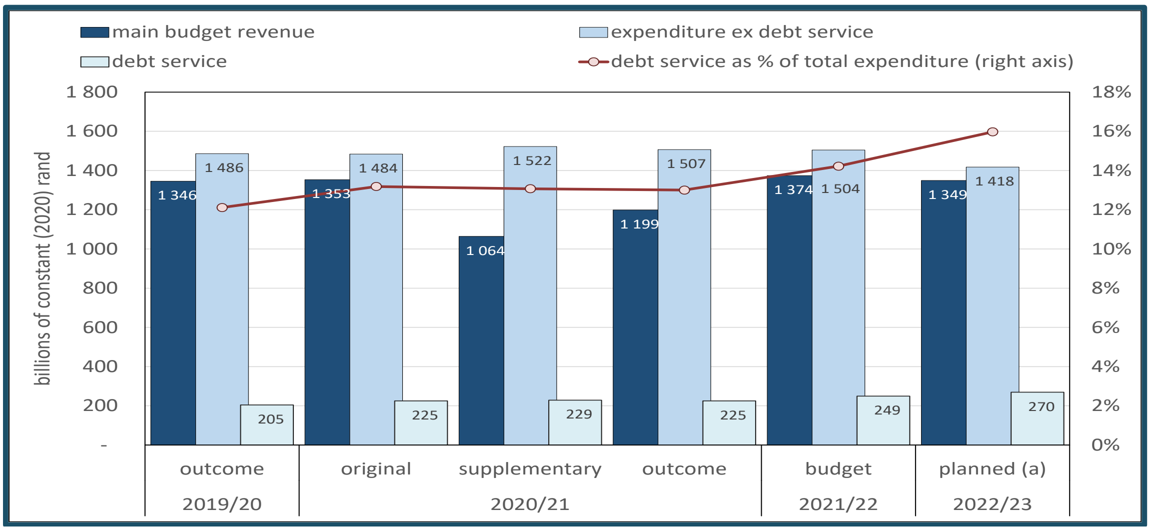
Briefing Note: Economic implications of the Medium Term Budget Policy Statement

At the start of the pandemic, the government took a conscious decision to maintain spending despite falling revenues in order to avoid further damage to the economy. That decision began to erode in 2021/22, and was fully reversed in the budget plans announced for 2022/3 in the Medium Term Budget Policy Statement (MTBPS). The resulting steep budget cuts are likely to prove a drag on growth. That said, as in 2020, the cuts rely on elimination of the COVID-19 Special Grant and a wage freeze for public servants. These measures are attractive for budget makers because they avoid fights over which programmes to eliminate or downsize. Experience in 2021 already showed, however, that because they place the burden of cuts squarely on critical parts of the electorate, they are unlikely to be carried out as currently designed.

Despite the renewed economic downturn in the third quarter 2021, South Africa aimed for a 7% cut in spending on programmes in 2022, as Treasury capped total spending and taxes while debt-service payments rose 8%. This approach mirrored a turn to austerity across Southern Africa, reflecting the comparatively weak position of middle-income economies on global financial markets compared to the Global North nations. They faced much stronger push back against rising spending – and soaring financing costs – as they grappled with the pandemic outcomes.

These realities leave South Africa with classic tough choices. The country can cut back on relief and investment programmes, which will fuel unrest and may block the economic recovery. Alternatively, the state could maintain spending in the face of escalating interest payments and pressure from multilateral institutions, ratings agencies and global pundits. Both paths involve substantial risks without promising easy solutions. In the event, as of late 2021 the government seemed inclined to go with pro-cyclical cuts in spending, despite the human and economic costs. Graph 20 shows the trend in spending in constant rand, including the plans announced for 2022/23. Since the population is growing almost 1.5% annually, spending would fall even more sharply in per-capita terms.

Graph 1. Planned main budget revenue, expenditure and debt service in constant (2020) rand (a), and debt service as a percentage of total expenditure, 2019/20 to 2022/23



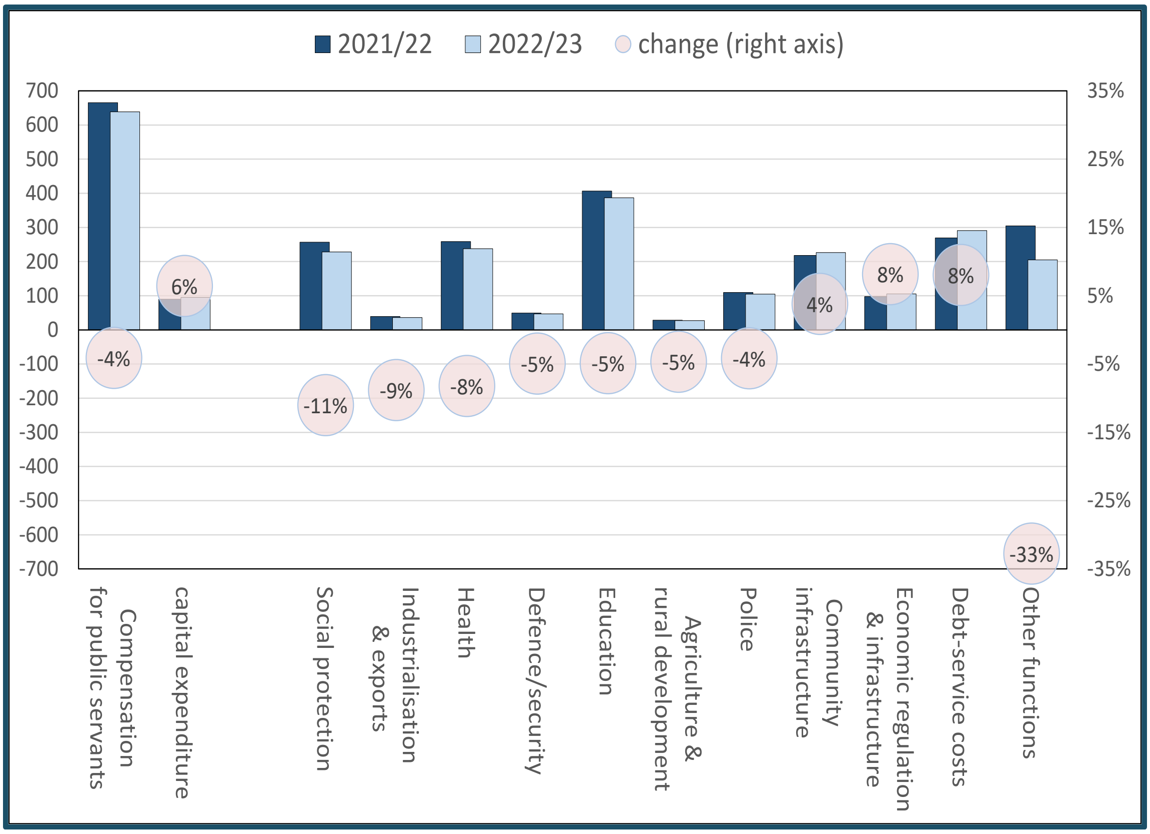
Note: (a) Deflated with CPI as estimated in budget documentation. *Source:* Calculated from Treasury. *Budget Review 2021* and *Medium Term Budget Statement* 2021. Data in excel spreadsheets. Accessed at www.treasury.gov.za in November 2021.

To fund the cuts, the Medium Term Budget Policy Statement (MTBPS) expected to end the COVID-19 Special Grant, leading to a 23% reduction in social grants in constant terms. This measure contributed two thirds of the anticipated reduction in government expenditure. The proposed wage freeze would reduce public servants' pay by 4% on average. In theory, that would permit a 5% cut in the budget for basic education, 8% for health and 7% for police without a similarly draconian cut in services.

In practice, it remained unclear if the state could actually enforce the proposed cuts. The government already reversed an effort to eliminate the COVID-19 Special Grant at the start of 2021 following the unrest in July. That uprising cost far more in lost growth, investment and incomes than the grants themselves. Similarly, the government did not implement the wage freeze for public servants proposed in the 2021/22 budget. Instead, it zeroed out the budgeted transfer to Infrastructure SA. This is a fairly common outcome of contentious austerity programmes. Public investment is usually project based, making it easier to cut than long-term service programmes that are linked to contractual employment agreements and community expectations.

The 2022/23 budget plan foresaw more targeted cuts for trade and industrial policy as well as for agriculture and land reform, as Graph 21 shows. The MTBPS does not publish estimates for departmental votes, but the projections by function foresaw a 9% cut in real terms to expenditure on industrialisation and export promotion, and 5% for agriculture and rural development. The decline in spending on industrial policy would obviously limit the scope for promoting economic reconstruction as the country recovers from the pandemic.

Graph 2. Spending plans by function in the 2021 MTBPS in constant rand terms (deflated by CPI)



Source: Calculated from National Treasury budget and MTBPS data.