Economics | South Africa

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Economic Commentary

National Budget 2017

Key points

- Radical economic transformation, but focusing on faster, more inclusive growth.
- Budget reduction slower than that anticipated in October 2016's Medium Term Budget Policy Statement (MTBPS).
- The consolidated budget **deficit** declines to 3,1% of gross domestic product (GDP) in 2017/18 from 3,4%, with 2016/17's outcome in line the MTBPS in October 2016 but higher than the originally budgeted 3,2%. The deficit is now budgeted to decline to 2,6% by 2019/20, higher than the 2,5% projected in the MTBPS. This means that gross public debt peaks at 52,9% of GDP in 2018/19 from the current 50,7%. Net loan debt rises to 48,1% in 2019/20 from 45,5%.
- **Revenue** fell short in 2016/17 as the downturn in the economy deepened. Tax revenue is estimated to have undershot by 2,6%, largely due to lower income tax collections from individuals and lower VAT revenues. In 2017/18 tax revenues are expected to grow by 10,6%, largely helped by taxes from individuals.
- Marginal tax of 45% on a new tax bracket for incomes over R1,5 million and reduced allowance for fiscal drag on other thresholds will boost collections from individuals by 13,2% and accounts for over 70% of additions from new tax proposals. As expected the fuel levy was hiked again by 30c/l and so-called 'sin' taxes were hiked by between 6,1% and 9%.
- **Expenditure** came in under budget in 2016/17 and is projected to grow by 8,2% in the year ahead. The budget further cuts the expenditure ceiling, baseline budgets and reallocates expenditure to 'critical new requirement', principally higher education.

Minister Gordhan's second budget was again delivered against the backdrop of political turmoil. Last year the budget was designed to restore some faith in policy after the sacking of the respected Nhlanhla Nene; this year the minister's own political life appears to be on the line following public attacks from the ANC Youth League, Gupta-associated lobby groups, and even from party leadership and President Zuma himself. The minister therefore had to try and keep on the path of fiscal consolidation while giving effect to the 'radical economic transformation' set out in the State of the Nation address on 9 February. The ANC's policy conference in June and its all-important elective conference in December have also raised the political heat and acrimony as key players jockey for position. Pre-budget speculation focused mainly on what taxes would be raised to plug the expected revenue gap. With an increase in VAT a political impossibility, a hike in the top marginal tax rate, below-inflation moves in thresholds and a large increase in the fuel levy were expected to be the main revenue measures, expectations that were largely fulfilled. On the spending side market hopes centred on commitments to discipline. While the minister placed great emphasis on more reform of State-Owned Enterprises (SOEs) and new measures to monitor public procurement, the recently announced Preferential Procurement Regulations (2017) have raised serious questions about the possibility of either containing costs or maintaining the quantity and quality of spending and seemingly fly in the face of other commitments made by Treasury. A new round of public sector wage bargaining is also looming, with important implications for medium term spending. Lastly, commendably, Treasury's vision of radical transformation is one of inclusive, win-win growth – 'This is not a transformation to be achieved through conquest, conflict or extortion, as in our past'.

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Economic background and assumptions

The economy narrowly averted recession in 2016, but better climatic conditions, higher commodity prices and hopes for an improved global economy will help growth in 2017. Real GDP is estimated to have grown by 0,5% in 2016 and Treasury is forecasting growth of 1,3% in 2017. These are marginally above our own forecasts of 0,4% and 1,2% and seem to be based on relatively conservative assumptions with respect to global growth and commodity prices. Even so, the recovery will be dependent on an improving policy and political environment. In the absence of this, confidence will remain weak and investment plans postponed. The forecasts also assume some stability in the rand, with lower imported inflation helping to bring overall inflation sustainably back into the target range and allowing for some monetary easing over time.

Medium-term prospects again remain dependent on the global economy and government finally getting its growth formula right. Treasury's forecasts are similar to ours and the market consensus.

The current account deficit is forecast to narrow over the period on better export demand and a slower rise in imports. The forecasts are actually more conservative than our own and look reasonable. However, the country will remain dependent on continued capital inflows.

Table 1 : Economic assumptions

	2013	2014	2015	2016	2017	2018	2019
Real GDP	2.3	1.6	1.3	0.5	1.3	2.0	2.2
Real HCE	2.0	0.7	1.7	0.9	1.3	2.0	2.3
Real GFCF	7.0	1.5	2.5	-3.6	1.5	1.6	2.8
Current account (% of GDP)	-5.9	-5.3	-4.3	-4.0	-3.9	-3.7	-3.8
Consumer inflation (%)	5.8	6.1	4.6	6.4	6.4	5.7	5.6

Source: National Treasury Budget Review 2017

Budget arithmetic

The key consolidated budget figures are set out in the table 2. It details the estimated outcome for the current fiscal year (2016/17), which ends in March, compared with the originally budgeted figures, as well as the budgeted figures over the next three years. The estimates at the time of the MTPBS in October 2016 are also shown. The assumptions for nominal GDP on which all the calculations are based are also shown.

Table 2 : Consolidated budget 2017

	2016/2017			2017/2018		2018/2019		2019/2020	
	Budget Feb-16	MTBPS Oct-16	Outcome Feb-17	MTBPS Oct-16	Budget Feb-17	MTBPS Oct-16	Budget Feb-17	MTBPS Oct-16	Budget Feb-17
Revenue (Rbn)	**1324.3**	**1301.0**	**1297.3**	**1416.9**	**1414.1**	**1537.9**	**1535.2**	**1670.4**	**1668.5**
% GDP	*30.2*	*29.7*	*29.4*	*30.1*	*29.8*	*30.3*	*29.9*	*30.4*	*30.1*
Yoy%	*8.3*	*6.6*	*6.2*	*8.9*	*9.0*	*8.5*	*8.6*	*8.6*	*8.7*
Expenditure (Rbn)	**1463.3**	**1451.5**	**1445.2**	**1564.0**	**1563.1**	**1676.0**	**1677.1**	**1809.4**	**1814.3**
% GDP	*33.3*	*33.1*	*32.8*	*33.3*	*33.0*	*33.0*	*32.7*	*33.0*	*32.7*
Yoy%	*6.0*	*5.7*	*5.9*	*7.8*	*8.2*	*7.2*	*7.3*	*8.0*	*8.2*
Balance (Rbn)	**-139.0**	**-150.5**	**-147.9**	**-147.1**	**-149.0**	**-138.1**	**-141.9**	**-139.0**	**-145.8**
% GDP	*-3.2*	*-3.4*	*-3.4*	*-3.1*	*-3.1*	*-2.7*	*-2.8*	*-2.5*	*-2.6*
GDP (Rbn)	**4388.4**	**4381.0**	**4409.8**	**4702.0**	**4741.2**	**5078.0**	**5129.2**	**5490.0**	**5545.5**
Yoy%	*7.7*	*7.2*	*7.9*	*7.3*	*7.5*	*8.0*	*8.2*	*8.1*	*8.1*

Source: National Treasury Budget Review 2017, MTBPS October 2016, Budget Review 2016

Expenditure

Obtaining better value for public money will be a central objective over the period ahead.

2017 National Budget Review

- Treasury's main objective can be summarised as 'reduce, reuse and recycle' as growth in average real annual expenditure has been reduced to 1,9% over the medium-term. This compares with annual average growth of 2,3% between FY13/14 and FY16/17. Real growth on non-interest expenditure will be 1,7% over the next three years. Real growth on current payments is forecast to average 1,8%

per annum over the medium term including debt service costs, which are projected to increase by 4,6% per annum over the medium term.

- By trimming spending on non-core goods and services as well as compensation budgets, the expenditure ceiling will be reduced by R26,1 billion over the next two years.
- Baseline budgets will also be reduced by R6,9 billion, R5,5 billion and R6,1 billion in 2017/18, 2018/19 and 2019/20 respectively. On a national level this includes the compensation of employees, which will be reduced by R437 million, R471 million and R497 million in 2017/18, 2018/19 and 2019/20 respectively. Goods and services, transfers to public entities and 'other' national spending items will be reduced by R2,1 billion, R2,8 billion and R1,2 billion over the next three years.
- Resources unlocked from the reduction in baseline budgets will be spent principally on higher education, post-retirement medical subsidies, school nutrition programmes and the Integrated Financial Management System.
- R30 billion has also been reprioritised, the bulk of which – R16,1 billion – will be allocated to higher education. The sources of reallocation include drawdowns on the contingency reserve (R4 billion in 2017/18 and R5 billion in 2018/19), rescinded provisional allocations (R389 million in 2017/18 and R11,1 billion in 2018/19), the National Skills Fund reserves (R5 billion in 2017/18) and social grant overestimations (R626 million in 2017/18 and R1,5 billion in 2018/19).

Table 3 : Government expenditure at a consolidated level

	Budget 2017/18		**Annualised changes**	
	Annual % change	**% of total**	**2016/17 2019/20**	**2013/14 2016/17**
General public services	**7.3**	**16.0**	**8.0**	**11.3**
of which: State debt costs	*11.0*	*10.4*	*10.5*	*13.1*
Defense	**3.2**	**3.1**	**4.5**	**5.2**
Public order & safety	**6.9**	**8.8**	**6.6**	**5.8**
Police services	*7.5*	*6.0*	*6.9*	*5.6*
Law courts	*5.5*	*1.4*	*5.8*	*7.3*
Prisons	*5.7*	*1.5*	*6.6*	*5.0*
Economic affairs	**5.5**	**11.4**	**6.4**	**5.0**
General economic, commercial & labour affairs	*-0.9*	*2.1*	*5.2*	*1.2*
Agriculture, forestry, fishing & hunting	*2.4*	*1.2*	*4.6*	*1.3*
Fuel & energy	*19.1*	*0.7*	*13.6*	*4.3*
Mining, manufacturing, construction	*4.5*	*0.2*	*2.7*	*3.7*
Transport	*8.9*	*6.4*	*6.7*	*6.9*
Communication	*-12.6*	*0.3*	*11.9*	*15.4*
Other industries	*6.4*	*0.2*	*6.4*	*6.5*
Economic affairs not elsewhere classified	*-6.1*	*0.3*	*-0.3*	*7.2*
Environmental protection	**7.6**	**0.6**	**5.0**	**5.0**
Housing & community amenities	**9.0**	**11.5**	**8.0**	**8.4**
Health	**9.7**	**11.9**	**8.3**	**8.3**
Recreation & culture	**7.3**	**0.7**	**5.2**	**5.8**
Education	**8.3**	**20.2**	**7.8**	**8.2**
Social protection	**8.2**	**15.4**	**7.6**	**9.3**
Votes & Direct changes	**7.7**	**99.6**	**7.5**	**8.1**
Total consolidated expenditure	**8.2**	**100.0**	**7.9**	**8.1**
Remuneration	***7.4***	***35.2***	***7.2***	***7.9***

- The Chief Procurement Officer also aims to save R25 billion by renegotiating contracts with government's top 100 suppliers, by using technology to reduce duplication and by cutting red tape amongst others
- The division of government expenditure is shown in table 3 above.

Revenue

Raising taxes when the economy is struggling is undesirable, but unavoidable, given the current fiscal circumstances. (Budget Review 2017)

Gross tax revenue of R1,1 trillion for 2016/17 came in lower than expected, registering a R30,4 billion shortfall (more than the R22,8 billion shortfall estimated at the time of the MTBPS) – the largest relative to budget since 2009/10 as tax collections were hurt by weak economic growth. Three of the main tax categories underperformed with personal income tax, value added tax and customs duties respectively bringing in R15,2 billion, R11,3 billion and R6,5 billion less than anticipated. The shortfall in personal income tax collections reflected lower wage increases as well as smaller bonus pay-outs, while that on VAT was the result of higher-than-anticipated VAT refunds. However, corporate tax revenue outperformed, bringing in an additional R6,8 billion.

Table 3 : Revenue estimates

	2017/18			Proposals	2016/17
	(Rm)	% growth	% of tax	(Rm)	(% overshoots)
Consolidated revenue	**1414101**	**9.0**			**-2.0**
Provincial and other revenue	**171684**	**7.0**			**-1.2**
National revenue	**1242417**	**9.3**			**-2.2**
Other revenue	**32880**	**2.9**			**19.9**
Less SACU payments	55951	41.8	4.4	0	0.0
Tax revenue	**1265488**	**10.6**	**100.0**	**28024**	**-2.6**
Incomes and profits	**739153**	**11.9**	**58.4**	**23339**	**-1.2**
Individuals	482086	13.2	38.1	16517	-3.5
Other companies	218692	6.6	17.3	0	3.4
STC	34717	32.7	2.7	6822	3.6
Other	3658	3.8	0.3	0	-7.3
Payroll and workforce	**16642**	**7.6**	**1.3**	**0**	**-12.3**
Skills dev fund	16642	7.6	1.3	0	-12.3
Property	**16509**	**2.9**	**1.3**	**-448**	**3.8**
MST	5775	3.0	0.5	0	7.4
Transfer duties	8423	2.1	0.7	-448	2.1
Other	2311	5.7	0.2	0	1.7
Goods and services	**439539**	**8.8**	**34.7**	**5133**	**-3.5**
VAT	312751	7.8	24.7	0	-3.7
Fuel levy	70902	12.6	5.6	3197	-2.4
Excise duties	39871	11.7	3.2	1936	-6.1
Electricity levy	8642	0.0	0.0	0	-0.4
Other	7374	9.9	0.6	0	4.0
International trade	**53647**	**10.9**	**4.2**	**0**	**-11.3**
Customs duties	52608	10.8	4.2	0	-12.1
Other	1040	17.7	0.1	0	79.2
Stamp duties & fees	**-0.6**	**-**	**0.0**	**0**	**-**
Memorandum items:					
Direct taxes	758105	11.8	59.9	23339	6.4
Indirect taxes (net)	507383	8.8	40.1	4685	-13.3

Source: National Treasury Budget Review 2015

To plug the R30,4 billion shortfall, Treasury announced the following tax proposals:

- A **new personal income tax bracket** for those earning above R1,5 million which will carry a 45% marginal tax rate. 100 000 taxpayers will be affected by this.
- **Increasing the dividend withholding tax rate** from 15% to 20% effective 22 February 2017. This was done partly to decrease the arbitrage opportunity which can arise when personal income taxes are increased and workers opt to receive their salaries in the form of dividends instead.

- Providing only **limited relief – of R2,5 billion – for bracket creep**, which means R12,1 billion additional revenue will be raised.
- A 30c/l increase in the **fuel levy** and a 9c/l **Road Accident Fund levy**.
- Increasing **excise duties** on alcohol and tobacco by between 6,1% and 9,0%.
- Increasing the withholding tax on **immovable property sales by non-residents** to 7,5% from 5% for individuals, 10% from 7,5% for companies and 15% from 10% for trusts.

The new tax proposals will raise R28 billion. R16,5 billion of this will be from personal income tax proposals (of which R6,8 billion will be from the dividend withholding tax proposal).

The **transfer duty-free threshold** for residential properties will be raised to R900 000 from R750 000 effective 1 March 2017 to give some support to the middle class. Other relief measures include:

- Increasing the **medical tax credit** for the first two beneficiaries to R303 from R286 per month and that for the remaining beneficiaries to R204 from R192 per month.
- Raising the **tax free savings account annual allowance** to R33 000 from R30 000.
- Raising the tax thresholds for all ages.

Looking ahead, consolidated tax revenue is expected to increase by 9,0%, 8,6% and 8,7% in 2017/18, 2018/19 and 2019/20 respectively. This is above the 6,2% growth recorded in 2016/17. Tax buoyancy (tax revenue growth as a percentage of growth in gross domestic product) deteriorated in 2016/17 (revenues grew faster than economic growth) but is expected to improve in subsequent years.

Financing

- Government's gross loan debt as a percentage of GDP is projected to increase to 52,3%, 52,9% and 52,4% respectively in 2017/18, 2018/19 and 2019/20 from an estimated 50,7% in 2016/17. Net loan debt is expected to increase to 47,0%, 47,6% and 48,1% of GDP from 45,5% in 2016/17.
- With rising debt comes an increase in debt service costs. Debt service costs as a percentage of GDP are projected to climb progressively to 3,6% in 2019/20 from 3,3% in 2016/17. Debt service costs were 11,2% of total expenditure in 2016/17. This will rise to 11,9% in 2019/20.
- The deficit will mainly be financed through the issuance of domestic long-term debt as shown in table 5.

Table 4 : Financing the National Budget

	2015/16	2016/17		2017/18	2018/19	2019/20
R billion	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Domestic short-term loans (net)	**13.1**	**25.0**	**41.0**	**21.0**	**21.5**	**22.0**
Treasury bills	7.3	25.0	41.0	21.0	21.5	22.0
Corporation for Public Deposits	5.8					
Domestic long-term loans (net)	**146.2**	**116.2**	**115.9**	**142.0**	**144.4**	**141.4**
Market loans (gross)	176.8	174.0	174.0	191.5	195.0	197.0
Loans issued for switches	-2.5		-0.9			
Redemptions	-28.1	-57.8	-57.2	-49.5	-50.6	-55.6
Foreign loans (net)	**-3.9**	**7.8**	**37.5**	**25.0**	**28.0**	**-17.1**
Change in cash and other balances	**13.0**	**7.3**	**-22.8**	**-21.2**	**-22.7**	**34.4**
Total	**168.4**	**156.3**	**171.6**	**166.8**	**171.2**	**180.7**

Source: National Treasury Budget Review 2017

Other issues

- The Budget Review makes mention of research undertaken about a graduate tax to be levied on university graduates, but says that such a tax is unlikely to raise the revenues needed to fund post-school education. Treasury estimates suggest that if each graduate faced a 1% increase in their marginal tax rate it would generate about R3 billion annually which falls far short of the R59,8 billion that the 26 public universities spent to operate in 2015.

- Government has proposed a tax on sugary beverages, which will come into effect as soon as the necessary legislation is approved by Parliament. Treasury has published a draft paper on the tax and it states that the sugar content will be the base on which the tax is applied, the proposed tax rate is 2,1c/gram for sugar content in excess of 4grams/100ml and some of the revenues will be used to support health-promotion interventions.

Assessment

The budget had to try and satisfy growing calls to meet increased spending needs and further 'radical economic transformation' while still pursuing fiscal consolidation to address rating agency concerns over the sustainability of government finances. With the economy doing little to help this year's balancing act was even more difficult than usual. Despite more measures to raise taxes and increased vigilance on expenditure there has been further slippage on the consolidation of public finances, with debt and interest service costs still rising. It is becoming increasingly clear that much stronger economic growth is required and that this will be a result of a clearer and more positive political and policy path. Treasury has done what it can to help this, but the main solutions lie elsewhere in government.