unicef
for every child

2018/19

National Budget Brief South Africa

Contents

Acronyms

AIDS | Acquired Immune Deficiency
BFI | Budget Facility for Infrastructure
DPME | Department of Planning, Monitoring and Evaluation
EBP | Executive Budget Proposal
ECD | Early Childhood Development
GDP | Gross Domestic Product
GHS | General Household Survey
HDI | Human Development Index
HIV | Human Immunodeficiency Virus
MINCOMBUD | Ministers' Committee on the Budget
MTBPS | Medium Term Budget Policy Statement
MTEF | Mid-Term Expenditure Framework
MTSF | Medium-Term Strategic Framework
NA | National Assembly
NCOP | National Council of Provinces
NDP | National Development Plan
OBI | Open Budget Index
OECD | Organisation for Economic Co-operation and Development
PFM | Public Finance Management
PIT | Personal Income Tax
SAA | South African Airways
TB | Tuberculosis
UNDP | United Nations Development Programme
VAT | Value Added Tax

Preface

This budget brief is one of five that explores the extent to which the national budget and social services sector budgets address the needs of children under 18 years in South Africa. The briefs analyse the size and composition of budget allocations for fiscal year 2018/19 as well as offer insights into the efficiency, effectiveness, equity and adequacy of past spending. Their main objectives are to synthesise complex budget information so that it is easily understood by stakeholders and put forth key messages to inform financial decision-making processes.

Key Messages and Recommendations

The South African economy performed marginally better than expected, but this growth is not strong enough to reverse unemployment trends or to counter the effects of rising poverty and inequality. The Government is encouraged to:

I. Maintain its strong spending on social grants for children; and
II. Sustain its poverty-reducing transfers to public schools and Non-Profit Organisations that deliver vital child-focused services.

Budget 2018 maintains the Government's commitment to social sector spending, although the anticipated public sector wage increases may compromise the gains. The Government is encouraged to:

III. Prioritise basic education and continue the gradual expansion of the post-school education and training sector; and
IV. Curtail the reductions in infrastructure spending, which will impact negatively on rural children's access to social infrastructure in the schooling and health sectors.

Fiscal adjustment-achieved by cutting expenditure across all levels of Government is producing mixed results for child-focused services at the national and provincial level. The Government is encouraged to:

I. Sustain its positive investment in the Early Childhood Development (ECD) sector and to continue its support for the comprehensive HIV, AIDS, tuberculosis (TB) grant;
II. Limit the reductions in provinces' unconditional block grant; and
III. Avoid using past spending performance as the most important criterion in deciding on reductions to infrastructure spending, because of the strategic importance of improving rural schooling and health infrastructure.

Budget 2018 provides less relief to personal income taxpayers and introduces a concomitant hike of 1.0 per cent in the Value Added Tax (VAT). The Government is encouraged to:

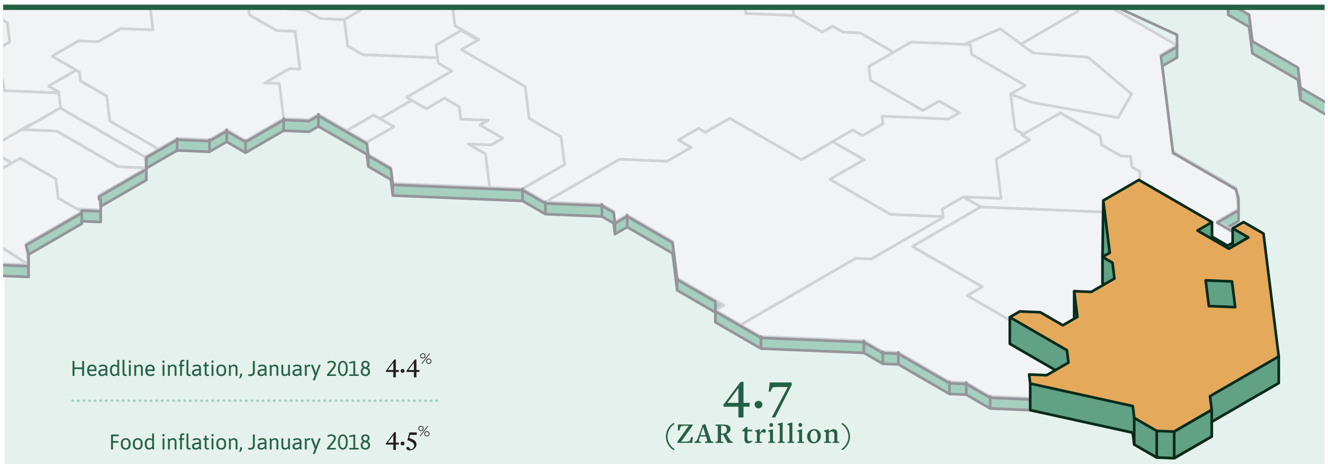
I. Increase the number of basic food stuffs that are zero-rated in recognition that South Africans, and specifically poor children, have diverse nutritional needs;
II. Examine carefully, existing tax expenditures and how these can be tilted to further support poor children, by, for example, increasing the allowance for learnerships and extending this to children in technical high schools and vocational education and training colleges; and
III. Build capacity with provincial governments to improve their own revenue collection systems and use additional financing to support vital infrastructure spending.

Budget reforms to improve the relevance and quality of infrastructure spending are welcomed. The Government is encouraged to:

I. Examine carefully whether this approach to infrastructure planning and implementation can be extended to the provincial and local government spheres;
II. Sustain its top ranking in the Open Budget Index (OBI) by providing more information on its financial position and strengthening national and provincial departments year-end reports; and
III. Continue its engagement with members of civil society to deepen the public's awareness, understanding and participation in the country's budget process.

SECTION 1.
Macro and Socioeconomic Context

TABLE 1:
Macroeconomic trends in South Africa: 2017/18 to 2020/21 | *Source: Budget Review 2018, Statistics South Africa mid-year population estimates 2017 and Statistics South Africa 2018 (http://www.statssa.gov.za/?p=10985)*



Headline inflation, January 2018	4.4%
Food inflation, January 2018	4.5%
Consolidated budget deficit as a % of GDP, 2017/18	-4.3%
Consolidated budget deficit as a % of GDP, 2018/19	-3.6%
Taxation as a % of GDP, 2018/19	26.8%
Debt service costs (interest) as a % of GDP, 2018/19	3.6%
Debt service costs (interest) as a % of GDP, 2020/21	3.7%
GDP, 2017	4.7 (ZAR trillion)
Real GDP growth, 2017	1.3%
GDP per capita, 2017 (ZAR)	81,462
Estimated population growth between 2016 and 2017	1.6%
Unemployment rate 4th quarter 2017	26.7%
Youth unemployment rate 4th quarter 2017	51.1%

Macroeconomic Trends

The South African economy performed marginally better than expected in 2017 and grew by 1.3 per cent in 2017 as opposed to the 1.0 per cent growth projection by the National Treasury. Official estimates of the growth in the total population are 1.6 per cent, suggesting that the Gross Domestic Product (GDP) per capita is falling in real terms. Unemployment remains a serious concern (27 per cent), threatening both income support to children and the overall political and social stability of the country. Unemployment among the youth is almost twice the national average, thus raising concerns about the sustainability of interventions to replace existing skills in the labour market. Food inflation continues to outpace consumer price inflation, but has slowed down considerably in 2017, thus offering some respite to consumers (Table 1).

Economic growth is projected to increase from 1.3 per cent in 2017/18 to 2.1 per cent in 2020/21, thus replacing the stagnant growth witnessed during the last few years. In the context of the country's high unemployment, this rate of growth is not sufficient. However, the economy managed to contain headline inflation below the centrally-set 6 per cent benchmark, which is generally good news for the poor. In the context of larger deficits, it is unsurprising to see the growth in tax revenue as a percentage of GDP and this contribution was increased by almost 2 percentage points between 2014/15 and the end of the 2018 Medium Term Expenditure Framework (MTEF) in 2020/21 (Figure 1).

Data for the first three quarters in 2017 highlighted the recovery in the agriculture sector (Table 2). This reflects the consistent summer rainfall in the inland regions and the contribution of the mining sector, which benefited from rising commodity prices. Of concern is the performance in sectors that have economy-wide implications, such as the decline in the contribution of the manufacturing sector and electricity and water as a result of falling consumer demand and the increased capacity of the national electricity system.

Social Development Trends

Child poverty and HIV/AIDS are key challenges. Children constitute one-third of the population, but around one out of every two children in South Africa is considered income poor, which is almost 15 per cent higher than their population share. (Table 3). Females (between the ages of 15 and 49) have a higher HIV prevalence rate than the general population, and in the context of female-headed households being much poorer than male-headed households, this situation has a direct negative impact on the well-being of poor children.

Policy Frameworks and Plans

The main instruments that affect planning in Government are the *National Development Plan (NDP)*, which sets out long-term planning goals for various facets of social and economic life in South Africa and the *Medium-Term Strategic Framework (MTSF)*[iii], which serves to domesticate the electoral mandate of the governing party. An important addition to the planning and budgeting link has been the introduction of the Department of Planning, Monitoring and Evaluation's *Mandate Paper*, which seeks to integrate the development priorities of the NDP into the annual budget process. The *Mandate Paper*

FIGURE 1:
Performance of the South African economy, 2014/15 to 2020/21 (%) | *Source: Budget Review 2018*

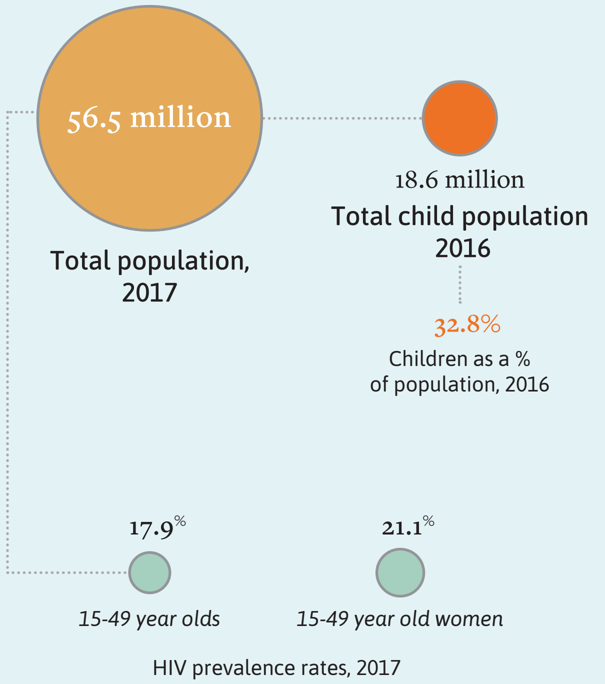
TABLE 2:
Real sector growth trends compared to GDP growth, 2011 to 2017 | *Source: Budget Review 2018*
Note: The Government's 2017 projection of GDP growth for the first three quarters of 2017 was updated by Statistics South Africa and the economy grew by 1.3% in 2017 as opposed to the 1.0% projection.[i]

	2011	2012	2013	2014	2015	2016	2017
Agriculture, forestry and fishing	2.0	1.8	3.6	6.9	-6.1	-7.8	21.9
Mining and quarrying	-0.7	-2.9	4.0	-1.4	3.9	-4.7	4.3
Manufacturing	3.0	2.1	0.8	0.1	-0.2	0.7	-1.2
Electricity and water	1.5	-0.4	-0.6	-1.3	-1.5	-3.5	-0.6
Construction	0.4	2.6	4.6	3.6	1.7	0.7	0.4
Wholesale and retail trade	4.1	4.0	1.9	1.4	1.4	1.2	-1.0
Transport and communication	3.5	2.4	2.8	3.1	1.1	0.4	1.2
Finance, real estate and business services	4.3	3.0	2.5	2.4	2.8	1.9	1.0
Personal services	2.5	2.1	2.2	1.7	1.1	1.2	1.1
General government	4.7	3.0	2.9	2.7	0.8	1.4	0.1
GDP	3.3	2.2	2.3	1.6	1.3	0.3	1.0

TABLE 3:

Social development trends in South Africa, 2015 to 2017[ii] | *Sources: Statistics South Africa mid-year population estimates 2017, GHS 2016, Living Conditions Survey 2015, World Health Organisation, 2016 and United Nations Development Programme (UNDP) 2016*

Poverty rate, 2015 (using Lower Bound Poverty Line)	39.9%
Child poverty rate, 2015 (using Lower Bound Poverty Line)	51.0%
Child poverty as a share of poverty (using Lower Bound Poverty Line)	45.8%
Poverty rate of female-headed households versus male-headed households (using Lower Bound Poverty Line)	33.5% and 19.2%
Human Development Index (HDI), 2015 (medium HDI ranking)	0.67
National life expectancy 2015	62.9%
Life expectancy: males, 2017	61.2 years
Life expectancy: females, 2017	66.7 years
Expected years of schooling for males, 2015	12.5
Expected years of schooling for females, 2015	13.6



does not replace the allocation process, which is performed by the National Treasury, but it tries to establish the context and the criteria within which prioritisation ought to take place. The key strategic priorities that were recommended for the 2018/19 financial year were:

- Job creation and small business development;
- Youth development;
- Maintaining inflation-adjusted infrastructure spending and maintenance of existing infrastructure;
- Land reform and agriculture development;
- Comprehensive social security, education and skills;
- Integrated plan to fight crime; and
- Regional integration and development.

A cursory glance at the actual Budget 2018 priorities suggests that the infrastructure proposal was not taken on board due to the severity of the cuts in this area. In the areas of education and skills, free higher education for the poor was prioritised, but the growth in basic education spending has been slowed down considerably, while incremental steps have been taken in realising the comprehensive social security system[iv]. There is some evidence, therefore, that the recommendations of the *Mandate Paper* are embedded in the Executive's budget proposal. However, further monitoring is needed to quantify the usefulness of this addition to the country's budget process.

TAKEAWAYS

- The economy performed marginally better than expected, but this growth is not strong enough to reverse unemployment trends or to counter the effects of rising poverty and inequality;
- Children bear the brunt of this rising poverty and inequality and are disproportionately represented among the poor;
- Strong contributions from the primary sectors in the economy (agriculture and mining) have added real value to the economy, but there are concerns about the flagging contributions of the manufacturing sector; and
- Government's attempt at linking the budgeting cycle more closely to its own planning horizon has borne some fruit, but it is too early to tell whether the Department of Planning, Monitoring and Evaluation's (DPME)*Mandate Paper* will refine and strengthen the National Development Plan's strategic incorporation into the annual budget process.

SECTION 2.
Aggregate Spending Trends and Priorities

Size of Spending[v]

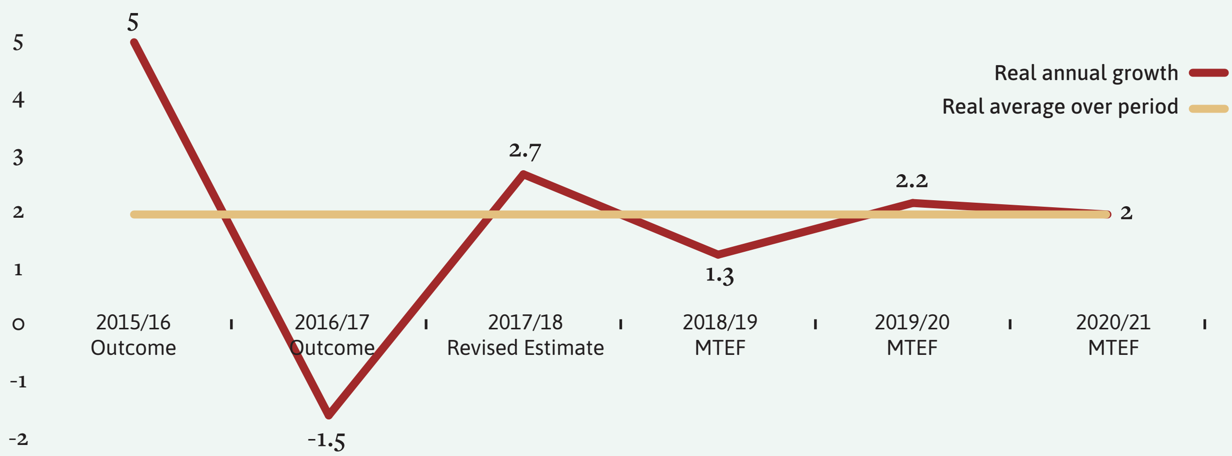
Consolidated government expenditure and proposed allocations constitute between 29-30 per cent of GDP over recent and projected years (Figure 2). Over the 2018 MTEF, consolidated government spending does not breach the 30 per cent mark and is indicative of the Government's attempt to moderate aggregate spending. At the end of the 2018 MTEF in 2020/21, consolidated government allocations constitute 29.8 per cent of the country's projected GDP.

Spending Changes

Consolidated government expenditure is projected to grow by 2.0 per cent in real terms on average between 2014/15 and 2020/21 (Figure 3). However, the average growth during this period does not adequately capture the fluctuations in spending prior to the 2018 MTEF. Lower spending in 2016/17 reflects, in part, the effects of the reduction in the spending ceiling and Government's attempts to control aggregate spending. Our calculations indicate that consolidated government expenditure will grow by

FIGURE 2:
Consolidated government expenditure and allocations as a % of the Gross Domestic Product (GDP), 2014/15 to 2020/21 | *Source: Budget Review 2018*

FIGURE 3:
Annual year on year growth in consolidated government expenditure and allocation, 2014/15 to 2020/21 (2017/18=100) | *Source: Budget Review 2018*



less than 2.0 per cent over the 2018 MTEF, thus further reinforcing the tight spending reins that have been imposed on large spending items in the consolidated budget.

Spending and Allocation Priorities in the Consolidated Government Budget

Non-interest expenditure (exclusive of debt servicing costs) is projected to grow from R1.5 trillion in 2018/19 to more than R1.7 trillion at the end of the present MTEF at a real average annual rate of 1.9 per cent. Expenditure on the basic education portfolio is set to increase from R247 billion in 2018/19 to R282 billion in 2020/21 at a meagre rate of 1.3 per cent on average. Allocations to social development and health are similar and are projected to grow by 2.3 per cent on average over the same period. The biggest winner is the post-school education and training sector (and tertiary institutions in particular), with a real average annual growth rate of 7.9 per cent over the 2018 MTEF.

Government's attempt to restrict expenditure and adhere to the self-imposed expenditure ceiling has been relatively successful, but developments in the wider public sector have undermined such efforts. Figure 5 shows that the expenditure ceiling in the Budget Review of 2017 is likely to be breached as indicated by higher projections in the MTBPS 2017 and the 2018 Budget Review. The 2018 Budget Review indicates that the 0.23 per cent excess in spending translates to R2.9 billion, which involves the recapitalisation of the South African Airways (SAA) and the South African Post Office. With the exception of 2017/18, the remaining years continue the trend of reduced expenditure ceilings, but the credibility of the later projections are dependent on better management of entities in the wider public sector. As indicated in the section below, the reduction in the spending ceiling will have serious consequences for child-focused services, especially the reduction in spending on social infrastructure in education and health.

FIGURE 4:
Consolidated government expenditure and allocation by function, 2017/18 to 2020/21 (ZAR billion) | *Source: Budget Review 2018*
Note: Values for present financial year (2018/19) and end of the MTEF (2020/21) explicitly indicated in graph

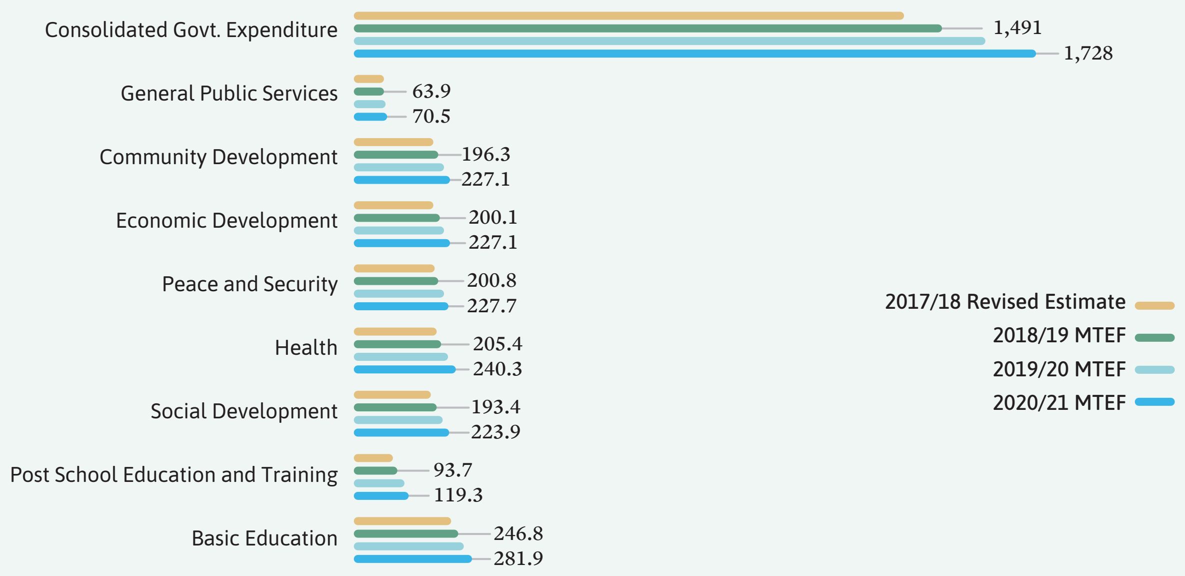


FIGURE 5:
Impact of Budget 2018 in revising the 2017 Budget forward expenditure estimates | *Source: Budget Review 2018 (own calculations)*

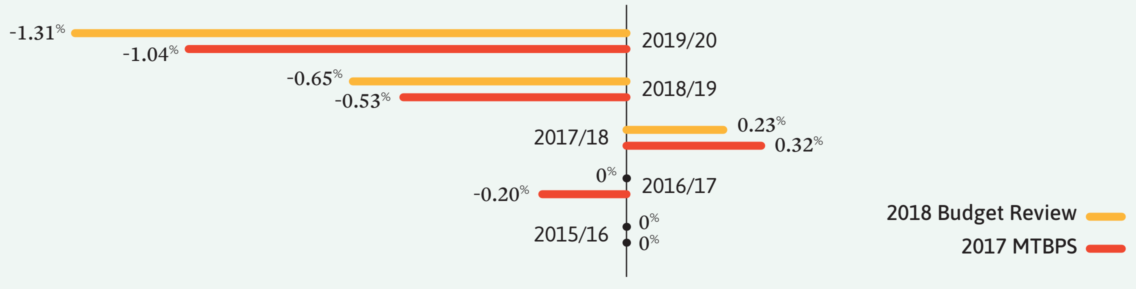
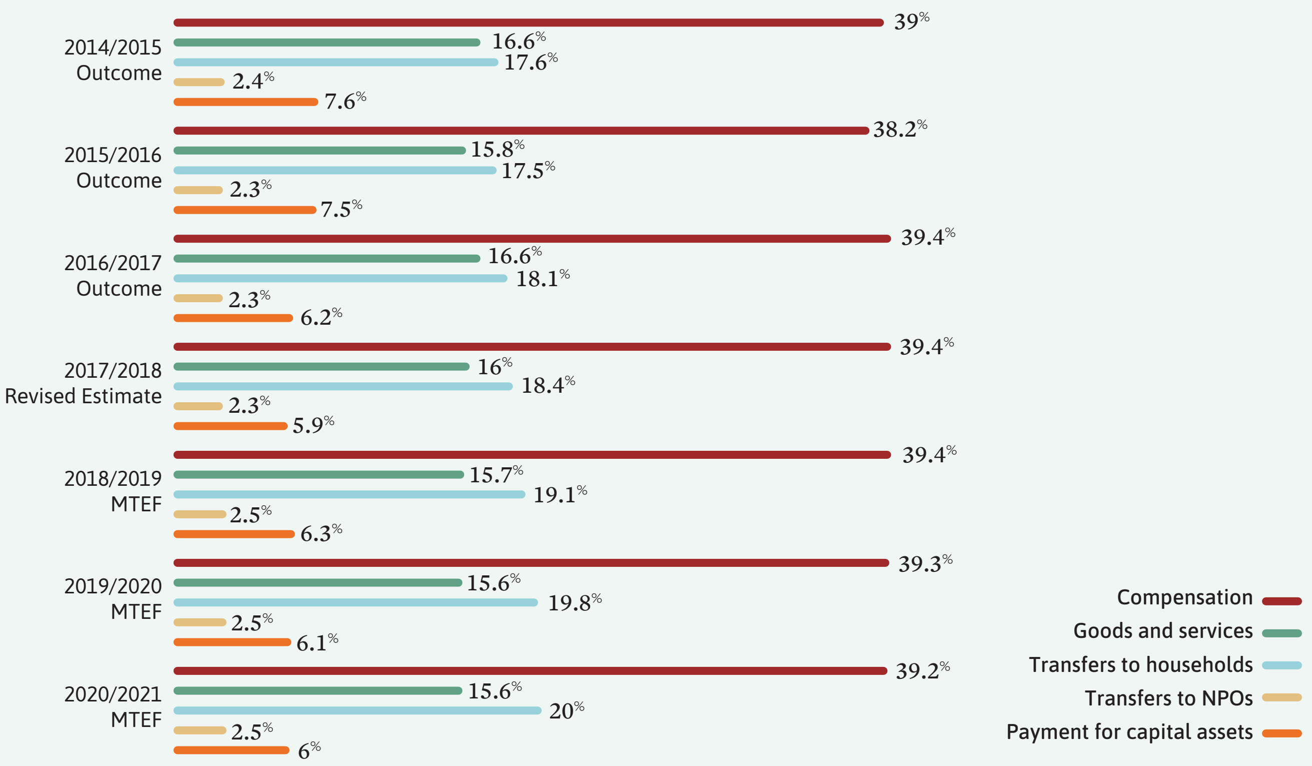


FIGURE 6:
Expenditure and allocation by type in the consolidated government budget, 2014/15 to 2020/21 (%)[vii] | *Source: Budget Review 2018 (own calculations)*
Note: The consolidated government budget totals exclude debt servicing costs.



Recurrent and Capital Spending and Allocations in the Consolidated Government Budget

Spending and allocations on compensation of employees remains around 39 per cent of the total budget, which is the largest expense. This number would be lower if debt service costs were also factored in, which makes wages consume about 12 per cent of the country's overall economic resources. This is in line with the OECD's guidance on what middle income countries should spend on compensation.[vi] Transfers to households are projected to grow from 17.6 per cent in 2014/15 to 20.0 per cent in 2020/21 due to increases in the social grants and provision for fee-free primary and secondary schooling. Transfers to NPOs remain constant at 2.5 per cent over the 2018 MTEF, while the acquisition of fixed assets suffers a decline in its overall share of spending from 7.6 per cent in 2014/15 to 6.0 per cent in 2020/21.

TAKEAWAYS

- Budget cuts have deepened as predicted in the UNICEF 2017 Budget Briefs series;
- Unfavourable expenditure developments in the wider public sector are putting further pressure on spending on vital child-specific services and programmes;
- Consolidated government expenditure is being expanded at a conservative inflation-adjusted rate of 1.9 per cent on average over the 2018 MTEF, but the proposals have produced winners and losers:
  – The winners include spending on higher education and vocational education and training, social grant transfers to households that outpace inflation, and a moderate attempt to preserve allocations to the Non Profit sector;
  – The losers are spending on basic education that is lower than consolidated spending and infrastructure spending that bears the brunt of the cuts at the national and provincial levels; and
- Budget 2018 continues the downsizing expenditure trends and this represents real dangers for investment in child-specific programmes and services.

SECTION 3.
Decentralisation and Sub-National Spending

Decentralisation Context and Sub-National Funding Guidelines

The Constitution of the Republic of South Africa grants equal status to the three spheres of Government in South Africa and promotes an overall principle of interdependent governance (Constitution of Republic of South Africa, 1997). Furthermore, the Constitution (Chapter 6) spells out the legislative authority of provinces via the provincial legislatures and Schedule 4 provides for functional areas of concurrent national and provincial legislative competence. In terms of the financing of provincial governments, Section 214 (a-c) of the Constitution[viii] makes provision for three different sources, namely a vertical division of revenue (among the three spheres of Government), a horizontal division of revenue (using a formula to divide resources among the nine provinces), and through special allocations (conditional grants that have strict conditions for their use).

The country's vertical division of revenue is not subject to an objective funding formula and political and policy judgement is used to arrive at the respective shares of the three spheres in Government. National government departments and entities are allocated 48 per cent of the nationally-raised revenue, while provinces' share of the revenue stabilises at 43 per cent over the MTEF. The share of the local government hovers around the 8 per cent mark. The Budget Review 2018 mentions an interesting, yet disturbing fact: 'Since 2011/12, interest payments have grown faster than allocations to national, provincial or local government, crowding out space for increasing productive expenditure' (Budget Review, 2018: 72). In the interest of public financial stability, the respective inter-governmental shares have remained similar during the period 2014/15 to 2016/17 (not represented in the graph to the right).

FIGURE 7:
National, Provincial and Local Government shares of nationally raised revenue, 2017/18 to 2020/21-vertical division of revenue (%) | *Source: Budget Review 2018*

Note: The shares are calculated on the total non-interest expenditure on the country's Main Budget (funding financed from the National Revenue Fund, excluding any sub-national own revenue streams)

Allocations to provinces' unconditional spending (the so-called provincial equitable shares) represent the horizontal division of revenue and is done via an objective funding formula based on demographic and relative needs indicators. In the 2018 MTEF, these shares are projected to grow at a real average annual rate of 1.6 per cent, which does not adequately capture the fluctuations in the funding of provinces. The stand-out provinces are Gauteng, which manages to achieve spending gains above the national average, while the allocations to the Eastern Cape represent the opposite trend.

FIGURE 8:
Inflation-adjusted revenue growth in the provincial equitable shares over the 2018 MTEF period (%) | *Source: Budget Review 2018 (own calculations)*

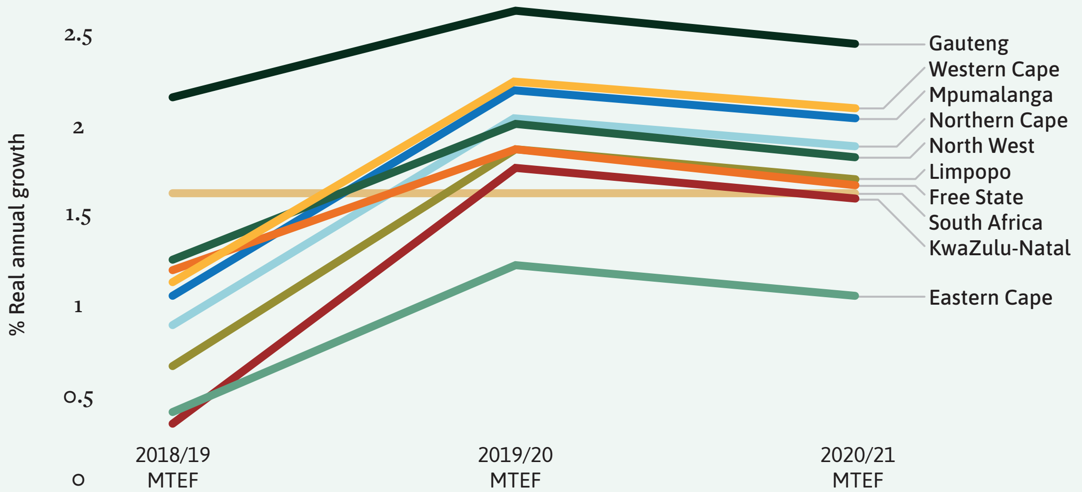


TABLE 4:
Reductions to the baseline spending of National Government, Provincial and Local Government over the 2018 MTEF (ZAR Million) | *Source: Budget Review 2018*

	2018/19	2019/20	2020/21	MTEF total
National Government	18,048	17,222	18,178	53,448
Goods and services	5,165	5,525	5,834	16,524
Transfers to public entities	10,402	9,393	9,917	29,712
Other national spending items	2,481	2,304	2,427	7,212
Provincial Government	5,182	6,387	6,797	18,366
Provincial equitable share	1,437	1,584	1,684	4,705
Provincial conditional grants	3,745	4,803	5,113	13,661
Local Government	3,152	5,212	5,499	13,863
Local Government conditional grants	3,152	5,212	5,499	13,863
TOTAL BASELINE REDUCTIONS	26,382	28,821	30,474	85,677

The growth in the provincial equitable shares allocation (1.6% on average) is less than the overall growth in the consolidated government budget (1.9% on average). Table 4 puts these developments into perspective by detailing the cuts to the provincial equitable shares and the various provincial conditional grants (special allocations). R85.7 billion is proposed to be removed from the three spheres of Government, and provinces' largest losses are in the special allocations (conditional grants): overall, provinces will lose R18.4 billion over the MTEF. In the context of further funding cuts, provincial unpaid bills, and increasing pressure to deliver services, these cuts may compromise service delivery to child-specific services and programmes.

Special allocations are transferred to provinces and Local Government to cover expenditure needs that are not covered adequately by sub-national governments or in instances of negative externalities or spill-over effects. Table 5 shows that capital or infrastructure grants bear the brunt of the proposed expenditure cuts and has implications for how Government will address the backlogs in social infrastructure in education and health. Furthermore, an important anti-poverty grant like the national school nutrition programme barely maintains its real value and is indicative of the financial strain in many child-specific programmes and services. Positive gains are registered for the ECD grant (15.9% on average over the MTEF) and the comprehensive HIV, AIDS, TB (5.9% over the corresponding period).

TABLE 5:
Inflation-adjusted growth in the key basic education, health and social development conditional grants over the 2018 MTEF (ZAR Million) | *Source: Budget Review 2018 (own calculations)*
Note: The green colour signifies real annual and average positive growth, while red represents real annual and average negative growth.

	2017/18 Revised Estimate	2018/19 MTEF	2019/20 MTEF	2020/21 MTEF	Real change between 2017/18 and 2018/19 (%)	Real average annual change over MTEF (%)
Basic Education						
Education infrastructure	10,046	9,918	10,314	11,467	-6.4	-0.8
HIV/AIDS (life skills)	245	243	257	271	-6.0	-1.9
Learners with profound disabilities	72	185	221	243	143.5	53.7
Maths, Science and Technology	365	370	391	413	-3.9	-1.1
National school nutrition	6,426	6,802	7,186	7,696	0.3	0.7
Health						
Comprehensive HIV, AIDS, TB	17,578	19,922	22,039	24,438	7.4	5.9
Health facility revitalisation	5,684	5,816	6,047	6,380	-3.0	-1.4
Health professions	2,632	2,784	2,940	3,102	0.3	0.2
National tertiary service	11,676	12,401	13,186	14,069	0.7	0.9
Social Development						
Substance abuse treatment	57	71	75	79	18.1	6.1
Early Childhood Development	318	491	518	553	46.4	15.9
Social worker employment	182	197	213	227	2.6	2.1
Other						
Community library service	1,420	1,424	1,501	1,584	-4.9	-1.6
Mass participation and sport development	586	587	620	654	-5.1	-1.6

TAKEAWAYS

- Provincial Governments are the centre of spending on children-specific programmes and services and are under severe financial strain due to the large cuts in expenditure over the medium term;
- Provinces have to sacrifice more than R18 billion over the 2018 MTEF to accommodate lower levels of government spending;
- There are noticeable reductions in provinces' unconditional share of nationally-raised revenue and in the special allocations that are transferred from the National Government;
- Furthermore, expenditure on capital grants have been drastically trimmed, thus delaying the roll-out of much-needed school and health infrastructure in the rural areas;
- However, positive gains are registered for the ECD grant (16% on average) and the comprehensive HIV, AIDS, TB (6% on average), which bodes well for the expansion of early childhood opportunities and investment in prevention and response to combat these debilitating diseases; and
- There is uncertainty about whether additional spending adjustments will have to be made, thus raising serious questions about the adequacy and sustainability of funding of children-specific programmes and services.

SECTION 4.
Financing the National Budget

Domestic Revenue

Tax revenue as a percentage of the country's GDP is projected to grow by almost 2 per cent over the present MTEF period. Tax revenue stabilised at around 26 per cent between 2014/15 and 2017/18, but grows more rapidly over the new MTEF period. Tax revenue is projected to increase from 25.9 per cent in 2017/18 to 27.2 per cent of GDP at the end of the present MTEF. Increases in tax revenue are strongly related to attempts to manage down the country's debt levels. Consolidated revenue constitutes almost one-third of total economic output in South Africa, which reinforces the need to monitor and scrutinise developmental expenditures.

Personal income tax (PIT) and taxes on consumption (most notably VAT) dominate the total tax revenue the Government levies on citizens and corporations (Figures 10 and 11). The share of PIT of total gross tax revenue is projected to increase from 37.9 per cent in 2017/18 to 38.1 per cent in 2020/21, while the introduction of the higher VAT (1% increase in 2018), increases the contribution of this indirect tax from 24.6 per cent in 2017/18 to 26.3 per cent at the end of the 2018 MTEF. Corporate tax as a share of total gross tax revenue has been declining recently and the latest projections confirm this trend. By the end of the 2018 MTEF, corporate tax will only account for 16.7 per cent of total tax revenues in South Africa.

Tax expenditures are an important part of any country's arsenal to promote social and economic goals. Total tax expenditure constitutes approximately 15 per cent of total tax revenue, which represents a sizeable reduction in the revenue available to the authorities. Tax expenditures grew

FIGURE 9:
Domestic revenue as a % of the GDP, 2014/15 to 2020/21 | *Source: Budget Review 2018*

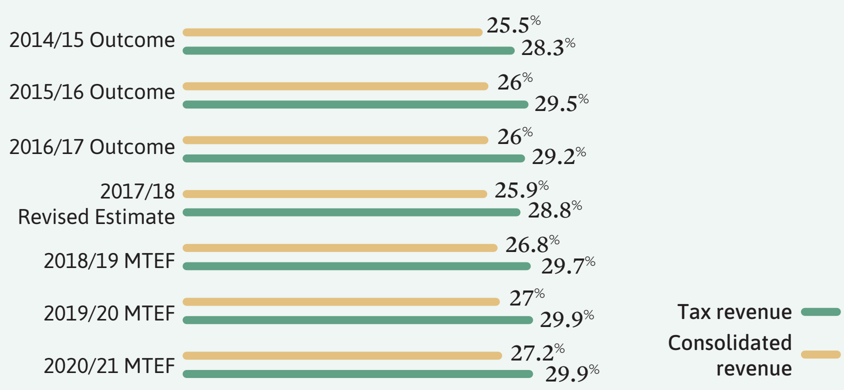
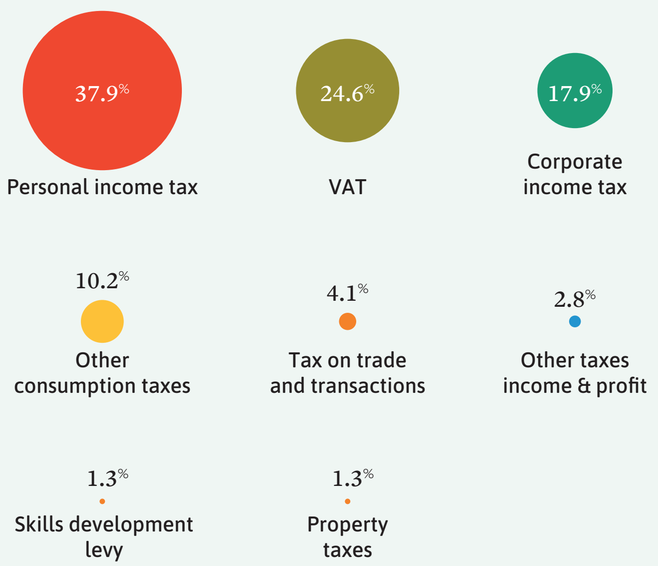
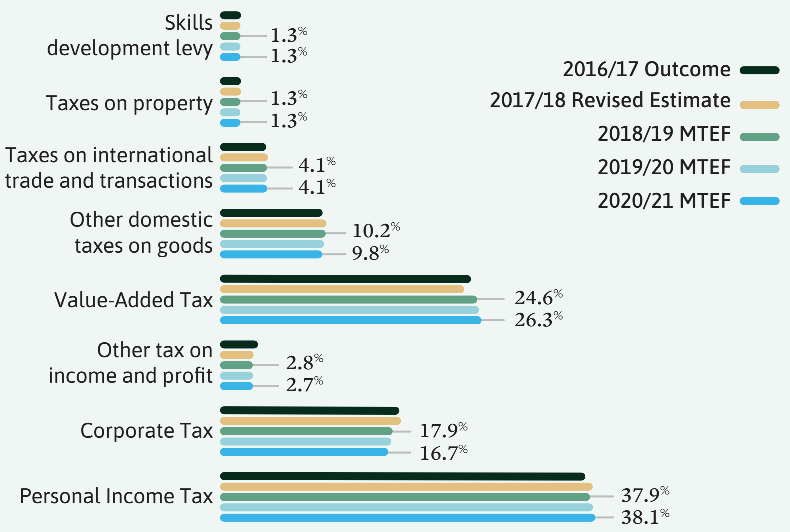


FIGURE 10:
Composition of gross tax revenue in 2017/18 (%) | *Source: Budget Review 2018*



from R123.1 billion in 2012/13 to R159.3 billion in 2015/16. Analysing tax expenditures from the point of view of children and young people, we note that children benefit from the VAT exemptions on basic foodstuffs, learnership allowances for late adolescents, and indirectly from the medical tax rebates that their parents claim. However poor families do not have access to medical schemes, thus slanting the benefits in favour of children in better-off families. The same can be said about the tax deductible benefits of pension and other retirement schemes.

FIGURE 11:
Composition of gross tax revenue, 2016/17 to 2020/21 | *Source: Budget Review 2018*



Borrowing

Total government debt is set to increase from 50.7 per cent in 2016/17 to 56.0 per cent of GDP in 2020/21 (Figure 11). Based on the OECD guidelines and review, South Africa can potentially breach the 40-55 per cent of GDP ratio, which is considered prudent for developing countries. Net loan debt (inclusive of government cash surpluses) is projected to increase from 45.6 per cent in 2016/17 to 52.2 per cent in 2012/21.

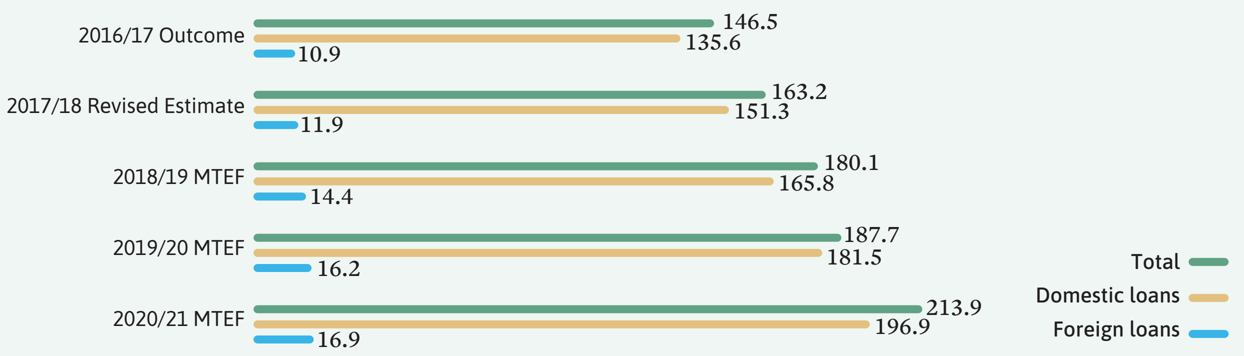
Debt service is increasing: the costs of servicing (the country's rising) debt, increases from R146.5 billion (or 3.3% of GDP) in 2016/17 to R214 billion (or 3.7% of GDP) at the end of the present MTEF. As can be seen from Figure 12, the largest debt servicing cost is on domestic loans, while a much smaller part of the cost involves servicing interests on international loans.

TABLE 6:
Tax expenditures in South Africa, 2012/13 to 2015/16 (ZAR Million)

	2012/13	2013/14	2014/15	2015/16
Personal income tax	51,233	55,603	56,338	58,256
Pension and retirement annuity contributions	26,314	28,467	30,485	31,772
Medical	20,272	21,883	19,750	20,442
Other	4,647	5,253	6,103	6,042
Corporate income tax	4,053	4,026	5,776	7,566
Small business corporation tax savings	1,939	2,318	2,414	2,356
Learnership allowances	857	830	511	728
Employment tax incentive		143	2,420	4,063
Other	1,257	735	431	419
Value-added tax	47,228	50,786	52,379	56,345
Zero-rated basic food items	18,628	20,107	21,503	22,793
Petrol	15,343	16,276	16,065	15,901
Municipal property rates	9,598	10,209	10,522	13,639
Other	3,659	4,194	4,289	4,012
Custom duties and excise	20,592	24,659	30,967	37,156
Total tax expenditure	123,106	135,074	145,460	159,323

FIGURE 12:
Public debt as a % of GDP, 2014/15 to 2020/21 | *Source: Budget Review 2018*

FIGURE 12:
Rising costs of servicing public debt, 2016/17 to 2020/21 (ZAR billion)



TAKEAWAYS

- The Government has adopted a two-pronged strategy to financing the budget, namely increasing taxation levels and reducing the spending ceilings of government departments;
- Personal income tax is the Government's most important source of tax revenue and contributes between 37-38 per cent of total tax revenue;
- The recent 1 per cent increase in VAT pushes its contribution to total tax revenue from 25.3 per cent in 2016/17 to 26.3 per cent in 2020/21;
- Tax expenditures constitute 15 per cent of total government tax revenue and our initial analysis of its impact on children suggests that children in families with access to retirement funding and medical schemes are likely to benefit more from tax concessions; and
- Public debt is set to rise from 51.5 per cent of GDP in 2018/19 to 56.0 per cent in 2020/21, which represents a much slower rate of growth than the corresponding projections in the 2017 MTBPS.

SECTION 5.
New Developments in Public Finance Management (PFM)

New Developments in PFM in South Africa

The general consensus suggests that during periods of fiscal consolidation or adjustment, governments have to navigate a careful balance between reductions in current and capital expenditure so that the productive capacity of the economy is not eroded further. However, this is exactly what is happening in that R13.7 billion (or 74%) of the R18.4 billion in provincial baseline reductions is dominated by cuts to infrastructure spending. Many of the child-focused services and programmes are dependent on good social infrastructure in basic education and health. This requires a closer examination to understand whether reforms to infrastructure spending are likely to accelerate the investment in child-focused services and programmes.

The introduction of the Budget Facility for Infrastructure (BFI) is a welcome development in light of the concerns about the relevance, effectiveness and efficiency of infrastructure spending. The essence of the BFI is the establishment of technical and political oversight structures to evaluate and monitor large and strategic infrastructure proposals. This is important because large infrastructure projects lock in funding (whether front-loaded or back-loaded), and if spent inefficiently, deprives the Government and the broader economy of much-needed resources that could be deployed more effectively. The technical structure evaluates the proposal on the basis of social and economic benefits, assessing externalities and risks and requiring financing and funding methods to be declared. The political structure (referred to as the Minister's Committee on the Budget or MINCOMBUD) is the political gatekeeper, and given this committee's role in sanctioning the Executive Budget Proposals (EBP), future and long-term infrastructure projects will only be approved if it fits into the larger policy and strategic visioning of the Government.

While the model could well improve the relevance and quality of infrastructure spending (and especially infrastructure spending for children), there are concerns about the extensive capacity requirements of the model and whether this model will be implemented at Provincial and Local Government level.[ix]

South Africa's results in the Open Budget Index (OBI) in 2017

South Africa continues to do well in international measures on the openness and transparency of its budget at national and provincial levels. The latest release of the Open Budget Index, South Africa achieved joint-first place ranking with New Zealand.[x] (Figure 13). Nonetheless, there are still opportunities for the Government to improve practices, such as:

- Providing more information on its financial position and elaborating on deviations between planned and actual revenue outcomes in year-end reports;
- Establishing platforms that will allow dialogue between members of the public and the Government during the budget implementation stage; and
- Pioneering a participatory auditing process based on the assumption that interested civil society partners may have excellent leads on the departments, sectors or themes to be probed for performance auditing.

FIGURE 13:
Evolution of South Africa's performance in the Open Budget Index, 2006 to 2017 | *Source: International Budget Partnership 2017 (https://www.internationalbudget.org/open-budget-survey/results-by-country/country-info/?country=za)*

TAKEAWAYS

- South Africa is the joint best performer in the world on budget transparency and has consolidated gains made since the first survey was done in 2006;
- The budget reform programme that was started in the early 1990s continues to lead in the world of budget openness and transparency, but South Africa needs to do more work on public participation and improving the engagement between the Executive and members of the public;
- Additional work needs to go into improving transparency and participation at the Local Government level where key basic services are delivered that affect the well-being of children; and
- A recent budget reform initiative, which aims to make future spending on infrastructure more relevant and quality-driven, is a welcome development that should accelerate the investment in child-focused infrastructure.

Key Events in the South African Parliamentary Calendar

2018

FEBRUARY

The introduction of the national budget via a joint sitting of the National Assembly (NA) and the National Council of Provinces (NCOP)

Public hearing on Fiscal Framework and Revenue Proposals and adoption of Fiscal Framework Report by the Standing Committees on Finance and Appropriations

MARCH

Provincial budgets are tabled in their respective provincial legislatures, 14 days after the tabling of the national budget in the National Assembly

National Treasury briefing on the 2018 Division of Revenue Bill

Public hearings on the 2018 Division of Revenue Bill and adoption of Appropriations Committee draft report on the Division of Revenue Bill

MAY

Consideration of final mandates on 2018 Division of Revenue Bill and adoption of Committee Report

MAY TO AUGUST
Appropriation Bill and Revenue Bills considered and passed

OCTOBER

Introduction of the Medium Term Budget Policy Statement (MTBPS), which updates the assumptions and forecasts in Budget 2018 and provides a glimpse into the Government's thinking on Budget 2019

NOVEMBER

Joint hearing by the Finance and Appropriations Committees in the NA and NCOP; The Finance Committees consider the fiscal and revenue frameworks, while the Appropriation Committees consider departmental and overall allocations

Portfolio Committees submit Budget Review and Recommendations Reports (BRRs)

Endnotes

i. Statistics South Africa (2018) '*Economic growth better than what many expected*' < http://www.statssa.gov.za/?p=10985> [accessed 12 March 2018].

ii. Data for the textbox were drawn from the United Nations Development Programme (UNDP), *Human Development Report 2016: Human Development for Everyone*, New York, UNDP, 2016 <http://hdr.undp.org/sites/default/files/2016_human_development_report.pdf> [accessed 15 August 2017]; poverty data were drawn from Statistics South Africa, *Poverty trends in South Africa: an examination of absolute poverty between 2006 and 2015*, Pretoria, Government Printers, 2017; population data were drawn from the official reports of the General Household Survey 2016: HIV prevalence rates were drawn from Statistics South Africa, *Mid-year population estimates 2017*, Pretoria, Government Printers, 2017.

iii. The MTSF report was downloaded from this address <http://www.gov.za/sites/www.gov.za/files/MTSF_2014-2019.pdf> [accessed 18 July 2017]; *The Presidency, The National Development Plan 2030: Our future-make it work*, Pretoria, Government Printers, 2011

iv. This includes further pilot funding for the National Health Insurance through the reductions on the tax credits of medical scheme contributions; monies set aide to address the implications of a recent court case about the adequacy of funding for Non-Profit Organisations that deliver welfare services; and financing efforts at curtailing violence against women and children.

v. Consolidated government spending includes provisions on the contingent reserve over the MTEF, allocations to public entities that are connected to departmental votes, but excludes debt service costs. This aggregate provides a more reliable indication of the total resources that are devoted to service delivery. This definition differs from our 2017 Budget series where we had excluded public entities from total consolidated government spending.

vi. OECD, *OECD Economic Surveys South Africa*, Paris, OCED Publishing, 2017

vii. '**Compensation of employees**' includes both a wage and a non-wage component (medical aid and other subsidies); '**Goods and services**' refers to all government payment in exchange for goods and services, but excluding those items used by Government for the construction and improvements to capital assets; '**Subsidies and other current transfers**' refers to non-repayable payments by Government for current purposes, i.e., payments for which no goods and services are received in return; '**Payment for capital assets**' includes the acquisition of fixed capital assets (assets that can be used continuously for at least one year), the acquisition of land and intangible assets (payment for purchase of land, forests, subsoil deposits, patents and leases) and capital transfers (non-repayable payments or transfers to enable recipient government entities to acquire capital assets etc.).

viii. Legally, these constitutional provisions find expression in the annual *Division of Revenue Bill/Act* that accompanies the main budget documentation at the start of the new financial cycle. The *Division of Revenue Bill/Act* is particularly helpful in listing in detail the conditions under which (conditional) grant funding should be used, including reporting requirements and the duration or life-span of the grant.

ix. Equal Education and Equal Education Law Centre (2018) *Joint Submission to the Standing Committee on Appropriations on the 2018 Division of Revenue Bill*, 09 March 2018

x. The International Budget Partnership (IBP, 2018): <https://www.internationalbudget.org/open-budget-survey/results-by-country/country-info/?country=za> [accessed February 2018]