exacerbates revenue shortfalls, as personal income tax receipts collapse.

Let us be clear: Growth, and only growth, can get South Africa out of the vicious fiscal cycle it is now in. If we are to save the public services that the poor and the public-at-large depend on, the Minister and the President must realise that they can no longer continue putting off the difficult decisions needed to turn around the economy.

Until now, it has been possible to delay the inevitable by raising new revenue, or going deeper into debt. This is no longer possible.

The fact is that there is no additional room to raise new revenue. This is because working families are already struggling with below inflation salary increases, and several years of steep tax and petrol price increases.

There is also no additional room to raise new debt, which is already approaching unsustainable levels.

That means the only way to keep the budget deficit at the same levels set out in February, is to reduce spending by approximately R84 billion in 2019/20, R68 billion in 2020/21 and R64 billion in 2021/22 – thus requiring a reduction of R216 billion over the medium term.

**Today the Democratic Alliance presents a credible plan to stabilise the deficit and the national debt over the next three years.**

The DA’s plan meets this target by achieving an adjustment of R235.85 billion over the MTEF period.

For far too long, government has avoided a difficult discussion with public sector unions about the cost and composition of the public wage bill. This discussion, and some resolution of it, is no longer avoidable. It is time for decisive moral action in the interests of the country.

The centre of the DA's proposal is a deep cut to the public wage bill over the MTEF period. We have done detailed work on this proposal in order to best ensure that (1) essential frontline public services are not affected, and (2) as many jobs are saved as possible.

The core of our proposal is a R168 billion cut to the public wage bill over the next three years:

- A 3-year freeze on all non-occupation specific dispensation (frontline) wages, saving R138.6 billion; and
- Reducing the number of highest paid head-office management staff in the public service by a third, saving R29.4 billion.

We minimise these cuts by proposing further revenue raising mechanisms and cuts to other superfluous programmes:

Once-off mechanisms:

- Auctioning digital spectrum would raise R32.5 billion
- Selling Telkom shares would raise R14.5 billion
- Selling Sentech would raise R1.8 billion

Cuts over MTEF period:

- Eliminating New Development Bank funding would save R13.25 billion
- Eliminating National Health Insurance funding would save R5.8 billion

| **Expenditure cuts over MTEF period** | | | | |
|---|---|---|---|---|
| R billion | 2020/2021 | 2021/2022 | 2022/2023 | Total MTEF |
| Freeze non-OSD wages | 21.9 | 45.7 | 71 | 138.6 |
| Cut New Development Bank | 4.25 | 4.5 | 4.5 | 13.25 |
| Cut National Health Insurance | 2.8 | 3 | - | 5.8 |
| **Total over MTEF period** | | | | **157.65** |
| Once-off mechanisms | | | | |
| Auction digital spectrum | | | | 32.5 |
| Reduce managers by a third | | | | 29.4 |
| Sell Telkom shares | | | | 14.5 |
| Sell Sentech | | | | 1.8 |
| Total once-off | | | | 78.2 |
| **Total over MTEF plus once-off** | | | | **235.85** |

**Reducing the public sector wage bill**

The government's wage bill currently accounts for 35% of total public expenditure, with spending projected to grow from R585 billion in 2018/19 to R713 billion in 2021/22. This is simply not sustainable, because the amount of money spent on salaries is crowding out productive investment.

This is clearly evidenced by the fact that, if we continue at the current trajectory, public sector infrastructure spending will be lower in 2021/22 than it was in 2016/17. In real terms, infrastructure investment has declined by 1.8% per year from 2017/18 to 2019/20, and is set to fall by an average of 6.3% from 2019/20 to 2021/22.

Instead of protecting infrastructure spending over the past decade, the government chose to sacrifice productive investment in favour of increasing public sector wages by 10.3% annually since 2009 – well above the rate of inflation. In the context of economic decline and in a country with 10,2 million unemployed people in desperate need of productive government spending, this was a profoundly unwise and indefensible choice.

For South Africa's fiscus to survive, it is time that we make the right choice by prioritizing the needs and future of the country as a whole over the demands of the union elite who have captured the public service. We simply must cut the public sector wage bill.

It is time for decisive moral action in the interest of our country.

When it comes down to it, there are only two major mechanisms through which to significantly reduce the wage bill: lower salaries and/or reduced personnel numbers.

Although significant spending cuts have become unavoidable, both of these mechanisms must be used with circumspection in a way that limits the impact on service delivery and protects the jobs of hardworking public servants who deliver critical frontline services, while ridding the public service of unproductive cadres deployed by the ANC to overpaid management positions.

Consequently, the DA proposes to cut the wage bill by:

- Freezing the wages of the 33.7% of public servants not covered by the Occupation Specific Dispensation (OSD) (including the likes of head-office managers and supervisors) at 2019/20 levels over the three-year MTEF period. This would yield R138.6 billion;
- Ensuring that the 66.3% of public servants covered by OSD receive inflation-linked increases over the MTEF period. In order to achieve this and stay within the deficit target, the government needs to mobilize an additional R9.55 billion. This can be achieved by reducing the number of managers at non-OSD salary levels 11 to 16.

*Freeze public sector wages for non-OSD personnel for three years*

This step would yield R138.6 billion over the MTEF period. The complete pay freeze would only affect the 33.7% of public servants who are not covered under OSD, while ensuring that the 66.3% of public servants who perform technical or frontline service delivery work get inflation-linked increases.

Freezing all non-OSD salaries at 2019/20 levels would not only correct a decade of immoral patronage-driven wage increases by the ANC, but it would also ensure that wages for non-OSD public servants are brought closer to parity with comparable salaries in the private sector.

The best available evidence suggests that the public sector wage premium increased from 18% in 2000[1] to 35% in 2005,[2] and then to between 52% and 93% in 2014.[3] This means that public sector workers currently earn between 52% and 93% more than their peers in the private sector. Even more worryingly, research from 2017 found that public sector salaries "penalise those at the bottom"[4] while rewarding largely unproductive millionaire managers.

The premium paid to public sector workers is a function of purely patronage-driven wage increases over the last decade, and there is little evidence that productivity has kept pace with wage growth. A 2017 report by the Financial and Fiscal Commission noted that "Despite a legislative framework that emphasises efficient and effective service delivery, there is increasing concern that government is not achieving maximum value in key areas of its budget."[5]

Exorbitant public sector wages is crowding out productive investment and South Africans are not getting value for money. It is time to choose country over cadres by reigning in spending on salaries for non-OSD personnel.

*To protect frontline service delivery, cut the number of millionaire managers:*

In addition to the R138.6 billion that would be saved by freezing non-OSD salaries, the government can save another R29.4 billion over the MTEF period through retrenchments and a hiring freeze on all managerial positions (non-OSD levels 11 to 16) until the number of managers is reduced by a third – approximately 9 200 posts.

As the resource envelope has shrunk over the past few years, average vacancy rates have increased to about 10% in national and provincial government. However, there is substantial evidence that the government has made another immoral choice by using their limited resources to fill management positions rather than frontline service delivery posts.

While the overall government vacancy rate stands at about 10%, most provincial education, health and social development departments currently have vacancy rates of over 15%. This is a clear indication that departments have chosen to protect the millionaire lifestyles of cadres in management positions over the hardworking teachers, nurses, doctors and police officers who deliver vital services to citizens.

The government in 2007 introduced the Occupation Specific Dispensation (OSD) in an attempt to attract and reward skilled personnel, like doctors, engineers, and teachers, through higher salaries. However, OSD has largely failed because the government has not limited salary increases to skilled workers. Instead, wage hikes have often favoured those in senior management positions at the expense of skilled public servants delivering frontline services to citizens.

The government currently spends close to R30 billion per year to fund the millionaire lifestyles of 27 650 managers in the public services. This includes R7.2 billion spent per year on middle managers in provincial governments, R6.1 billion on senior managers in provinces, R8.1 billion on middle managers in national government, and R8.3 billion on senior managers in national government. On average, each of the 9 774 senior managers in national and provincial government takes home R1.4 million per year, with the highest level managers being paid just under R2 million per year.

This is in sharp contrast to the average annual salary of R169 466 paid to a police officer, the average public school teacher's salary of R273 209, and the average R302 000 paid to a public sector nurse per year.

To correct this immoral imbalance, the DA proposes a hiring freeze and retrenchments over the MTEF period until the number of managers have been reduced by a third, yielding an additional R29.4 billion in savings.

## Additional Information and Notes:

1. **Fiscal Framework and Macroeconomic outlook- February 2019**

| **Table 1.2 Consolidated government fiscal framework** | | | | |
|---|---|---|---|---|
| **R billion/percentage of GDP** | **2018/19**<br>**Revised estimate** | **2019/20**<br>**Medium-term estimates** | **2020/21** | **2021/22** |
| **Revenue** | **1,455.2**<br>*28.8%* | **1,583.8**<br>*29.3%* | **1,696.4**<br>*29.2%* | **1,836.6**<br>*29.4%* |
| **Expenditure** | **1,665.4**<br>*32.9%* | **1,826.6**<br>*33.7%* | **1,948.9**<br>*33.5%* | **2,089.0**<br>*33.4%* |
| **Budget balance** | **-210.2**<br>*-4.2%* | **-242.7**<br>*-4.5%* | **-252.6**<br>*-4.3%* | **-252.4**<br>*-4.0%* |
| **Table 1.6 Projected state debt and debt-service costs** | | | | |
| **R billion/percentage of GDP** | **2018/19** | **2019/20** | **2020/21** | **2021/22** |
| **Gross loan debt** | **2,814.3**<br>*55.6%* | **3,042.9**<br>*56.2%* | **3,357.8**<br>*57.8%* | **3,683.6**<br>*58.9%* |
| **Debt-service costs** | **182.2**<br>*3.6%* | **202.2**<br>*3.7%* | **224.1**<br>*3.9%* | **247.4**<br>*4.0%* |
| **Net loan debt** | **2,522**<br>*49.9%* | **2,829**<br>*52.3%* | **3,147**<br>*54.1%* | **3,471**<br>*55.5%* |
| **Table 3.1 Macroeconomic performance and projections** | | | | |
| **Percentage change** | **2018/19**<br>**Estimate** | **2019/20** | **2020/21**<br>**Forecast** | **2021/22** |
| Real GDP growth | 0.7 | 1.5 | 1.9 | 2.1 |
| Nominal GDP growth | 7.2 | 7.0 | 7.4 | 7.5 |
| CPI inflation | 4.9 | 5.2 | 5.5 | 5.4 |
| **GDP at current prices (R billion)** | **5,059.1** | **5,413.8** | **5,812.4** | **6,249.1** |
| **Table 1.1 Macroeconomic outlook – summary** | | | | |
| **Real percentage growth** | **2018**<br>**Estimate** | **2019** | **2020**<br>**Forecast** | **2021** |
| **Real GDP growth** | **0.7** | **1.5** | **1.7** | **2.1** |
| Consumer price index (CPI) inflation | 4.7 | 5.2 | 5.4 | 5.4 |

*Source: National Treasury*

## 2. Updated Fiscal Framework

What has changed since February:

- Expenditure increased
- The deficit for the 2018/19 financial year is confirmed to be bigger than what was stated in February
- Another revenue shortfall is expected
- GDP growth and the inflation expectation for 2019 and over the medium term is lower than what was expected in February

Increased appropriations:

- The original 2019 Appropriations bill (B6-2019) did not include any financial assistance to Eskom, however the fiscal framework in the Budget Review 2019 publication accounted for a R 23 billion bailout to Eskom for each year over the medium terms.

- Appropriations Bill (B6B-2019), which was passed, included a R17.65 billion bailout to Eskom. Given that the original fiscal framework made provision for R23 billion, the R17.65 billion allocation did not breach the framework (Expenditure in the framework was still R5.3 billion more than what was appropriated).

- The Special Appropriation Bill allocates an additional bailout to Eskom amounting to R26 billion in 2019/20 and R33 billion in 2020/21. This breaches the fiscal framework that was adopted by Parliament by R20.65 billion in 2019/20 and R10 billion in 2020/21.

Additional bailouts to SABC, SAA, and Denel:

- In the budget tabled in February the contingency reserve has been increased to R13 billion in 2019/20. Budget Review 2019 states "Government has revised the contingency reserve for 2019/20 to respond to possible requests for financial support". Additional financial support was said to be financed by the contingency reserves and the sale of non-core assets. It is very likely that bailouts to SAA, SABC and Denel will not affect the total expenditure reflected in the adopted fiscal framework but will deplete the contingency reserve.

- Bailouts (apart from the Eskom bailout):

  - **SABC: Total of R3.2 billion** - R2.1 billion has already been transferred, and a further R1.1 billion will be transferred as soon as certain conditions are met. It is possible that the R1.1 billion will only be accounted for in the 2020/21 financial year, but it is unlikely. Hence the assumption will be made that the total amount of R3.2 billion will be allocated in the current financial year.

  - **SAA: Assume R7.5 billion** - A bailout of R5.5 billion has already been approved. In addition to the R5.5 billion, SAA has requested at least an additional R2 billion to stay afloat in the current financial year.

  - **Denel: R1.8 billion in 2019/20 and R1 billion 2020/21** - The bailout in 2020/21 is still to be approved.

- If these bailouts are financed completely from the contingency reserve, the reserve will be reduced to R 500 million down from R13 billion. It is highly likely that the contingency reserve will be completely depleted, if the trend of the past two financial years continues.

| | **2019/20 R' billion** |
|---|---|
| SABC | 1.8 |
| DENEL | 3.2 |
| SAA | 7.5 |
| **Total Additional Bailouts** | **12.5** |
| **Contingency reserve** | **13** |
| **Post-bailouts contingency reserve** | **0.5** |

Revenue collection:

- Budget Review 2019 stated that the revenue collection shortfall amounted to R42.8 billion for 2018/19, however since then it was confirmed that the shortfall was actually R57.4 billion. Hence the budget deficit, debt, and debt to GDP will have to be revised for 2018/19. This will also influence debt servicing cost over the medium term. The revised deficit for 2018/19 will have to increase by R14.6 billion, changing the deficit from 4.2% of GDP to 4.4% in 2018/19, gross loan debt to approximately 55.92% of GDP from 55.6%, and net debt to 50.1% of GDP from 49.9%.

- Another revenue shortfall is expected for the current financial year (2019/20). PwC expects a shortfall of between R30-45 billion, Mazars expects a R50 billion shortfall. We use a shortfall of R60 billion in this document.

Growth and inflation expectation:

| **Budget 2019 (National Treasury)** | | | |
|---|---|---|---|
| | **2019** | **2020** | **2021** |
| | **Forecast** | | |
| Real GDP growth | 1.5% | 1.7% | 2.1% |
| Consumer price index (CPI) inflation | 5.2% | 5.4% | 5.4% |
| | **2019/20** | **2020/21** | **2021/22** |
| Real GDP growth (Financial year) | 1.5% | 1.9% | 2.1% |
| **SARB (September 2019)** | | | |
| | **2019** | **2020** | **2021** |
| | **Forecast** | | |
| Real GDP growth | 0.6% | 1.5% | 1.8% |
| Consumer price index (CPI) inflation | 4.2% | 5.1% | 4.7% |

- Projected GDP growth and inflation for 2019 are expected to be lower than what was expected in February 2019. The implication is that nominal GDP will be lower than expected, which will inflate the deficit to GDP ratio and the debt to GDP ratio. It also means that expected revenue over the medium term is likely to be lower than what was expected in February 2019.

Revised framework:

| R billion/percentage of GDP | 2018/19 | 2019/20 | 2020/21 | 2021/22 |
|---|---|---|---|---|
| | Revised estimate | Medium-term estimates | | |
| **Revenue** | **1,440.60** | **1,523.80** | **1,646.82** | **1,780.21** |
| | *28.48%* | *28.66%* | *28.97%* | *29.13%* |
| **Expenditure** | **1,665.40** | **1,847.25** | **1,958.90** | **2,089.00** |
| | *32.92%* | *34.74%* | *34.46%* | *34.19%* |
| **Budget balance** | **-224.8** | **-323.45** | **-312.1** | **-308.79** |
| | *-4.44%* | *-6.08%* | *-5.49%* | *-5.05%* |
| **Gross loan debt** | **2,828.90** | **3,138.25** | **3,512.63** | **3,894.83** |
| | *55.92%* | *59.02%* | *61.80%* | *63.74%* |
| **Net loan debt** | **2,537** | **2,924** | **3,302** | **3,682** |
| | *50.1%* | *55.0%* | *58.1%* | *60.3%* |
| **Nominal GDP** | **5,059.10** | **5,317.11** | **5,683.99** | **6,110.29** |

- Additional assumptions and notes

  - Assumes that bailouts for SAA, Denel, and SABC are completely financed through the depletion of the contingency reserves.
  - Does not account for additional debt servicing cost.
  - Does not assume additional taxes.
  - Assumes no major redemption of new debt over the medium term.

- Adjustment made:

  - Increased the budget deficit and debt levels for 2018/19 by R14.8 billion.
  - Increased expenditure in 2019/20 and 2020/21 to account for the proportion of expenditure that will breach the current fiscal framework.
  - Adjusted GDP at current prices (nominal GDP) to account for lower GDP and inflation expectations.
  - Adjusted revenue in 2019/20 to account for the expected shortfall, and reduced revenue in 2020/21 and 2021/22, to adjust for lower growth expectations (used tax buoyancy[1] to estimate the effect).
  - Adjusted deficits based on the above-mentioned points.
  - Adjusted gross debt and net debt levels to account for above-mentioned points.
  - Assumes a revenue shortfall of R60 billion for 2019/20.
  - Does not account for higher debt servicing costs.

[1] Expected ratio between growth in nominal GDP and the growth in revenue.

**Reducing the budget deficit:**

Based on the revised fiscal framework, in order to keep the budget deficit at the same levels set out in February, there needs to be an adjustment (fiscal effort) of approximately R84 billion in 2019/20, R68 billion in 2020/21 and R64 billion in 2021/22 (R216 billion over the medium term). Adjustments bigger than these would result in smaller deficits than what was presented in the budget in February. **This is based on the assumption that the revenue collection shortfall will amount to R60 billion in 2019/20.**

**Infrastructure expenditure:**

**Public-sector infrastructure expenditure and estimates**

| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | MTEF |
|---|---|---|---|---|---|---|---|---|
| **R billion** | Outcomes | | | Estimates | | | | total |
| Energy | 65.9 | 67.0 | 55.1 | 50.6 | 52.6 | 52.8 | 52.8 | **158.1** |
| Water and sanitation | 31.5 | 30.8 | 26.8 | 38.3 | 42.8 | 41.8 | 47.4 | **132.0** |
| Transport and logistics | 81.3 | 70.9 | 75.4 | 78.0 | 94.8 | 103.8 | 115.3 | **313.9** |
| Other economic services | 13.2 | 14.3 | 17.1 | 16.7 | 15.1 | 14.2 | 15.2 | **44.5** |
| Health | 10.3 | 10.4 | 9.7 | 12.1 | 11.8 | 11.1 | 11.5 | **34.3** |
| Education | 18.0 | 17.8 | 17.6 | 18.5 | 18.2 | 19.0 | 19.8 | **56.9** |
| Human settlements[1] | 18.3 | 18.3 | 14.3 | 18.2 | 18.8 | 19.0 | 19.7 | **57.5** |
| Other social services | 11.9 | 10.3 | 11.2 | 10.6 | 10.3 | 9.9 | 10.4 | **30.6** |
| Administration services[2] | 10.9 | 10.1 | 9.1 | 12.3 | 11.7 | 12.2 | 13.1 | **37.0** |
| **Total** | **261.2** | **249.9** | **236.2** | **255.1** | **276.1** | **283.8** | **305.1** | **864.9** |
| National departments | 14.5 | 15.8 | 14.9 | 15.9 | 16.0 | 16.8 | 18.6 | **51.5** |
| Provincial departments | 60.6 | 62.6 | 62.3 | 61.7 | 60.7 | 60.4 | 63.7 | **184.8** |
| Local government | 54.7 | 54.4 | 58.8 | 65.9 | 66.7 | 67.3 | 71.0 | **204.9** |
| Public entities3 | 17.8 | 17.1 | 13.2 | 20.6 | 20.8 | 22.8 | 23.7 | **67.4** |
| Public-private partnerships | 4.3 | 4.8 | 4.8 | 5.9 | 6.1 | 5.5 | 5.8 | **17.3** |
| State-owned companies[3] | 109.3 | 95.2 | 82.2 | 85.2 | 105.8 | 110.9 | 122.3 | **339.0** |
| **Total** | **261.2** | **249.9** | **236.2** | **255.1** | **276.1** | **283.8** | **305.1** | **864.9** |
| *% Change* | | **-4.3%** | **-5.5%** | **8.0%** | **8.2%** | **2.8%** | **7.5%** | |
| **Total excluding SOEs** | **151.9** | **154.7** | **154.0** | **170.0** | **170.3** | **172.8** | **182.8** | 525.9 |
| *% Change* | | **1.8%** | **-0.5%** | **10.4%** | **0.2%** | **1.5%** | **5.8%** | |
| **CPI index** | | 100.0 | 103.0 | 107.8 | 112.3 | 118.1 | 123.6 | |
| **Total in real terms** | | **249.9** | **229.3** | **236.7** | **245.8** | **240.4** | **246.8** | |
| *% Change* | | | **-8.2%** | **3.2%** | **3.9%** | **-2.2%** | **2.7%** | |
| **Total excluding SOEs in real terms** | | **154.7** | **149.5** | **157.7** | **151.6** | **146.4** | **147.9** | |
| *% Change* | | | **-3.4%** | **5.5%** | **-3.9%** | **-3.4%** | **1.0%** | |

*Source: National Treasury Table D1 and own calculations*

In Nominal Terms:

- In nominal terms public sector infrastructure expenditure increased on average by 1.6% per year from 2016/17 to 2019/20. Based on the current framework (2019/20-2021/22) public sector infrastructure expenditure is set to increase on average by 6.2% per year.
- Public sector infrastructure expenditure, excluding expenditure by SOEs, increased on average by 3% from 2016/17 to 2019/20. Based on the current framework (2019/20-2021/22) public sector infrastructure expenditure, excluding expenditure by SOEs, is set to increase on average by 2.5% per year.

In Real Terms:

- In real terms public sector infrastructure expenditure contracted on average by 0.4% per year from 2017/18 to 2019/20. Based on the current framework (2019/20-2021/22) public sector infrastructure expenditure is set to increase on average, in real times by 1.4% per year.
- In real terms public sector infrastructure expenditure, excluding expenditure by SOEs, contracted on average by 1.8% from 2017/18 to 2019/20. Based on the current framework (2019/20-2021/22) public sector infrastructure expenditure, excluding expenditure by SOEs, is set to contract on average by 6.3% per year.
- In real terms public sector infrastructure expenditure is set to be lower in 2021/22 than it was in 2016/17.

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[3] Prudence Kwenda and Miracle Ntuli, "A detailed decomposition analysis of the public-private sector wage gap in South Africa," *Development Southern Africa*, 35 (6), 2018, accessed October 25, 2019; https://www.tandfonline.com/doi/full/10.1080/0376835X.2018.1499501.

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[5] "Public Sector Productivity – The Case of Secondary Education," *Financial and Fiscal Commission*, accessed October 25, 2019; https://ffc.co.za/docman-menu-item/commission-submissions/934-2016-2017-chapter-6-public-sector-productivity.