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SUBMISSION FROM THE NATIONAL TREASURY TO THE COMMISSION OF ENQUIRY INTO HIGHER EDUCATION AND TRAINING

Please find attached the input from the National Treasury with respect to the feasibility of making higher education and training fee-free in South Africa.

Kind regards

pp Jdebruyn

Lungisa Fuzile
Director General
Date: 30/06/2016

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NATIONAL TREASURY INPUT TO THE COMMISSION OF ENQUIRY INTO HIGHER EDUCATION FUNDING

This submission covers the financial implications of a fee-free higher education in universities and TVET colleges and locates those financial implications within the broader research findings on the costing and financing the White Paper on Post School Education and Training.

THE FINANCIAL IMPLICATIONS OF A FEE-FREE HIGHER EDUCATION AND TRAINING IN UNIVERSITIES AND TVET COLLEGES

Between 2017 and 2030, assuming inflation growth in allocations for universities and TVET colleges to compensate for 'no fees' will require:

- R552.5 billion in additional funding for universities and
- R90.9 billion in additional funding for TVET colleges.

If the 'no fee' policy is to be implemented in the 2017 academic year, then over the 2017 Medium Term Expenditure Framework (MTEF) period (financial years 2017/18, 2018/19, 2019/20) an additional R90.5 billion will be required - R71 billion for universities and R19.5 billion for TVET colleges.

The 2017 MTEF is based on the fiscal consolidation measures articulated in Chapter 3 of the 2016 Budget Review (attached as Annexure A) released on Budget Day 24 February 2016.

Summary of the fiscal consolidation measures

In response to the deteriorating economic outlook and heightened risk of external shocks, the 2016 Budget sets a course of fiscal consolidation, proposing a sustainable budget deficit that will result in stabilising the growth of public debt. These steps restore the public finances to a sustainable path.

Over the medium term government will lower the expenditure ceiling, bolster tax revenues, actively manage fiscal risks emanating from state-owned companies and sharply restrict the growth of compensation budgets. This results in deficit targets of 3.2 per cent in 2016/17, 2.8 per cent in 2017/18, and 2.4 per cent for the following year. These targets will be achieved through the process of fiscal consolidation already initiated in the 2015 Budget. The 2015 Budget introduced consolidation measures amounting to R42 billion and in the 2016 Budget a further R73 billion in adjustments were proposed.

These included:

- Increased revenue through tax policy measures that raise an additional R18.1 billion in 2016/17, and R15 billion in each of the subsequent two years.
- A lowering of the expenditure ceiling by R10 billion in 2017/18 and R15 billion in 2018/19 by reducing compensation budgets.
- Reprioritisation amounting to R31.8 billion over the next three years to meet new spending needs, without increasing the total expenditure envelope.

These measures will ensure that over the medium term government's debt-to-GDP ratio will stabilise and begin to reduce. Net debt will stabilise at 46.2 per cent of GDP in 2017/18.

Impact of the 'no fee' policy

The additional R90.5 billion required to finance the "no-fee" policy over the 2017 MTEF would either have to be found through reprioritisation (which takes funding from other government departments), tax increases or through an increase in the budget deficit via increased borrowing (which impacts long term debt sustainability).

SUMMARY OF RESEARCH FINDINGS ON THE COSTING AND FINANCING THE WHITE PAPER ON POST SCHOOL EDUCATION AND TRAINING.

1. The financial implications of a 'no fee' policy for higher education and training should be viewed in the broader context of the overall plan for the post school education and training sector as outlined in the White Paper.
2. An Inter Departmental Task Team comprised of the National Treasury, the Department of Higher Education and Training, Department of Planning, Monitoring and Evaluation, and the Financial and Fiscal Commission as observers was set up in March 2015 to explore alternate funding options for the post-school education and training (PSET) sector, and estimate the likely costs and resource implications of implementing the PSET system as articulated in the White Paper. The full report will be sent to the Commission.
3. The National Development Plan (NDP) and the 2013 White Paper for PSET calls for the provision and expansion of the higher education sector as one of its objectives for improving skills development and training for inclusive economic growth. The proposals set out in the White Paper have far reaching implications for the country's public finance system, but it sets some ambitious targets for the system, both in relation to enrolment numbers and in relation to improving the quality of education. The White Paper was published without any formal estimate of its likely costs and resource implications.

Table 1: Summary of targets in the White Paper on PSET

Sector	Actual (Year)	Target (2030)	% increase
TVET colleges	702 000 (2014)	2 500 000	256%
Community colleges	265 000 (2011)	1 000 000	277%
University	937 000 (2014)	1 600 000	71%

STRUCTURE AND SIZE OF THE PSET SYSTEM

4. At the core of the PSET system are 26 public universities, 50 public TVET colleges spread over 260 campuses, and over 3 000 community colleges (previously known as Adult Learners Centres). Collectively, these institutions enrolled a total of about 1.9 million people in 2014. Sector Education and Training Authorities (SETAs) funded about 312 561 learners in 2014/15 across a wide range of programmes including learnerships, apprenticeships and skills programmes.
5. The DHET's policy directives, giving effect to the NDP, envisage the continued rapid expansion of the PSET system. The sector has expanded rapidly in recent years; the number of enrolees has increased significantly over the past 15 years: TVET College enrolees increased by 70% between 2010 and 2013 (from 360,000 to 640,000), with most of this increase accounted for by the expansion of NATED courses – post-school engineering and business courses. The number of university students rose by nearly 80% (from 560,000 to 980,000) between 2000 and 2013.
6. Fundamentally, the White Paper's targets change the structure of the PSET system; growing the share of enrolments in lower and mid-level qualifications compared to university-level qualifications. The share of enrolments in TVET colleges will therefore account for about half of all enrolments in the PSET system by 2030 whereas the proportion of university enrolments will decline from 50% in 2014 to 31% in 2030.

THE FUNDING AND EXPENDITURE OF PSET

7. In 2014/15, R76.3 billion (or 2% of GDP) was spent on the PSET system, with R53.5 billion having been appropriated through the budget. This figure may underestimate the total spending by government, as some of the expenditure by other departments and public entities on the PSET system cannot be easily identified. The remainder of expenditure in the PSET system came from student fees, earmarked payroll taxes (which fund the National Skills Fund and SETAs), and various other sources of "third stream" income (donations, consulting work, rental income, etc.), most of which goes to a handful of universities. In 2000, grants from government accounted for nearly 50% of all university income, a figure that had dropped to 40% by 2013. Over the same period, student fees rose from 24% of university income to 33%.

8. It is important to note that the increase in reliance on student fees does not mean that the full burden of the changing funding model has been passed onto households. This is because there has been considerable growth in the contribution made to university fees by the National Student Financial Aid Scheme (NSFAS). This rose from around R510 million in 2000 to just under R7 billion in 2014/15, an average annual rate of increase of over 20% per year. NSFAS loans now account for about 40% of student fees. Between 2010/11 and 2014/15, disbursements to universities from NSFAS doubled from R3.3 billion to R7 billion, at an annual average rate of 20%.

9. Between 2010 and 2014, the average annual increase in university fee income per student full-time equivalent (FTE) was 9.2%; above inflation. Therefore, although the policy decision to focus on NSFAS has increased access for the poor, the decrease in the state subsidy has likely resulted in higher fees for all students. As a result, university study has become more expensive for students who are not eligible for the NSFAS award; which is of particular concern for those in the so-called "missing middle". Many students from these "middle income" households obtain university places but get no financial assistance from the state.

10. Allocations to TVET colleges from the fiscus rose at an annual average rate of 9% between 2010/11 and 2015/16, from R4.4 billion to R6.2 billion. TVET colleges receive the majority of their funding through direct transfers from the Department of Higher Education and Training. Government also supports TVET colleges through student bursaries provided by the NSFAS and specific funding provided by the NSF and the SETAs. There has also been a substantial rise in NSFAS-sourced financing for TVET colleges, which increased nearly seven-fold in five years, from R300 million in 2010/11 to R2 billion in 2014/15. Despite this increase in government funding, it has not kept up with increases in enrolments over the same period.

11. The bulk of expenditure in the entire PSET system is on universities. Expenditure in the university sector amounted to R52.9 billion in 2014/15, or 71% of the total spend. Expenditure on the TVET sector and on community colleges accounted for about R8.5 billion (12% of total expenditure) and R1.7 billion (2% of total expenditure) in the same period, respectively.

12. A total of R13.8 billion was collected through the Skills Development Levy (SDL) in 2014/15. Of this amount 10% is spent on administration, 20% goes to the National Skills Fund (NSF), 50% is available for grants to be allocated to support skills development and projects in support of sector skills plan implementation whilst 20% goes to grants to employers for submission of training plans and reports to SETAs. The intention is that employers are incentivised to train their workers and to take part in the training of new entrants to the labour market, through participation in learnerships, apprenticeships or internships.

ESTIMATING THE COSTS OF IMPLEMENTING THE WHITE PAPER

13. As noted earlier, the 2013 White Paper on the PSET sector set ambitious targets for enrolment growth at institutions of higher learning (as shown in Table 1). In seeking to cost the implications of implementing the White Paper, the Interdepartmental Task Team modelled three different implementation plans.

    a. The *status quo* scenario estimates the cost of the PSET system if it expands to accommodate all the enrolment targets, but does not change in any other way (i.e. there is no change in the mix of enrolments by programme, throughput rates, size of classes, the mode of delivery, etc.)

    b. *Full policy scenario* estimates the cost of a PSET system that both expands to the size envisaged by the White Paper and undergoes significant transformation, with very different parameters for the mix of courses, delivery mechanisms, class sizes and throughput rates – changes that are intended to improve the quality of education and its relevance to the needs of the economy.

    c. A *mixed scenario* in which enrolments increase but at a slower pace, while other changes to the system seek to improve the mix of activities and the quality of teaching and learning.

Table 2: Summary of cost estimates under different scenarios (nominal terms)

(R'million)	2014	2030		
Sector	Current value	Status Quo *(Annual growth rate)*	Full Policy *(Annual growth rate)*	Mixed Scenario *(Annual growth rate)*
TVET colleges	8 720	70 301 *(14%)*	292 214 *(23%)*	107 943 *(17%)*
Universities	52 920	265 533 *(11%)*	334 264 *(13%)*	249 240 *(10%)*
Community Colleges	1 844	14 840 *(14%)*	26 761 *(19%)*	17 130 *(16%)*
Total*	**63 197**	**352 394 *(11%)***	**654 958 *(16%)***	**376 031 *(12%)***
Total costs as % of GDP	***1.7%***	***2.3%***	***4.4%***	***2.5%***

** Includes NSFAS and other institutions*

14. Key cost drivers in the university sector include enrolment numbers; higher number of lecturers with a PhD; increases in the number of students enrolled in PhD programmes; and a higher percentage of students housed in university residences. In TVET colleges, these are enrolment growth; improvements to the quality of current programmes; and changes to the mix (and duration) of training programmes. Current information shows community college inputs such as learning materials and lecturer, as the driving costs in the sector.

15. In order to estimate the gap between the above-mentioned costs of the PSET sectors (if the White Paper is implemented) and likely revenues, the following assumptions have been made:

    - Student fees rise at only the rate of inflation (average 6.2% a year)
    - All public subsidies, grants to the NSFAS, and revenues of SETA and the NSF rise at an average rate of 2.9% in real terms
    - Third stream income rises proportionately with the sum of student fees and subsidies
    - Government subsidies to NSFAS grow at 2.9% a year in real terms, although the number of students requiring assistance will grow more quickly than that.

Table 3: Summary of funding shortfall under the projected growth scenarios in PSET

(R'million) nominal	2030		
Sector	Status Quo	Full Policy	Mixed Scenario
TVET	-R14 266	-R232 199	-R73 373
Universities	-R47 010	-R100 071	-R42 426
Community Colleges	-R12 025	-R22 987	-R14 323
NSFAS	-R17 915	-R14 740	-R832
Total	**-R91 216**	**-R369 235**	**-R130 954**
Deficit as % of tax revenues	***2.3%***	***9.4%***	***3.3%***

16. In addition to the increased annual costs of delivering PSET to a much larger number of learners, the increase in enrolments will also require a substantial increase in infrastructure, both for classrooms, laboratories, workshops, and residential accommodation. Not only would infrastructure expansion carry high costs, but the rate of expansion might not be practically achievable. For instance, the increase in FTE students required in TVET colleges under the full policy scenario would mean that at least 15 to 20 additional campuses would need to be built per annum over the next 14 years if the average current campus size of 12 000 students is maintained and more if there is to be a TVET college in each district municipality. Similarly, it is unlikely that a sufficient number of skilled TVET college lecturers could be found and trained to accommodate such rapid growth within the White Paper time period.

Table 4: Infrastructure costs required for increased enrolments (nominal prices)

(R'm)	Total infrastructure spending between 2016 and 2030		
Sector	Status Quo	Full Policy	Mixed Scenario
TVET	R196 520	R589 498	R139 000
Universities	R52 764	R150 013	R70 579
Community Colleges	R0	R31 996	R7 085
Total	**R249 284**	**R771 506**	**R216 664**

PERFORMANCE AND THE FUTURE OF PSET

17. The purpose of the PSET system is not to only expand access by enrolling students, but to educate and train young people so they can get find productive employment. There is clear evidence that higher education does increase the likelihood of one's securing employment. The question is whether, and to what extent, the PSET system produces graduates efficiently. Measuring this is not straightforward, but a key indication of success is the extent to which enrolled students graduate and find gainful employment. Measured against this goal, indicators from South Africa's PSET sectors are demonstrating an inefficient post schooling system.

18. In the case of the universities, the positive effects of rising enrolments have been reinforced by rising graduation rates, increasing the system's efficiency and effectiveness. The number of graduates rose more than 25% faster than the number of enrolments, reaching over 180 000 in 2013 compared to 80 000 in 2000. According to the Council for Higher Education, 27% of undergraduates who entered universities in 2005 obtained their degrees in 2007; with an overall graduation rate of 51% of students who completed the qualifications six years after enrolment. For post-graduate degrees, five-years after enrolment, about 35% of Masters and PhD students had graduated.

19. In the TVET sector, low throughput rates is one of the biggest challenges faced. In 2013, the average throughput rate for the National Certificate Vocational (NCV) programmes was just 10.8%; for every ten students that enrol in an NCV course, only one will complete the course after six years. This clearly undermines the efficiency of the system and greatly increases the cost of producing graduates. It consequently costs, on average, R454 260 to produce a single NCV graduate. While NC(V) programmes were originally intended to be targeted to learners who have completed Grade 9 (NQF1), colleges increasingly accept and encourage enrolments from students who have completed higher qualifications; often in response to the difficulties experienced by learners with only Grade 9 in coping with the NC(V). This creates inefficient and expensive learning pathways for the education system as a whole since many learners are being funded first to complete their schooling to grade 11 or 12 and then funded again to complete the NCV from NQF level 2 through to level 4 (an equivalent of Matric).

FINANCING OPTIONS FOR CONSIDERATION

20. The White Paper for PSET seeks to increase enrolments to 5.1 million by 2030, effectively doubling the size of the system while improving the quality of training programmes. Modelling estimates from the work undertaken by the Interdepartmental Task Team reveal that about R652 billion will be needed for PSET in 2030 (or R249 billion in real 2014 prices); compared to total expenditure of R74 billion in 2014. Expenditure will consequently exceed funding available, leading to a shortfall of R333.2 billion in 2030. If we assume that the shortfall is financed solely through tax revenues and there are no increases in any other funding sources (such as fees or third stream income); Value-Added Tax (VAT) for example would need to increase by 4 percentage points, from 14 to 18 per cent, to meet this shortfall.

21. Funding the envisaged expansion and changes to the PSET system according to the White Paper will pose a major funding challenge for government. Options for consideration on how to address the estimated funding shortfall in the PSET system include the following:

    a. Reduce expenditure by:
       - improving inefficiencies;
       - reducing enrolment targets;
       - changing the mode of delivery; or
       - decreasing spending per capita.

    b. Increase funding to the PSET system by:
       - increasing the amount of state funding available through higher taxes; or
       - increasing non-state sources or accessing funding from alternative sources.

    c. Revisiting and reviewing the PSET policy targets. The modelling work shows that there are trade-offs between access and quality. If the levels of quality and throughput remain low, particularly in the TVET college sector, the benefits of rapidly increased enrolments to either students or the economy will be minimal.

22. If the entire shortfall in the system is to be funded through the fiscus, then the increase required in the next appropriations process, the 2017 MTEF period, could be anything from R157 billion to R293 billion.

	Addition to baseline (R'million)	% increase from existing baseline
Status Quo Scenario	R156 528	7%
Full Policy Scenario	*R293 432*	*100%*
Mixed Scenario	R226 584	55%

CONCLUDING REMARKS

23. The results of the exercise of costing the implementation of the White Paper on PSET have highlighted the ambition of the proposed expansion and changes to the PSET system. These include an envisaged PSET system in which the number of students enrolled in universities, TVET colleges and community colleges increases from 1.9 million in 2014 to over 5 million in 2030. If the far-reaching changes to the mix and quality of educational offerings proposed are also considered, it is estimated that full implementation would require a near tripling of spending in real terms. Unless there were equally substantial changes to projected revenue flows, this would leave a substantial deficit between the expected costs of the system and its expected revenues. This widens further when consideration is taken of the fact that there would also have to be an extensive expansion of infrastructure for all the PSET sectors.

24. While it is possible to argue that the rapid expansion of skills in the working population that would flow from the achievement of the goals of the White Paper might raise South Africa's growth rate, it seems doubtful that South Africa can afford to expand the PSET system as rapidly as the White Paper envisages. Indeed, the deficits estimated by the task team assume that economic growth will average nearly 3% a year between 2015 and 2030, a rate that is itself considerably faster than present growth rates.

25. Consideration should be given to amending or moderating the rate of growth in the PSET targets, which can then be used as the basis for planning and budget-making. Other considerations include focusing on raising throughput rates to lower the average cost of producing a graduate; increasing the size of classes (to reduce average costs of course delivery per student); increasing the quality of teaching and learning so as to increase pass rates; and focusing resources more intently on the school-to-university/TVET college transition (i.e. putting in place more effective bridging programmes).

26. In addition to focusing on increasing the efficiency of the PSET system, attention also needs to be on making the system of student loans currently built around NSFAS financially sustainable. One of the fundamental principles of the student funding scheme is to seek to place some of the burden for paying for tertiary education on the individuals who stand to benefit the most from that education, while allowing poor students to defer payment until they acquire the skills they seek. The current low repayment rate socialises the cost of these private gains and makes the financing of the system less sustainable.

27. Further research is required in planning for improved implementation of the White Paper on PSET. The drivers of university expenditure should be better understood. Before expanding occupational, higher certificates and other programmes at TVET colleges, a clear detailed picture of their costs is required. There is a need for an integrated funding model for technical and vocational programmes and more research and modelling are required around how fiscal funding and the Skills

Development Levy can be combined to enhance the delivery of certain training programmes.

28. The PSET system has become the focal point of student unrest in response to rising fees and unequal access. The enormity of the challenge in funding this system is reflected in the estimates produced by this report. Achieving the full policy scenario is unaffordable, and there are trade-offs between the ability of the state to expand the system while improving the quality of education and training. Hard decisions must be made if the PSET system is to contribute meaningfully to the growth and development of the country.

ANNEXURE A

3

Fiscal policy

In brief

- Given recent deterioration in the economic outlook, government proposes fiscal policy adjustments to reduce the budget deficit and stabilise debt. In line with these changes, projected deficits in each year of the forecast are lower than estimates set out in October 2015. A primary surplus will be achieved in 2016/17. Government is committed to achieving these targets and will take additional steps to do so as conditions warrant.
- The expenditure ceiling has been reduced by R25 billion over the next three years compared with the 2015 MTBPS. Tax adjustments will yield gross revenue increases of R48.1 billion over the next three years.
- National debt is projected to stabilise at 46.2 per cent of GDP in 2017/18 and to decline thereafter. Rising debt-service costs reflect the weaker exchange rate and higher interest rates.
- Risks to the fiscal outlook include below-projection GDP growth, increases in inflation-linked expenditure and the weak balance sheets of several state-owned entities. Government is actively managing these risks.

Overview

Fiscal policy adapts to deteriorating economic environment

In the four months since government presented the 2015 *Medium Term Budget Policy Statement* (MTBPS), the economic environment has deteriorated significantly, dragging down South Africa's GDP growth and revenue projections. Bond yields have increased markedly and the rand exchange rate has depreciated by 14 per cent against the US dollar. This deterioration is partly the consequence of a weakening global outlook. Falling commodity prices, increased risk aversion and rising interest rates in developed economies have led to an outflow of capital and a broad pattern of currency depreciation across developing countries.

The economic slowdown also reflects diminished confidence among South African consumers and businesses. Growth expectations have been further reduced by continued energy constraints. More recently, drought has curtailed agricultural output and increased food prices. Investors responded negatively to changes in the finance portfolio announced on 9 December last year, which prompted questions about South Africa's commitment to prudent fiscal management, raising the premium on government debt. At the same time, new public spending requirements have arisen in higher education and to provide drought relief.

Table 3.1 Macroeconomic performance and projections, 2012/13 – 2018/19

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Percentage change		**Actual**		**Estimate**		**Forecast**	
GDP at current prices (R billion)	**3 328**	**3 610**	**3 844**	**4 073**	**4 388**	**4 751**	**5 161**
Real GDP growth	2.1	2.2	1.6	0.9	1.2	1.9	2.5
GDP inflation	5.8	6.1	4.8	5.1	6.4	6.3	6.0
CPI inflation	5.6	5.8	5.6	5.4	6.6	6.2	5.9

Source: National Treasury

In December 2015, ratings agencies, citing poor economic growth prospects and other concerns, either downgraded South Africa's sovereign credit rating for foreign-currency debt or put the country on a negative outlook, raising the possibility of a downgrade to sub-investment grade status. The impact of such an event, if it were to occur, is difficult to predict. In a more benign scenario, a downgrade would probably lead to a short-term spike in interest rates and further weakening of the rand. In a less favourable scenario, it could trigger a sharp reversal of capital flows and precipitate a recession. In such an event, aggressive austerity measures would likely be required to restore the public finances to a sustainable position.

Since 2012, government has maintained core social and infrastructure programmes. However, sluggish economic growth has weighed heavily on revenue collection – constraining the very resources needed to close the budget deficit. The outlook for economic growth over the next three years is the lowest it has been since the medium-term expenditure framework (MTEF) was introduced in 1997. It appears that structural, rather than cyclical factors, are the primary cause of a protracted period of slower growth in South Africa and the world economy.

Fiscal proposals intended to pre-empt need for stronger action in future

These considerations have prompted government to propose additional revenue and expenditure measures over the medium term, pre-empting the need for stronger action in future.

Securing fiscal sustainability

The 2016 Budget proposals reinforce government's commitment to a prudent, sustainable fiscal policy trajectory, and respond actively to the changed circumstances since the tabling of the 2015 MTBPS.

Over the next three years, government will lower the expenditure ceiling, bolster tax revenues, actively manage fiscal risks emanating from state-owned companies and sharply restrict the growth of compensation budgets.

Deficit will close more rapidly than announced in 2015 MTBPS

As a result of these measures, the budget deficit will close more rapidly than announced at the time of the 2015 MTBPS. In 2016/17, for the first time since the 2009 recession, government will achieve a consolidated primary surplus: revenue will exceed non-interest spending. The budget deficit will fall from 3.2 per cent in 2016/17 to 2.8 per cent in 2017/18, and 2.4 per cent the following year.

Table 3.2 Consolidated fiscal framework, 2012/13 – 2018/19

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
		Outcome		Revised		Medium-term estimates	
R billion/percentage of GDP				estimate			
Revenue	907.6	1 008.1	1 100.0	1 223.1	1 324.3	1 436.7	1 571.6
	27.3%	*27.9%*	*28.6%*	*30.0%*	*30.2%*	*30.2%*	*30.4%*
Non-interest expenditure	950.1	1 034.5	1 116.5	1 245.6	1 308.9	1 403.4	1 509.6
	28.6%	*28.7%*	*29.0%*	*30.6%*	*29.8%*	*29.5%*	*29.2%*
Interest payments	93.3	109.6	121.2	135.3	154.3	168.7	185.6
	2.8%	*3.0%*	*3.2%*	*3.3%*	*3.5%*	*3.6%*	*3.6%*
Expenditure	1 043.4	1 144.1	1 237.7	1 380.9	1 463.3	1 572.1	1 695.2
	31.4%	*31.7%*	*32.2%*	*33.9%*	*33.3%*	*33.1%*	*32.8%*
Budget balance	**-135.9**	**-136.0**	**-137.8**	-157.9	**-139.0**	**-135.3**	**-123.6**
	-4.1%	*-3.8%*	*-3.6%*	*-3.9%*	*-3.2%*	*-2.8%*	*-2.4%*
Primary balance	**-42.6**	**-26.4**	**-16.6**	**-22.6**	**15.4**	**33.4**	**62.0**
	-1.3%	*-0.7%*	*-0.4%*	*-0.6%*	*0.4%*	*0.7%*	*1.2%*

Source: National Treasury

To achieve its fiscal goals, government proposes to:

- Increase revenue through tax policy measures that raise an additional R18.1 billion in 2016/17, and R15 billion in each of the subsequent two years.
- Lower the expenditure ceiling by R10 billion in 2017/18 and R15 billion in 2018/19 by reducing compensation budgets, complemented by measures to restrict hiring.
- Reprioritise R31.8 billion over the next three years to meet new spending needs, without increasing the total expenditure envelope.

Relative to projections contained in the 2015 MTBPS, these steps will lead to additional fiscal consolidation of R18 billion in 2016/17, R25 billion in 2017/18 and R30 billion in 2018/19. This adds to the R42 billion of consolidation measures (R25 billion in spending reductions and a R17 billion tax increase) announced in the 2015 Budget. The fiscal consolidation will see gross tax revenue increase by 1.5 percentage points of GDP and main budget non-interest expenditure (excluding the Eskom appropriation) fall by 0.5 percentage points of GDP between 2015/16 and 2018/19.

Budget proposes additional fiscal consolidation of R73 billion over medium term

Table 3.3 Consolidation measures, 2015/16 – 2018/19

R billion	2015/16	2016/17	2017/18	2018/19
2015 Budget Review				
Expenditure reductions	10	15		
Revenue increases	17			
2016 Budget Review				
Expenditure reductions			10	15
Revenue increases		18	15	15

Source: National Treasury

Government is committed to achieving its medium-term budget deficit targets and will take additional steps to fulfil this commitment as conditions warrant. Future budgets may alter the mix of revenue and expenditure measures proposed without reducing the overall size of the consolidation. For example, government could decide to moderate tax increases in favour of stronger spending reductions, or vice versa.

Additional steps will be taken to meet deficit targets, if necessary

Tax policy reforms to boost revenue

Budget proposes R48 billion increase in gross taxes over medium term

The 2016 Budget proposes tax increases of R48 billion over the next three years relative to the 2015 MTBPS estimates. In 2016/17, an additional R7.6 billion in revenue will be raised by limiting relief for the effects of inflation on personal income tax (fiscal drag). Increases in the fuel levy and specific excise duties will amount to R9.5 billion, while adjustments to capital gains tax and transfer duty raise R2 billion. Another R30 billion in revenue has been included in the baselines of the two outer years (R15 billion in 2017/18 and R15 billion in 2018/19), with details of tax policy proposals to be determined following consultation and review, and set out in subsequent budgets.

Lowering the expenditure ceiling

The 2016 Budget proposals reduce growth in baseline expenditure by R25 billion over the MTEF period compared with 2015 MTBPS estimates. These reductions – R10 billion in 2017/18 and R15 billion in 2018/19 – will be applied to the compensation budgets of national and provincial departments.

Table 3.4 Expenditure ceiling,[1] 2012/13 – 2018/19

R million	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
2013 Budget Review	864 658	942 000	1 015 718	1 092 747			
2014 Budget Review		935 071	1 014 222	1 091 253	1 168 284		
2015 Budget Review			1 006 905	1 081 214	1 152 833	1 250 086	
2015 MTBPS			1 001 789	1 077 527	1 152 833	1 250 086	1 354 422
2016 Budget Review			1 001 874	1 076 705	1 152 833	1 240 086	1 339 422

1. Non-interest spending financed from the National Revenue Fund, excluding skills development levy, special appropriations in 2015/16 for Eskom and New Development Bank, debt management and Gold and Foreign Exchange Contingency Reserve Account transactions

Source: National Treasury

New appointments subject to clear human resource plans aligned with lower budgets

To effect these measures, appointments to fill administrative and managerial vacancies will be blocked on government's payroll system starting in April 2016. The National Treasury, working with provincial treasuries and the Department of Public Service and Administration, will consider authorising appointments only after departments have submitted clear human resource plans aligned with reduced compensation budgets and greater efficiency. In many cases, these plans will need to trim employment of non-critical personnel, eliminate supernumerary positions and establish a sustainable level of authorised, funded posts that will be closely monitored in the years ahead.

Reprioritising for new spending needs

Service delivery to the poor has been protected from reductions

Government has responded to new spending needs without compromising expenditure limits. Care has been taken to avoid reducing budgets that would adversely affect service delivery to poor South Africans.

The 2016 Budget proposes to reprioritise spending amounting to R31.8 billion over the MTEF period to support higher education and South Africa's contributions to the New Development Bank. In addition, R3.5 billion of this amount will be added to the contingency reserve in 2016/17 in response to elevated macroeconomic risks. Additional allocations for small business development and performance monitoring have also been made. These allocations are funded by large reductions in budgets for non-essential goods and services in national departments, including travel, complemented by stronger cost-containment initiatives, and reforms to procurement and supply chain management.

Compensation budgets of departments with high vacancy rates have been significantly reduced, as have transfers to several national public entities. A commensurate share of the reprioritisation has been sourced from provincial and local government allocations. Where infrastructure programmes have persistently underspent, prudent cuts have been made.

Risks to the fiscal outlook

GDP growth, food inflation, energy prices and stability of state-owned companies are main risks to forecast

The main risks to government's fiscal consolidation plans are weaker-than-expected economic outcomes, inflation and the financial position of several state-owned entities:

- A weaker-than-expected economic growth performance in the outer years of the framework would reduce revenue growth, pushing out the year in which debt is to stabilise. Further increases in interest rates, combined with a weaker exchange rate and rising inflation, would raise the cost of borrowing and increase the stock of debt.
- Food inflation has increased and Eskom has approached the energy regulator for higher tariff increases. If these result in higher consumer price index inflation over the coming year, there will be upward pressure on inflation-linked expenditure, including compensation, social grants and free basic services.
- Several state-owned entities are in financial distress. The financial position of South African Airways has deteriorated since October 2015. In the event of default, government will likely be called on to pay a portion of its guarantee to the airline, which currently stands at about R14.4 billion.

Contingency measures may be necessary if risks materialise

If any of these risks were to materialise, government would need to consider contingency measures. In the event of slower growth or higher inflation, government may reprioritise spending, further reduce baseline allocations or defer new programmes. Government is working with state-owned companies facing financial difficulties to stabilise their balance sheets and implement realistic turnaround plans (see Chapter 8).

Fiscal framework

Consolidated deficit for 2015/16 in line with 2015 MTBPS projections

At 3.9 per cent of GDP, the consolidated deficit in 2015/16 is broadly in line with the 2015 MTBPS estimate. Deficit estimates for the outer years of the framework improve on average by about 0.4 per cent of GDP compared with the October 2015 projection, as a result of tax policy proposals and reductions in spending. Excluding the R23 billion Eskom appropriation announced in the 2015 Budget, consolidated non-interest expenditure will grow at an annual average rate of 7.3 per cent over the next three years. Current transfers and subsidies are expected to grow on average by 6.8 per cent over the next three years, mainly reflecting inflation-related increases to social grants. Goods and services budgets grow by 6.9 per cent over the same period.

Compensation stable at 35 per cent of total spending

Compensation as a share of total spending is projected to remain at about 35 per cent between 2015/16 and 2018/19. After taking account of reprioritisation, the wage agreement and proposed reductions in national and provincial compensation, the consolidated wage bill is expected to grow at a nominal annual average of 7.4 per cent over the MTEF period.

Table 3.5 Consolidated operating and capital accounts, 2012/13 – 2018/19

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
		Outcome		Revised estimate		Medium-term estimates	
R billion							
OPERATING ACCOUNT							
Current revenue	**892.2**	**992.9**	**1 083.3**	**1 181.2**	**1 310.5**	**1 431.1**	**1 567.2**
Current payments	**919.6**	**1 006.5**	**1 086.0**	**1 188.3**	**1 283.0**	**1 377.5**	**1 481.5**
Compensation	376.3	408.2	437.0	476.8	516.8	551.5	590.9
Goods and services	162.9	174.2	187.5	193.7	204.7	221.9	236.6
Interest payments	93.3	109.6	121.2	135.3	154.3	168.7	185.6
Current transfers and subsidies	287.1	314.6	340.2	382.5	407.2	435.4	468.4
Current balance	**-27.5**	**-13.7**	**-2.7**	**-7.1**	**27.4**	**53.6**	**85.7**
Percentage of GDP	*-0.8%*	*-0.4%*	*-0.1%*	*-0.2%*	*0.6%*	*1.1%*	*1.7%*
CAPITAL ACCOUNT							
Capital receipts	0.3	0.2	1.3	0.2	0.1	0.1	0.1
Capital payments	66.3	75.8	86.4	97.9	100.4	105.6	110.5
Capital transfers	52.4	57.5	59.7	65.1	68.7	73.9	83.2
Capital financing requirement	**-118.4**	**-133.1**	**-144.8**	**-162.8**	**-168.9**	**-179.3**	**-193.5**
Percentage of GDP	*-3.6%*	*-3.7%*	*-3.8%*	*-4.0%*	*-3.8%*	*-3.8%*	*-3.7%*
Financial transactions[1]	10.0	10.8	9.7	12.0	8.5	0.4	-0.8
Contingency reserve	–	–	–	–	6.0	10.0	15.0
Budget balance	**-135.9**	**-136.0**	**-137.8**	**-157.9**	**-139.0**	**-135.3**	**-123.6**
Percentage of GDP	*-4.1%*	*-3.8%*	*-3.6%*	*-3.9%*	*-3.2%*	*-2.8%*	*-2.4%*

1. Transactions in financial assets and liabilities

Source: National Treasury

Capital-financing requirement remains broadly unchanged at 3.8 per cent of GDP over MTEF period

Nominal growth in capital payments declines from 16 per cent in 2015/16 to an annual average of 4.1 per cent over the medium term, as funds allocated to underspending capital grants are reallocated to priority areas. Capital transfers grow by a nominal annual average of 8.5 per cent, reflecting funding for local government infrastructure. The capital-financing requirement as a share of GDP will remain broadly unchanged, at about 3.8 per cent over the three-year spending period. This reflects relatively strong growth in capital spending by the South African National Roads Agency Limited and the Passenger Rail Agency of South Africa, financed in part by drawdowns on their reserves.

From 2016/17 onwards, government will close its current deficit

From 2016/17 onwards, government will close its current deficit – the difference between current revenue and spending on compensation, goods and services, interest, and current transfers and subsidies. The resultant savings are expected to reach 1.7 per cent of GDP in 2018/19, equivalent to 44 per cent of government's budgeted capital spending.

Elements of the consolidated budget

The consolidated budget includes the main budget as well as spending by provinces, public entities and social security funds financed from their own revenue.

Main budget framework

The main budget framework summarises spending financed by revenue and borrowing deposited into the National Revenue Fund. The main budget deficit, which is government's borrowing requirement, will be 4.2 per cent of GDP in 2015/16, declining to 2.9 per cent in the outer year. The main budget primary deficit – the difference between revenue and non-interest spending – is projected to narrow, reaching a surplus in 2017/18.

Main budget primary surplus expected in 2017/18

Table 3.6 Main budget framework, 2012/13 – 2018/19

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
	Outcome			Revised estimate	Medium-term estimates		
R billion/percentage of GDP							
Revenue							
Gross tax revenue after proposals	813.8	900.0	986.3	1 069.7	1 174.8	1 296.5	1 434.7
Non-tax revenue	16.2	18.9	18.3	41.7	14.5	15.1	14.4
SACU[1]	-42.2	-43.4	-51.7	-51.0	-39.4	-51.1	-63.0
National Revenue Fund receipts[2]	12.3	11.7	12.6	14.2	12.2	3.8	2.5
Main budget revenue	**800.1**	**887.3**	**965.5**	**1 074.5**	**1 162.0**	**1 264.3**	**1 388.7**
	24.0%	*24.6%*	*25.1%*	*26.4%*	*26.5%*	*26.6%*	*26.9%*
Expenditure							
National departments	420.2	453.4	490.0	546.8	559.8	594.1	637.8
Provinces	380.9	410.6	439.5	471.8	499.8	542.3	582.9
Local government	76.2	82.6	87.7	99.7	104.9	113.3	125.8
Non-interest allocations	**877.4**	**946.6**	**1 017.2**	**1 118.2**	**1 164.6**	**1 249.8**	**1 346.5**
Debt-service costs	88.1	101.2	114.8	129.1	147.7	161.9	178.6
Contingency reserve	–	–	–	–	6.0	10.0	15.0
Main budget expenditure	**965.5**	**1 047.8**	**1 132.0**	**1 247.3**	**1 318.3**	**1 421.7**	**1 540.0**
	29.0%	*29.0%*	*29.5%*	*30.6%*	*30.0%*	*29.9%*	*29.8%*
Main budget balance	**-165.4**	**-160.5**	**-166.6**	**-172.8**	**-156.3**	**-157.4**	**-151.3**
	-5.0%	*-4.4%*	*-4.3%*	*-4.2%*	*-3.6%*	*-3.3%*	*-2.9%*
Primary balance	**-77.2**	**-59.3**	**-51.8**	**-43.7**	**-8.6**	**4.5**	**27.2**
	-2.3%	*-1.6%*	*-1.3%*	*-1.1%*	*-0.2%*	*0.1%*	*0.5%*

1. Southern African Customs Union. Amount made up of payments and other adjustments
2. Previously classified as extraordinary receipts
Source: National Treasury

As a result of weaker GDP growth, a tax revenue shortfall of R4 billion is projected for 2015/16 compared with 2015 MTBPS projections. This reflects under-collections in personal income tax (R4 billion), value-added tax (R2.4 billion) and dividend withholding tax (R1.4 billion), partially offset by the strong performance of customs duties (R3.2 billion above projections) and marginally higher corporate income tax.

Tax revenue shortfall of R4 billion projected for 2015/16 compared to 2015 MTBPS

In addition, the recent depreciation of the rand has improved anticipated receipts from financial transactions, which includes revaluation profits on government's foreign exchange deposits at the Reserve Bank. When used to meet government's foreign-currency commitments, these revaluations generate additional cash receipts into the National Revenue Fund. This revenue source has been revised up by R6 billion in the current year, and by R7.3 billion over the MTEF period. Upward revisions to gross tax and National Revenue Fund receipts are partially offset by higher payments to

Southern African Customs Union members as a result of better-than-expected customs duty receipts.

Non-interest spending to decline to 26.4 per cent of GDP in 2018/19

In real terms, non-interest expenditure (excluding the Eskom appropriation) will grow by 2.2 per cent in 2015/16 and by 0.2 per cent in 2016/17. As a share of GDP, non-interest spending declines to 26.4 per cent in 2018/19 from 26.9 per cent in the current fiscal year.

Table 3.8 details the changes to main budget revenue and expenditure estimates since Budget 2015. For 2015/16, the disposal of Vodacom shares and subsequent allocation to Eskom is reflected in revised non-tax revenue receipts and payments for financial assets. In 2016/17, total expenditure has been revised up due to higher debt-service costs and the skills development levy. Payments for capital assets have been revised down in 2016/17 and 2017/18, reflecting the reprioritisation of underspending capital grants towards other priority areas.

Table 3.7 Revisions to main budget revenue and expenditure estimates, 2015/16 – 2017/18

	2015/16		2016/17		2017/18	
R billion/percentage of GDP	**2015 Budget**	**2016 Budget**	**2015 Budget**	**2016 Budget**	**2015 Budget**	**2016 Budget**
Revenue						
Gross tax revenue	1 081.3	1 069.7	1 179.2	1 174.8	1 289.7	1 296.5
Non-tax revenue	17.0	41.7	17.9	14.5	18.6	15.1
SACU[1]	-51.0	-51.0	-36.5	-39.4	-45.4	-51.1
National Revenue Fund receipts	2.0	14.2	5.4	12.2	2.5	3.8
Main budget revenue	**1 049.3**	**1 074.5**	**1 166.0**	**1 162.0**	**1 265.4**	**1 264.3**
Percentage of GDP	*25.0%*	*26.4%*	*25.7%*	*26.5%*	*25.7%*	*26.6%*
Expenditure						
Current payments	324.1	327.4	351.5	359.7	376.0	383.7
of which:						
Compensation of employees	*137.6*	*137.1*	*146.6*	*148.5*	*155.1*	*154.8*
Goods and services	*60.1*	*61.1*	*64.0*	*63.3*	*67.5*	*66.8*
Debt-service costs	*126.4*	*129.1*	*141.0*	*147.7*	*153.4*	*161.9*
Transfers and subsidies	873.0	874.0	925.6	933.0	980.1	1 009.5
Payments for capital assets	16.7	16.4	17.4	14.4	19.3	13.0
Payments for financial assets	3.5	29.5	0.3	5.0	0.4	5.0
Provisional allocation not assigned to votes	–	–	–	0.3	–	0.5
Contingency reserve	5.0	–	15.0	6.0	45.0	10.0
Total expenditure	**1 222.3**	**1 247.3**	**1 309.9**	**1 318.3**	**1 420.8**	**1 421.7**
Percentage of GDP	*29.2%*	*30.6%*	*28.9%*	*30.0%*	*28.8%*	*29.9%*

1. Southern African Customs Union. Amounts made up of payments and other adjustments
Source: National Treasury

Exchange rate depreciation and rising interest rates have increased the medium-term forecast of debt-service costs. In total, debt-service costs are revised up by R18 billion from 2015/16 to 2017/18. As a ratio of GDP, debt-service costs increase from 3.2 per cent in the current year to 3.5 per cent in the outer year.

Table 3.8 National government debt-service costs, 2014/15 – 2018/19

	2014/15	2015/16	2016/17	2017/18	2018/19
R million	**Outcome**	**Revised**		**Medium-term estimates**	
Domestic loans	106 522	118 596	134 175	148 103	164 057
Short-term	14 743	16 242	19 674	23 607	26 425
Long-term	91 779	102 354	114 501	124 496	137 632
Foreign loans	8 276	10 515	13 545	13 824	14 499
Total	**114 798**	**129 111**	**147 720**	**161 927**	**178 556**
As percentage of:					
GDP	*3.0*	*3.2*	*3.4*	*3.4*	*3.5*
Expenditure	*10.1*	*10.4*	*11.2*	*11.4*	*11.6*
Revenue	*11.9*	*12.0*	*12.7*	*12.8*	*12.9*

Source: National Treasury

Social security funds, public entities and provincial balances

The social security funds, provinces and public entities have a combined cash surplus over the medium term, which partially offsets the main budget deficit. In aggregate, social security funds continue to generate a large cash surplus, increasing from R19 billion in the current fiscal year to R26 billion in 2018/19. Compared with the 2015 Budget, the Unemployment Insurance Fund has revised up its 2015/16 surplus by R12 billion, while the Compensation Fund has revised down its revenue projections by about R5 billion in each year from 2015/16 to 2017/18.

Table 3.9 Consolidated budget balance, 2012/13 – 2018/19

R billion	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Main budget	-165.4	-160.5	-166.6	-172.8	-156.3	-157.4	-151.3
Social security funds	17.8	13.5	15.8	19.2	20.6	23.4	25.9
Provinces	6.5	4.3	6.2	-0.4	-1.0	0.3	0.6
Public entities	5.3	6.2	6.3	-3.5	-1.0	-0.3	2.5
RDP Fund[1]	-0.1	0.6	0.5	-0.5	-1.2	-1.3	-1.3
Consolidated budget balance	**-135.9**	**-136.0**	**-137.8**	**-157.9**	**-139.0**	**-135.3**	**-123.6**

1. Reconstruction and Development Programme Fund
Source: National Treasury

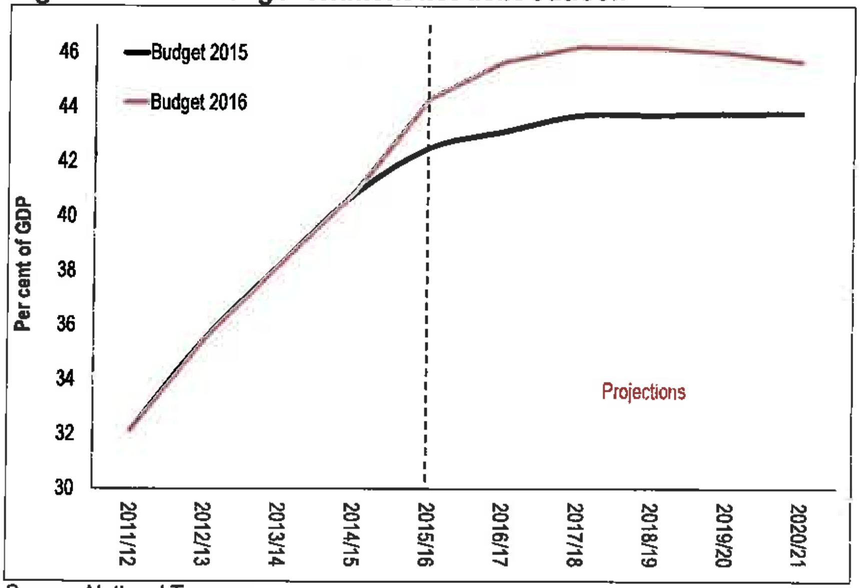
As a result of the 2015 public-sector wage agreement, projections of provincial surpluses have been reduced sharply compared with the 2015 Budget. Some provinces will draw on accumulated reserves, running a deficit in 2015/16 and 2016/17. Surpluses projected for public entities in October 2015 have been lowered by R3 billion in 2015/16 and R4 billion over the MTEF period, mainly due to higher projected infrastructure spending and lower transfers from government.

Debt outlook

Consolidation stabilises government's debt-to-GDP ratio

Over the medium term, the proposed consolidation will stabilise and begin to reduce government's debt-to-GDP ratio. The depreciation of the rand, however, has increased the stock of foreign debt by an estimated R45 billion in 2015/16. This increase, combined with lower nominal GDP, results in net debt stabilising at 46.2 per cent of GDP in 2017/18. At the time of the 2015 MTBPS, net debt was projected to stabilise at 45.7 per cent of GDP in 2019/20.

Figure 3.1 National government net debt outlook



Source: National Treasury

Public-sector borrowing

Public-sector borrowing requirement will be R254.6 billion in 2015/16

The public-sector borrowing requirement will be R254.6 billion or 6.2 per cent of GDP in 2015/16, broadly unchanged from the 2015 Budget estimate. In 2018/19, the borrowing requirement narrows to 3.9 per cent of GDP, reflecting the main budget consolidation and lower borrowing by state-owned companies. Total public-sector debt – gross government debt, non-financial state-owned companies and local government – was 61.9 per cent of GDP in 2014/15. Public-sector debt accumulation will slow, in line with the narrowing of the consolidated deficit and revisions to the borrowing plans of state-owned companies.

Table 3.10 Public-sector borrowing requirement,[1] 2012/13 – 2018/19

	2012/13	2013/14	2014/15	2015/16		2016/17	2017/18	2018/19
		Outcome		Budget	Budget		Medium-term estimates	
R billion/percentage of GDP				2015	2016			
Main budget	165.4	160.5	166.6	173.1	172.8	156.3	157.4	151.3
Social security funds	-17.8	-13.5	-15.8	-11.6	-19.2	-20.6	-23.4	-25.9
Provinces	-6.5	-4.3	-6.2	-0.2	0.4	1.0	-0.3	-0.6
Public entities	-5.3	-6.2	-6.3	0.3	3.5	1.0	0.3	-2.5
RDP Fund[2]	0.1	-0.6	-0.5	0.6	0.5	1.2	1.3	1.3
Consolidated government	**135.9**	**136.0**	**137.8**	**162.2**	**157.9**	**139.0**	**135.3**	**123.6**
	4.1%	*3.8%*	*3.6%*	*3.9%*	*3.9%*	*3.2%*	*2.8%*	*2.4%*
Local authorities	**7.3**	**7.8**	**9.0**	**9.5**	**9.5**	**9.8**	**10.0**	**10.9**
	0.2%	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*
State-owned companies[3]	**58.3**	**56.7**	**78.7**	**83.8**	**87.2**	**72.9**	**83.5**	**67.1**
	1.8%	*1.6%*	*2.0%*	*2.0%*	*2.1%*	*1.7%*	*1.8%*	*1.3%*
Borrowing requirement	**201.5**	**200.4**	**225.6**	**255.4**	**254.6**	**221.6**	**228.8**	**201.6**
	6.1%	*5.6%*	*5.9%*	*6.1%*	*6.2%*	*5.1%*	*4.8%*	*3.9%*

1. A negative number indicates a surplus and a positive number a deficit

2. Reconstruction and Development Programme Fund

3. SANRAL and Trans-Caledon Tunnel Authority are included as public entities under consolidated government borrowing

Source: National Treasury