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**PARLIAMENT**  
OF THE REPUBLIC OF SOUTH AFRICA

## 2017 Budget Analysis

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## Executive summary

The 2017/18 budget aims to give effect to the transformation agenda of Government. It attempts to be redistributive by making several expenditure proposals to support the poor. Increases in social assistance grants to the most vulnerable and three new conditional grants take effect in 2017/18.

Through the budget, government is able to allocate resources to policy priorities and to improve the quality and effectiveness of spending within sustainable limits. The budget, however, depends on the economy to generate resources to finance transformation and to invest in human and physical capital. The 2017 Budget emphasises the need for transformation. This objective is constrained by several years of low growth.

The 2017 Budget proposes a R10 billion reduction to the expenditure ceiling for 2017/18. The 2017 Budget also proposes measures to raise an additional R28 billion in revenue. Compared to the 2016 Budget, the country's net debt-to-GDP ratio is expected to be higher over the medium term expenditure framework (MTEF). Despite a slower path to fiscal consolidation compared to the 2016 Budget, the country seems likely to achieve a primary surplus (budget balance excluding debt service cost) in 2018/19.

The estimated consolidated revenue collection of R1 324.3 billion for 2016/17 was revised downwards by R27 billion to R1 297.3 billion since the 2016 MTBPS. The 2017 tax proposals are projected to raise an additional R28 billion in 2017/18. Changes to personal income tax, dividend withholding tax, taxes on property and indirect taxes will contribute to the additional estimated collection for 2017/18.

A review of the current tax expenditure is an area for consideration for additional tax proposals. Current considerations are to reprioritise medical aid credits so as to support the National Health Insurance (NHI) fund. In order to expand the VAT base, government is considering the removal of the current zero rating on fuel. According to National Treasury, the removal of the VAT zero-rating on fuel is roughly calculated to potentially increase VAT revenue by R18 billion.

The R1 563 billion consolidated estimated expenditure for 2017/18 is R864 million less than the indicative allocation for 2017/18 in the 2016 MTBPS.

The division of nationally raised revenue to be allocated to provinces and local governments increases slightly, while the national government's share decreases in 2017/18.

## Purpose

The purpose of the budget analysis report is to assist members with their deliberations and approval of the fiscal framework and revenue proposals. It further aims to assist members in determining the consistency of the changes to the division of revenue with the fiscal framework, taking into account the service delivery obligations of all affected national departments, provincial government departments and local governments.

## Introduction

The South African budget process is governed by legislation. The fiscal policy stance of government, which informs the final budget process, is presented to Parliament in October each year. Subsequent to the tabling of the final budget proposals in Parliament it must be enacted in law.

The Parliamentary Budget Office assists members with their deliberations and advises members on the economic background to the fiscal framework, redistribution of funds, and the changes made since the previous budget.

This report, therefore, provides policymakers with strategic information relating to the allocation of nationally raised funds. It further provides the macroeconomic background to the fiscal framework, the proposed changes to the fiscal framework, and the debt outlook for the country. Changes to revenue and expenditure are discussed to provide members with an overview of where the additional revenue is coming from and how it was allocated.

## Strategic direction for budget allocations

The 2017/18 budget, in-line with President Jacob Zuma's State of the Nation Address, aims to give effect to the transformation action agenda, by financing government programmes to:

- Ensure that many more people live in dignity every year
- Radically improve access to services and economic participation across all racial lines
- Energise growth and create jobs
- Increase investment and development at all spheres of government

The budget attempts to be redistributive by making the following expenditure proposals: No student whose combined family income is below R600 000 per annum will face fee increases at universities and TVET colleges for 2017

- All poor students who applied and qualified for NSFAS awards, and who have been accepted by a university or a TVET college, will be supported
- An increase in the threshold above which transfer duty is paid from R750 000 to R900 000

Changes to social assistance grants to the most vulnerable include:

- An increase to the old age grant of R90 to R1600 for pensioners over the age of 60, and R1620 for those over 75
- The disability and care dependency grants increase by R90 to R1600 a month
- Foster care grants increase by R30 to R920 a month
- The child support grant increases by R20 to R380 a month

Three new conditional grants take effect in 2017/18 to:

- Expand access to early childhood development (ECD) and improve ECD facilities
- Provide for increased employment of social workers
- Improve opportunities for learners with profound disabilities

### Fiscal policy

The budget depends on the economy to generate resources to meet basic social needs, finance transformation and investment in human and physical capital. The 2017 Budget Review emphasises the need for transformation and further fiscal consolidation. Realising these objectives is, however, constrained by low economic growth. In recent years, there has been a marked slow-down in the growth in spending on capital assets, creating fiscal space for current payments, and transfers and subsidies.

An alternative view to fiscal consolidation is to increase the use of fiscal policy to stimulate the economy. What if government borrow more to support the much needed transformative household consumption by the poor and increased public sector investment to increase GDP? According to Pasinetti (1998) economies could run deficits while sustaining and even lowering their debt-to-GDP ratio if the interest rate is consistently lower than the growth rate. Therefore, over a medium term framework and longer, Government can consider using fiscal policy to stimulate growth, which could have a positive impact on the level of debt-to-GDP and debt repayments as a percentage of GDP.

Prominent economists, including Ben Bernanke, the former chair of the US Federal Reserve, and economics Nobel laureate Paul Krugman made strong cases after the global financial crisis that, countries should spend their way out of the recession. The implication for South Africa to take an aggressive countercyclical policy approach would mean increasing debt for targeted spending. Not all spending will, however, translate into higher growth and support the transformative plans of government. However, borrowing more to make transfers to support consumption by the poorest households and catalytic infrastructure spending would have an impact.

For example the impact of borrowing for a targeted programme to increase household consumption is:

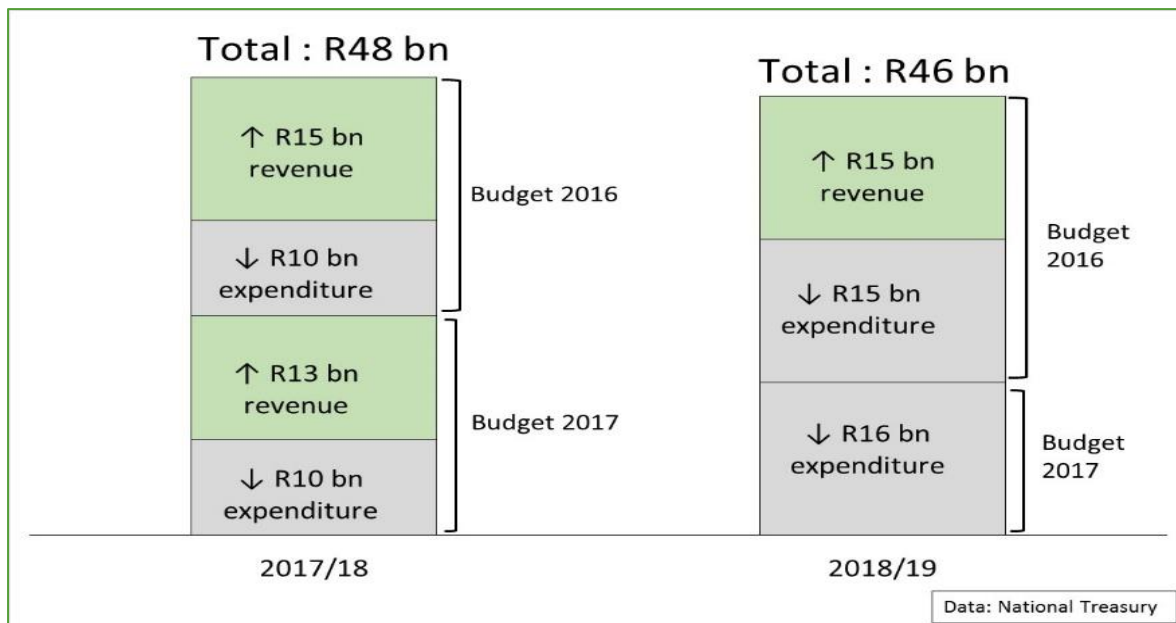
- If government borrows R1.00 to support a R1.00 increase in household consumption of the poor (or infrastructure investment)
- The average multiplier for sectors that would benefit from this spending is 1.6 (see p.20 of 2017 Budget review for multipliers)
- The increase to GDP of that R1.00 consumption should be R1.60. Therefore, the contribution to the growth rate is greater than the interest rate

### Fiscal framework

The 2017 Budget was presented in the context of slow growth and revenue collection. With the central fiscal objective of stabilising debt as a share of GDP, government proposed further measures to increase revenue and slow expenditure growth over the Medium Term Expenditure Framework.

The economy grew by 0.3 per cent in 2016, its slowest annual growth since 2009. The revenue collection outcomes is expected to be R30.4 billion less than was projected in the 2016/17 main budget. The combination of lower-than-forecast growth and revenue has resulted in government proposing additional fiscal consolidation measures. The 2017 Budget Review proposed a R10 billion reduction to the expenditure ceiling for 2017/18 – this is further to the R10 billion reduction proposed in the 2016 Budget Review. The 2017 Budget Review also proposed measures to raise an additional R28 billion in revenue.

Figure 1: Proposed changes to the fiscal framework since the 2016 Budget



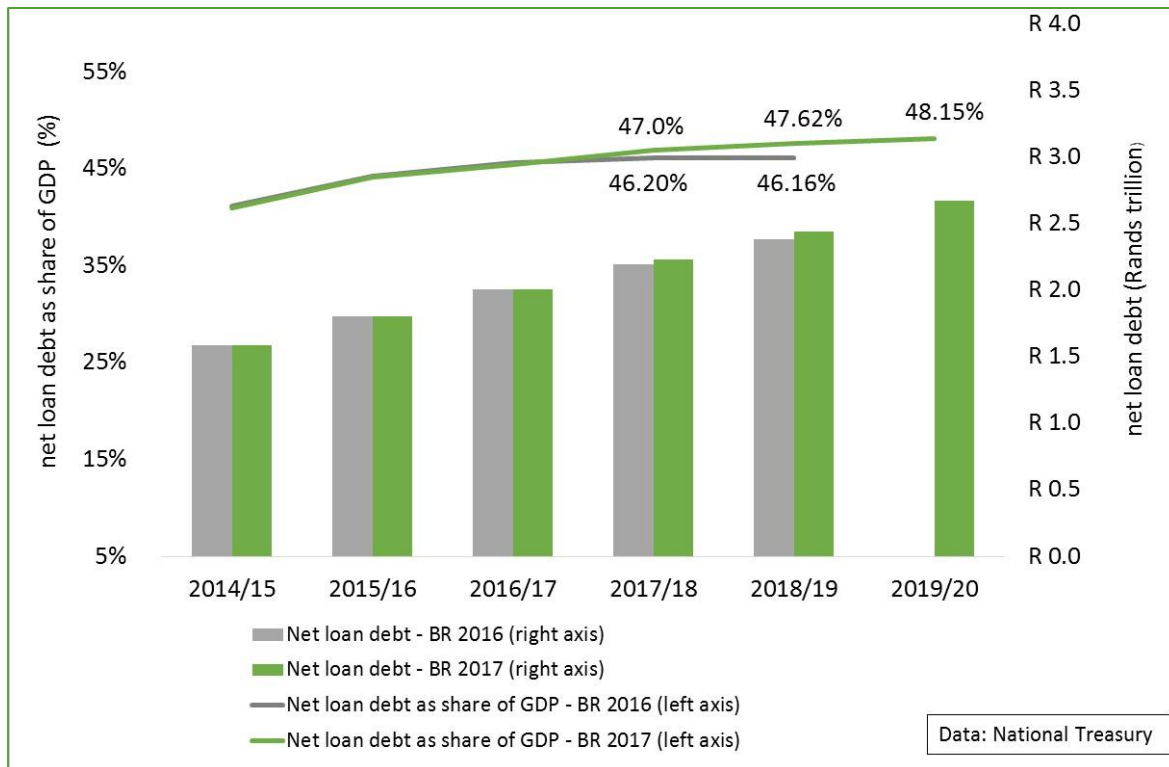
Source: National Treasury

The measures to raise additional revenue include the introduction of a new PIT tax bracket for individuals earning R1.5 million or more per annum, an increase in dividend withholding taxes to 20 per cent, limited fiscal drag relief for PIT, an increase to the fuel levy and an increase in the duty free threshold for estate transfer. Some of these proposals are discussed in the revenue section.

## Debt

Despite the increased fiscal effort to realise the country's primary fiscal objective, revisions to the debt-to-GDP outlook have been necessary. Compared to the 2016 Budget, the country's net debt-to-GDP is expected to be higher over the MTEF. This is due to downward revisions to nominal GDP growth, as well as the overall higher Rand value of net debt stock. Despite a slower path to fiscal consolidation compared to the 2016 Budget, the country seems likely to achieve a primary surplus (excluding debt service cost) in 2018/19. This suggests successful fiscal consolidation efforts. Figure 2 shows the slower stabilisation of debt-to-GDP ratios.

Figure 2: Slower stabilisation of debt-to-GDP



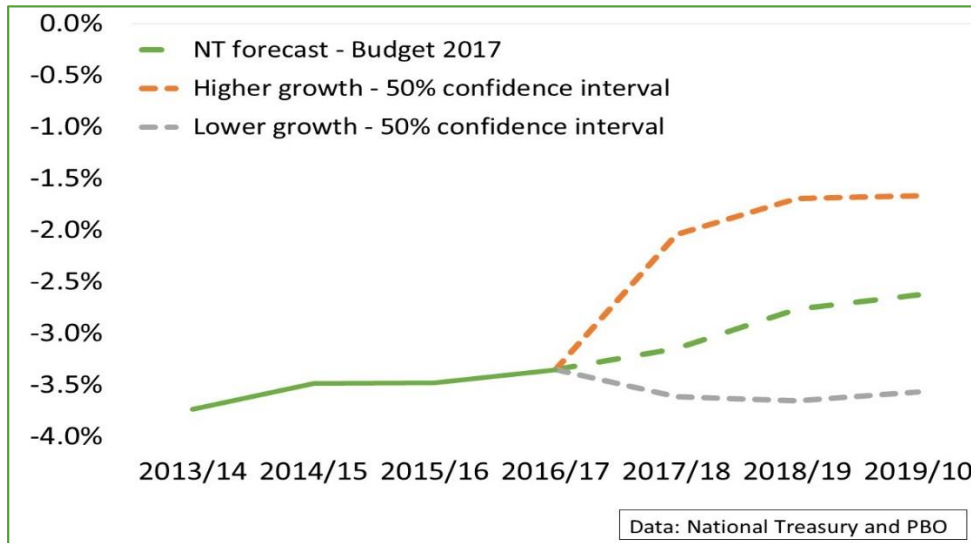
Source: National Treasury

Revised projections of the country's debt-to-GDP outlook as well as the primary balance are sensitive to the country's growth outlook. Revised growth projections, from National Treasury as well as other institutions suggest that, the economy is poised for a modest recovery in 2017 following its poor performance in 2016 – its worst since 2009. There is however considerable uncertainty in the growth outlook owing to a range of domestic and international factors. Figures 3 and 4 below show the sensitivity of National Treasury projections to lower and higher growth. Based on the historical forecast error of Treasury's growth and revenue forecasts since 2009, budget balance and net-debt as a share of GDP outturns for the MTEF can be calculated with a 50 per cent confidence interval<sup>1</sup>. Figure 3 shows the budget balance as a share of GDP. The graph shows the 50 per cent confidence interval. There is a 50 per cent probability that the budget deficit will be between 2 per cent and 3.6 per cent, compared to the point estimate of 3.1 per cent provided by National Treasury.

<sup>1</sup> These are based on National Treasury's historical economic and fiscal forecast errors (see PBO 2016, and PBO 2017 forecast auditing reports). Historical forecast errors, since the global financial crisis, are used to estimate "high growth" and "low growth" outturns with a 50% confidence interval. Simplified assumptions regarding the expenditure level, debt level and GDP inflation are made as part of the exercise, with the intention of illustrating the uncertainty and sensitivity of fiscal objectives to growth, rather than provide an alternate estimate to Treasury.



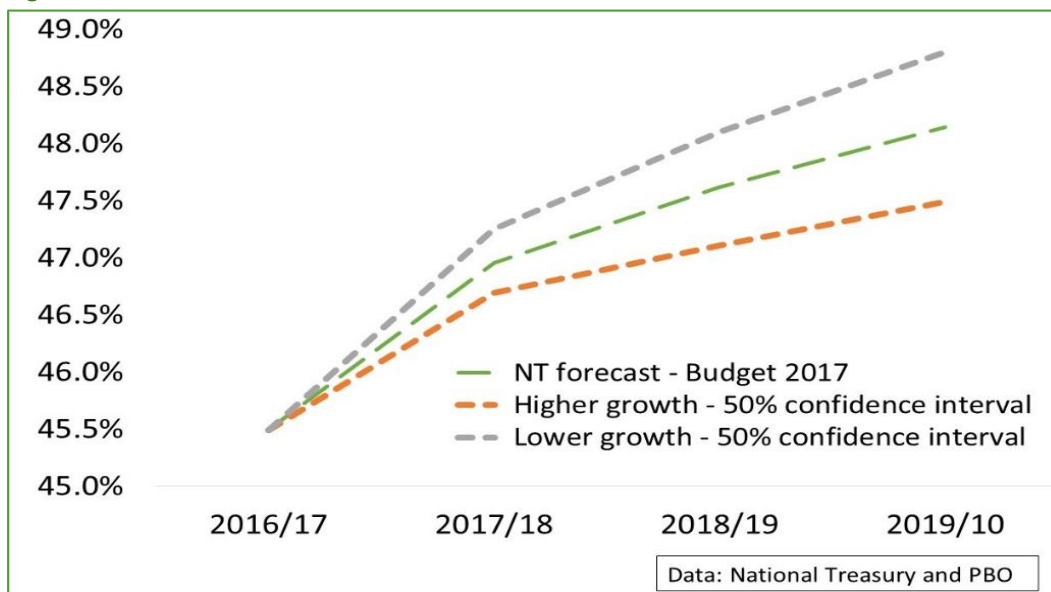
Figure 3: Budget balance (consolidated) as a share of GDP (%)



Source: National Treasury

Figure 4 shows the net debt as a share of GDP. The graph further shows 50 per cent confidence intervals, which provides a range rather than a point estimate. There is a 50 per cent probability that the debt-to-GDP ratio will be between 47.3 per cent and 46.7 per cent in 2017/18, compared to the point estimate of 46 per cent provided by National Treasury.

Figure 4: Net debt as a share of GDP



Source: National Treasury

## Revenue

The estimated consolidated revenue collection of R1 324.3 billion for 2016/17 was revised downwards by R27 billion to R1 297.3 billion since the 2016 Budget. National Treasury expects tax revenues to grow slower than the economy. Corporate income tax (CIT), one of the four main sources of revenue, is expected to exceed its 2016 Budget estimate. Under-collection is projected to arise mostly from personal income tax (PIT), followed by value added tax (VAT)

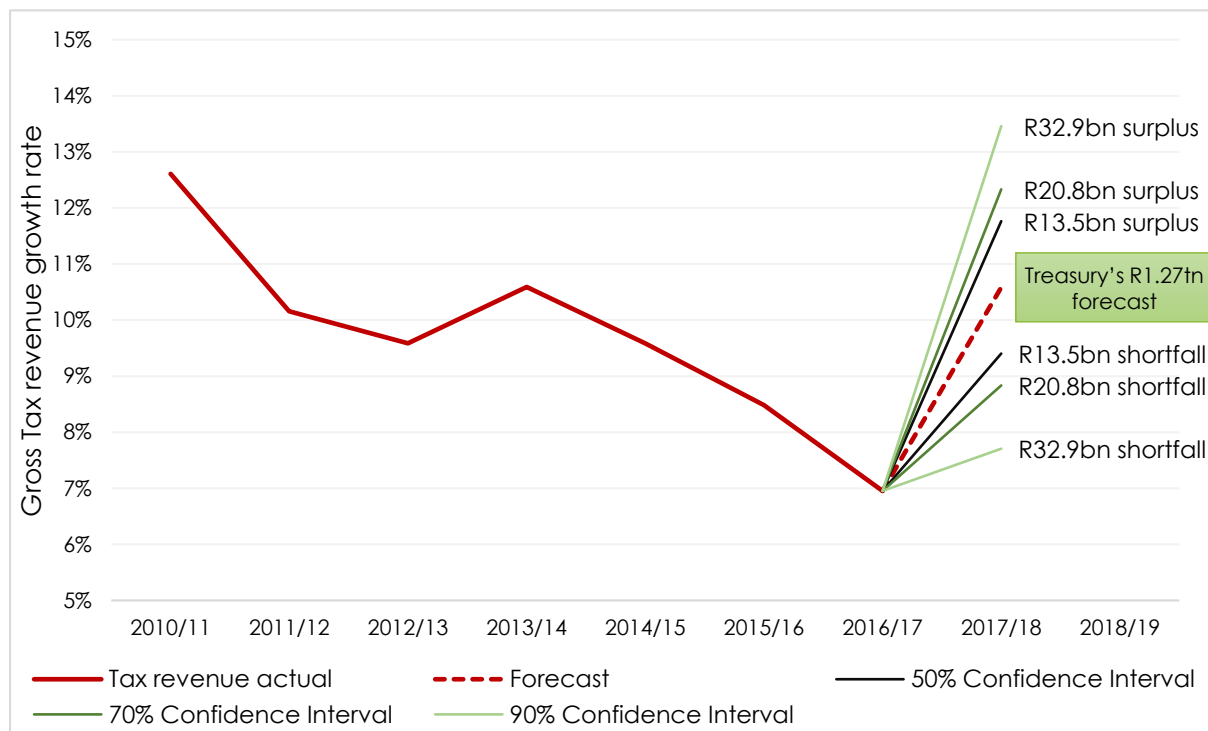
and then customs duties. As a result of the significant collection shortfall, tax buoyancy<sup>2</sup> is anticipated to fall below a value of one for the first time since the 2009/10 year. The lower than estimated tax collections may be as a result of an array of reasons including economic, social, administrative and tax policy decisions.

Using Treasury's historical forecast errors after the global financial crisis, Figure 5 shows the degree of uncertainty inherent in the Tax revenue forecast.

Specifically, the chart shows Treasury's Gross Tax Revenue forecast for 2017/18 of R1.27 trillion. Our analysis estimates a 50 per cent probability of the actual tax revenue collected for 2017/18, falling somewhere between a 13.5 billion shortfall and a R13.5 billion surplus.

Similarly there is a 70 per cent chance of the final tax revenue collection figure falling somewhere between an R20.8 billion surplus and R20.8 billion shortfall, and a 90 per cent chance of a range between a surplus and shortfall of R32.9 billion.

Figure 5: Forecast Uncertainty: Gross Tax Revenue for 2017/18



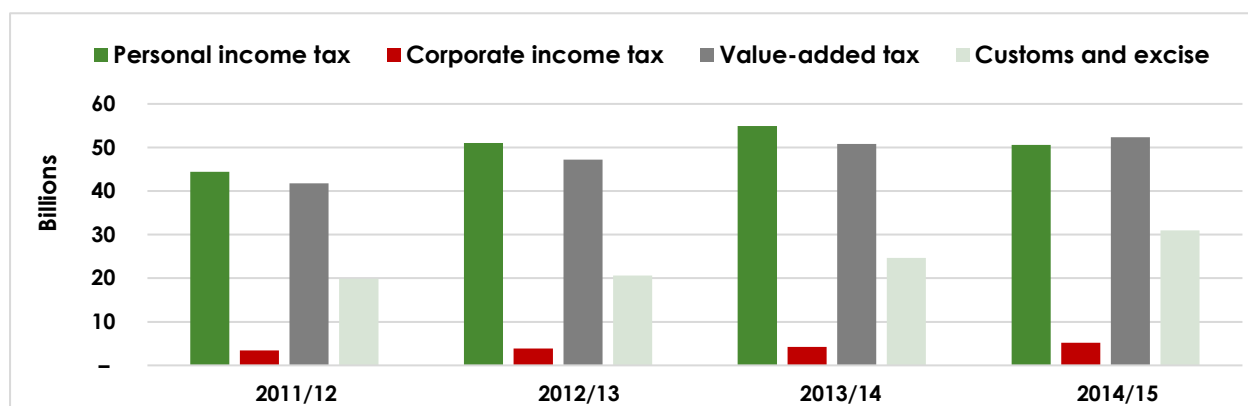
Source: PBO

In line with the 2016 MTBPS commitments of raising additional revenue, the 2017 budget provides revenue proposals that enables government to attain the main fiscal policy objectives of reducing the budget deficit and stabilising the debt-to-GDP ratio. The 2017 tax proposals are projected to raise an additional R28 billion in 2017/18. Changes to personal income tax, dividend withholding tax, taxes on property and indirect taxes will contribute to the additional R28 billion estimated collection for 2017/18.

<sup>2</sup> Tax buoyancy reflects how responsive gross tax revenue growth is in relation to GDP growth, a value below one reflects slower growth, while a value above one reflects faster growth.

While considering additional taxation revenue proposals, a review of the current tax expenditure is also an area for consideration. Figure 6 shows a four year trend of tax expenditure of the four main tax instruments benefitting from the tax expense.

Figure 6: Tax expense per revenue instrument



Sources: National Treasury

Table 1 compares of the tax expenditure between the four main taxation instruments, PIT, CIT, VAT and Customs and Excise duties. PIT and VAT account for almost 80 per cent of the tax expenditure over the period 2011/12 to 2014/15. With CIT and customs and excise tax expense account for just more than 20 per cent of tax expenses.

Table 1: Main areas of tax expenditure

Tax expenditure estimated at R127 000 billion or 14.7 per cent of gross revenue:			
<b>PIT expenditure main areas</b>	<b>R50 billion</b>	<b>VAT expenditure main areas</b>	<b>R48 billion</b>
Pension and Retirement	R26 bn (51 %)	19 Basic food items	R19bn (40 %)
Medical Aid	R19 bn (38 %)	Fuel (petrol + diesel + paraffin)	R18bn (37 %)
Other	R5 bn (11 %)	Other	R11bn (23%)
<b>CIT expenditure main areas</b>	<b>R4.8 billion</b>	<b>Customs &amp; Excise main areas</b>	<b>R24 billion</b>
Small Business Corp	R2 bn (43%)	Motor Vehicles	R18.5 bn (77 %)
ETI <sup>3</sup> and Learnership subsidies	R1.9bn (41%)	Diesel Refund	R3.9 bn (16%)
Other	R0.9bn (16%)	Other	R1.6 bn (7%)

Sources: National Treasury

Pension and retirement, and medical aid credits comprise most of the tax expenditure in PIT. This includes both the employers and individual taxpayers' contributions towards retirement. VAT expenditure covers mainly zero rating -n basic food items, and on fuel. Corporate income tax expenditure relates to support to small business corporations, ETI and learnerships. Custom and excise tax expenditure is mainly for imports related to the motor vehicle industry and diesel refunds.

<sup>3</sup> ETI: Employment tax incentive

The current fiscal position of Government necessitates the review of some of the tax expenditure items. It is important to ensure well targeted tax expenditure, and effective and efficient allocation. Current considerations are to reprioritise medical aid credits, to support the National Health Insurance (NHI) fund. In order to expand the VAT base, government is considering the removal of the current zero rating on fuel.

Table 2 shows a four year average, from 2011/12 to 2014/15, VAT amount including zero-rating on fuel. Excluding the zero rating on fuel reduces the VAT expenditure from R48.0 billion to R30.1 billion. This calculation, all other things equal, shows a potential increase of at least R18 billion in VAT revenue.

Table 2: VAT Proposal for 2018/19

R million	4yr average with fuel	4yr average without fuel	Estimated contribution
<b>Value-added tax</b>			
Zero-rated supplies	46 909	29 015	
<i>19 basic food items</i>	19 336	19 336	
<i>Petrol</i>	15 371	–	15 371
<i>Diesel</i>	1 884	–	1 884
<i>Paraffin</i>	639	–	639
<i>Municipal property rates</i>	9 474	9 474	
<i>Reduced inclusion rate for commercial accommo</i>	204	204	
Exempt supplies (public transport and education)	1 130	1 130	
<b>Total value-added tax</b>	<b>48 039</b>	<b>30 145</b>	<b>17 894</b>

Sources: NT data, and PBO calculation

## Expenditure

Table 3 shows changes to consolidated functional expenditure since the 2016 Medium Term Budget Policy Statements (MTBPS). Total consolidated revised expenditure amounts to R1 445 billion in 2016/17. This amount is R6.27 billion less than the R1 452 billion estimated in the 2016 MTBPS. The R1 563 billion consolidated estimated expenditure for 2017/18 is R864 million less than the indicative allocation for 2017/18 in the 2016 MTBPS. The two outer years increased by R1 052 million in 2018/19 and R4 907 million in 2019/20 since the 2016 MTBPS.

Table 3: Changes to consolidated functional expenditure since the 2016 MTBPS

	2016/17	2017/18	2018/19	2019/20
<b>R million</b>				
<b>Basic education</b>	<b>-1 773</b>	<b>-1 816</b>	<b>-630</b>	<b>-480</b>
<b>Health</b>	<b>1 637</b>	<b>3 085</b>	<b>2 511</b>	<b>2 941</b>
<b>Defence, public order and safety</b>	<b>579</b>	<b>777</b>	<b>150</b>	<b>318</b>
<b>Post-school education and training</b>	<b>355</b>	<b>942</b>	<b>-267</b>	<b>512</b>
<b>Economic affairs</b>	<b>-5 988</b>	<b>-1 312</b>	<b>2 216</b>	<b>4 415</b>
<b>Human settlements and municipal infrastructure</b>	<b>-1 299</b>	<b>-1 843</b>	<b>-1 936</b>	<b>-1 871</b>
<b>Agriculture, rural development and land reform</b>	<b>-317</b>	<b>-411</b>	<b>-497</b>	<b>-443</b>
<b>General public services</b>	<b>2 135</b>	<b>918</b>	<b>-565</b>	<b>-830</b>
<b>Social protection</b>	<b>-194</b>	<b>85</b>	<b>223</b>	<b>199</b>
<b>Debt-service costs</b>	<b>-1 408</b>	<b>-1 290</b>	<b>-153</b>	<b>144</b>
<b>Consolidated expenditure</b>	<b>-6 272</b>	<b>-864</b>	<b>1 052</b>	<b>4 907</b>

Source: PBO own calculations from National Treasury data

The biggest change in the revised 2016/17 estimates is within the Economic affairs function group, with estimated under-expenditure of R5 988 million. Basic education estimates under expenditure of R1 773 million, while debt-service cost are estimated to be R1 408 million lower than the previous estimate. The medium term expenditure frameworks (MTEFs) for Health, Defence, public order and safety, Post-school education and training, General public service, and Social protection have increased since the 2016 MTBPS, while all other function groups were reduced. Allocations for Health is estimated to increase by R10 174 million from 2016/17 to 2019/20. Human settlements and municipal infrastructure is estimated to decrease by R6 950 million from 2016/17 to 2019/20.

Table 4 shows changes to the 2016 MTEF consolidated economic classification expenditure since the 2016 MTBPS. The table also shows the actual outcome for 2015/16 and the revised estimates for 2016/17. Consolidated under expenditure on compensation of employees and payment for capital assets are the main contributors to the total estimated under expenditure for 2016/17.

Table 4: Changes to consolidated economic classification expenditure since the 2016 MTBPS

	2015/16 Outcome	2016/17 Revised estimate	2016/17	2017/18	2018/19	2019/20
<b>R million</b>						
<b>Current payments</b>	<b>798 900</b>	<b>873 876</b>	<b>-185</b>	<b>1 582</b>	<b>3 666</b>	<b>5 774</b>
Compensation of employees	472 779	512 240	-2 782	935	1 667	1 352
Goods and services	190 855	208 276	3 727	2 032	2 883	3 684
<b>Transfers and subsidies</b>	<b>441 362</b>	<b>471 908</b>	<b>1 774</b>	<b>175</b>	<b>2 054</b>	<b>9 293</b>
Provinces and municipalities	108 160	112 736	-364	1 894	2 006	283
Departmental agencies and accounts	26 101	24 852	-22	-1 245	-1 323	-1 073
Higher education institutions	27 479	30 651	147	397	-1 095	-3 806
Public corporations and private enterprises	30 695	31 941	1 148	-2 838	-3 174	3 393
Households	218 673	239 779	1 211	1 643	4 475	9 226
<b>Payments for capital assets</b>	<b>102 586</b>	<b>93 013</b>	<b>-8 105</b>	<b>-3 008</b>	<b>-4 590</b>	<b>-10 043</b>
<b>Consolidated expenditure</b>	<b>1 373 106</b>	<b>1 445 205</b>	<b>-6 272</b>	<b>-864</b>	<b>1 052</b>	<b>4 907</b>

Source: PBO own calculations from National Treasury data

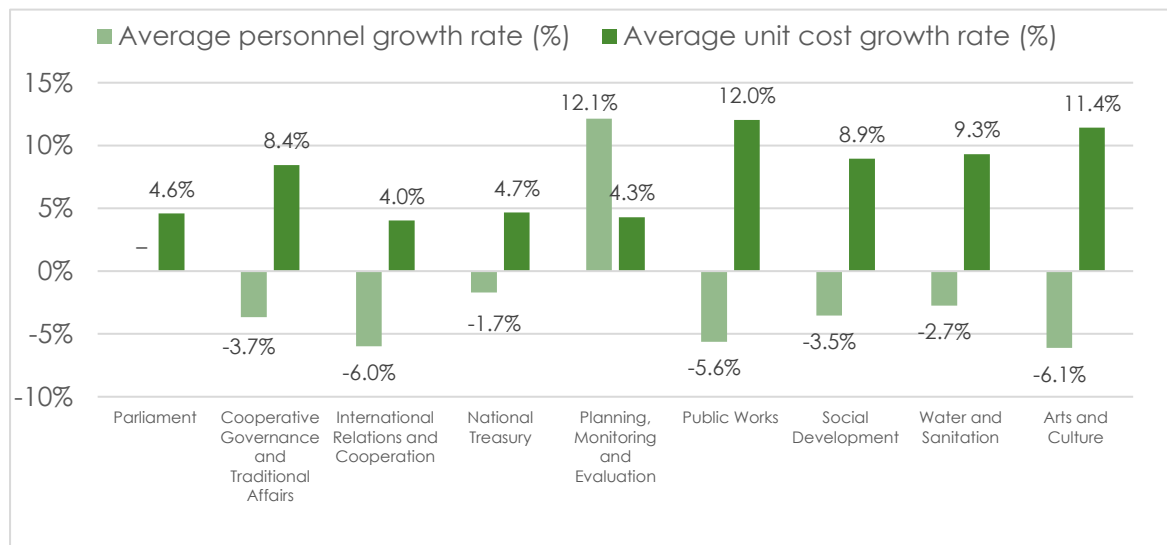
Current payments are estimated to increase by R10 837 million from 2016/17 to 2019/20 since the tabling of the 2016 MTBPS. Transfers and subsidies increase by R13 297 million from 2016/17 to 2019/20 since the tabling of the 2016 MTBPS of which transfers to households are the contributor to this increase. Estimated payments for capital assets decline by R25 745 million from 2016/17 to 2019/20 since the tabling of the 2016 MTBPS.

### Fiscal risks

To address elevated fiscal risks, government is managing the national and provincial wage bill, improving budget execution and stabilising the operations of financially troubled public entities.

Public-service wage settlements generally provide for increases equal to inflation, plus a premium that is not linked to performance. National and provincial government salaries rose by an average of about 1.8 per cent faster than inflation between 2008/09 and 2015/16. In recent years, government has withdrawn nearly all identified funding for vacant posts and blocked appointments to non-critical vacant posts on the payroll system. The annual average budget growth for compensation of employees is projected to be 7.2 per cent over the 2017 MTEF. The total average personnel growth rate is -1.2 per cent over the 2017 MTEF. Figure 7 shows the estimated changes in headcounts and unit costs in selected national departments over the 2017 MTEF.

Diagram 7: Changes to consolidated economic classification expenditure since the 2016 MTBPS



Source: National Treasury

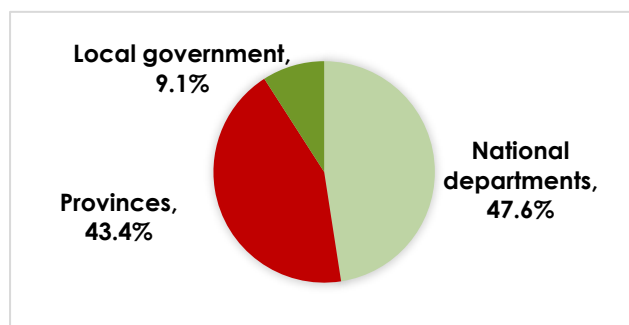
Parliament does not plan to make any changes to headcount numbers. The Department of Planning, Monitoring and Evaluation plans to increase headcounts by 12.1 per cent and one of the highest decreases in headcount numbers over the MTEF is reflected by the Department of Arts and Culture at 6.1 per cent. The number of funded post in the Department of Planning, Monitoring and Evaluation is 350. This Department is, however, planning to increase the headcounts to 468 by 2019/20.

The average growth in unit cost varies between 4.0 and 12.0 per cent. These growth rates depend on the change in headcount, composition of the workforce, as well as the annual adjustments in the salary levels of employees. It is impossible from this diagram, however, to determine the planned average annual salary adjustments for each department.

### Division of Revenue

Diagram 8 shows the division of nationally raised revenue of R1 409.2 billion in 2017/18. The national sphere receives 47.6 per cent, which is slightly lower than the 48 per cent allocated in 2016/17. Provinces will receive 43.4 per cent and the local government sphere receives 9.1 per cent. Provinces and local government receive 0.3 per cent and 0.2 per cent, respectively, more in 2017/18 than in the 2016/17 financial year.

Diagram 8: Division of nationally raised revenue between the three spheres of government



Source: National Treasury

## Conclusion

The South African economic is projected to grow by 1.3 per cent in 2017 and 2 per cent in 2018. Although not sufficient to create sufficient employment opportunities and eradicate poverty, should these projections be realised, it will mark an improvement on the previous year. The consequence of 0.3 per cent real GDP growth in 2016 is reflected in the estimated shortfall of R30.4 billion in revenue collection in 2016/17.

The additional tax revenue raised from the 2017/18 revenue proposals, comes primarily from the upper end of the income spectrum.

The 2017 Budget is a continuation of government's policy of fiscal consolidation, while maintaining core spending commitments, especially in education, health and social protection.

The projected narrowing of the budget balance will require that departments and other institutions plan and spend public funds carefully to ensure value for money.