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Budget 3.0: Slower growth, higher debt, less expenditure, more work ahead

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South Africa's finance minister tabled a Budget on 21 May with the support of the Government of National Unity partners. VAT will remain at 15 per cent and Cabinet is agreed that reviews of expenditure should be intensified. The revised budget protects frontline services though several provisional spending proposals have been withdrawn. But the problems of sluggish growth and high debt levels remain. Substantial spending cuts will be needed if the Treasury's fiscal consolidation goals are to be achieved. More rapid growth will require far-reaching structural and fiscal reforms.

Background to the May 2025 Budget

The Treasury's February budget proposals were rejected before being tabled in Parliament. A revised budget in March saw the "fiscal framework" adopted by the National Assembly, but the minister subsequently withdrew both the revenue and appropriation bills in the face of political and legal challenges. Never before has South Africa's budget been through three iterations before parliamentary endorsement.

The initial 2-percentage-point VAT increase was proposed to reverse the rising debt-GDP ratio while accommodating planned spending increases in a context of slow economic growth. Political opposition to the VAT proposal was broad-based, including opposition parties and substantial factions within the ANC. There is no change to VAT in the revised budget, and the accompanying extension of VAT zero-rating to several basic foodstuffs has also been dropped. It remains to be seen whether the alternative revenue and spending adjustments will be sufficient to achieve the Treasury's primary fiscal objective, which is to ensure that the debt-GDP ratio peaks this year and declines thereafter.

The macroeconomic context

Since the initial budget proposals in February, the macroeconomic outlook has deteriorated.

In the 2024 Budget, growth for that year was projected at 1.3%. By February the Treasury's estimate was 0.8%. The outcome reported in the latest GDP statistics is 0.6%. GDP inflation also came in below expectations, and overall *nominal growth* in GDP last year was just 4.4%, down from 7.1% and 5.5% in 2022 and 2023 respectively. Gross fixed capital formation declined by 3.7% in 2024, and in real (inflation-adjusted) terms is still 9% below levels of investment achieved fifteen years ago.

In February the Treasury's growth projection for 2025 was 1.9% – this has now been revised down to 1.4% and forward estimates for 2026 and 2027 have also been reduced. The nominal GDP estimate for 2025/26 is now R7,872 billion, down from R7,999 billion projected in February, a reduction of 1.6%.

This has consequences for tax revenue. The estimate of revenue in 2025/26 *before tax proposals* has been reduced by R10.5 billion since February. This is a reduction of just 0.5%, indicating somewhat more optimistic assumptions about tax buoyancy.

But the Treasury's GDP projections are now higher than those of several other analysts, both for real growth and GDP inflation. A recovery in investment spending is anticipated, but it is hard to see where the impulse for this will emerge. Both gross domestic expenditure and exports declined in 2024, and both business and consumer confidence remain depressed.

If the problems were cyclical, this would call for an expansionary fiscal stance. But there has been slow economic growth and a structural budget imbalance for the past decade, debt has increased to 75% of GDP, and debt service costs are now crowding out other spending priorities. Partly because investment has been so low for so long, it is now widely accepted that South Africa's GDP growth is *structurally* constrained to 1-1.5% a year for the foreseeable future.

On tax

The minister's initial VAT proposal would have raised about R60 billion in 2025/26 in additional revenue. It was accompanied by personal income tax (PIT) relief to largely offset the fiscal drag effects of inflation, and no adjustment to the fuel levy, equivalent to about R4 billion in real tax relief. The overall impact would have been an increase in the tax burden equivalent to nearly 1% of GDP, effected through a rise in consumer prices and therefore a real decline in household buying power.

In the revised tax proposals of 12 March, VAT was proposed to increase from 15% to 15.5% in May this year and by a further 0.5% in April 2026. The proposed personal income tax relief was dropped, so for the second year in a row there would be no change to the PIT thresholds and rebates or to medical tax credits.

In the May budget, there is no VAT increase, there is no personal income tax relief and an additional R4 billion is raised through inflation-related adjustments to the general fuel tax.

Personal income tax and VAT are the two largest sources of tax revenue. Whereas the VAT rate has been adjusted just once since 1993 – it was increased from 14% to 15% in 2018 – the effective PIT tax burden changes every year because of threshold and other adjustments. The impact on households of these adjustments is perhaps less obvious than the impact of a VAT change, and so fiscal drag is sometimes referred to as a "stealth tax".

Since 2014, the average rates of personal income tax have increased by about 3 percentage points for most taxpayers, calculated for constant price (CPI-adjusted) income cohorts. This has mainly been the result of below-inflation threshold adjustments, and the addition of a 45% bracket in 2016/17. The lower tax threshold (currently R95,750 per annum) has declined by about 20% in real terms, bringing about 850,000 additional individuals into tax-paying brackets. In effect, over the past decade, the personal income tax burden has increased by substantially more than the Treasury's initial proposed 2 percentage point increase in VAT – though the PIT adjustments have taken effect more gradually and do not affect those below the tax threshold.

It is clear, however, that the increase in the PIT burden since 2014, through its effect on disposable household income, has in part been offset by reduced revenue from VAT and other consumption taxes and from corporate income.

This is likely to happen again in 2025/26. Consumer demand will be held back by depressed after-tax income of households and the fuel levy increase, dragging down GDP growth, real incomes and tax revenue.

The May budget acknowledges that its tax projections are insufficient to narrow the budget deficit further in 2026/27, and so a further tax increase of R20 billion is signalled next year, without specifying its form. An additional R7.5 billion over the next three years has been allocated to SARS and the hope is that this will enable R20-R50 billion a year in tax debt to be collected, offsetting the need for higher tax rates. This may or may not be realistic.

There is political momentum behind the idea of a wealth tax. But administratively, this is wishful thinking – wealth is extraordinarily difficult to define for tax purposes. And wealth is internationally mobile, so even the perception that it is a target of tax reform inhibits investment and erodes the income tax base. A better strategy is to strengthen SARS's capacity to counter tax evasion and collect what is due.

Within the consolidated budget framework, there may be scope for strengthening revenue from non-tax sources – water tariffs, road tolls, research council contracts, provincial hospital fees, gambling levies, traffic fees and license charges – but these are not major sources of revenue.

So the focus must increasingly fall on the spending side of the budget. At this stage, this appears to be a welcome point of agreement between parties in the GNU.

Consolidated expenditure

Despite the slowdown in economic growth, between the February 2024 Budget and February 2025, R253 billion was added to non-interest spending plans, or a net increase of R173 billion after drawdowns on provisional allocations and contingency reserves.

In addition to adjustments for higher personnel costs, the original (February) 2025 Budget proposal added additional funding for infrastructure investment, early retirement costs, education, health and other "frontline" services, social grants, employment programmes, and modernisation of SARS and Home Affairs.

The net increase in non-interest spending was reduced to R142 billion in the March budget and then reduced further to R74 billion in the May budget, of which R43.5 billion is in the 2025/26 year.

The main problem on the spending side of the budget is that a 5.5% increase had already been agreed for public service salaries in 2025/26, over 1 percentage point higher than nominal growth last year and more than 2 percentage points higher than the current consumer price inflation rate.

The "front-line" health and education services funded by provinces are currently experiencing considerable financial stress. Insufficient funds for personnel, equipment and maintenance of facilities are in large measure a consequence of salary increases and staffing requirements that have exceeded available funds during recent fiscal consolidation years. The consolidated budget for the "social wage" continues to be prioritised in Treasury's budget plans, but it has been over-stretched in recent years by additional allocations for student financial aid, the social relief of distress grant, early childhood development, and new employment programmes.

The changes in spending plans between February and May 2025 were as follows:

- An increase in allocations to SARS of R2 billion in 2025/26 and a total of R4 billion over the three-year MTEF,
- Reduced inflation-related adjustments to social grants amounting to savings of R21.7 billion over the MTEF,
- Revised allocations to Defence to take account of the early withdrawal from the DRC, comprising an increase in 2025/26 of R1.2 billion and a reduction of R3.2 billion over the next two years, and a further R6.8 billion reduction over the MTEF in provisional allocations for defence personnel costs,
- A reduction in provision for early retirement costs from R11 billion over 2025/26 and 2026/27 to R5.5 billion,
- Removal of provisional allocations for employment programmes amounting to R15.2 billion over 2026/27 and 2027/28,
- Removal of provision for disaster management infrastructure allocations amounting to R4 billion over the MTEF,
- A reduction from R19.2 billion to R12.3 billion in provisional infrastructure allocations to PRASA,
- R2 billion reduction over the MTEF in provisional infrastructure allocations to metros,
- R9.5 billion reduction in provisional allocations to education,
- R8.2 billion reduction in provisional allocations to health services,
- Removal of R2.6 billion in provisional allocations to Correctional Services,
- R7.2 billion reduction in provisional allocations to Home Affairs for digitisation and human resources.

Non-interest expenditure allocations were reduced between February and May by a total of R87.6 billion, or about 1.5%, mainly in provisional amounts. It seems likely, however, that at least some of these allocations, including personnel-related costs in frontline services and defence, modernisation of home affairs services and provision for employment programmes, will need to be reinstated in the adjustments budget or in future years.

Over the MTEF period debt service costs were revised up by about R1 billion and the contingency reserve was reduced by R11.4 billion. There is now little room for disaster-related or other unanticipated spending needs.

It is notable that there were no changes made to the proposed allocations to provinces or municipalities, other than amounts tagged as provisional and therefore not included in the tabled Division of Revenue Act. No specific adjustments have yet been made for the withdrawal of USAid funding of health services.

There have also been no changes to the spending plans of extra-budgetary accounts and public entities, other than the additional funding proposed for SARS and the reduction in provisional allocations to PRASA. And yet the largest spending increases in this year’s budget are in extra-budgetary entities that are not directly controlled by either Treasury or parliamentary appropriations. National main budget expenditure in 2025/26 increases by 2.4% compared with the 2024 Budget forward estimate for the same year. But additional spending attributed to provinces, social security funds, and public entities increases by a staggering 24.2%, or R52.1 billion.[1]

[1] Annexure F of the May 2025 revised *Budget Review*, Summary of the consolidated budget: expenditure of provinces, social security funds and public entities (after netting off receipts from the main budget) in 2025/26 – R267 952 million, by comparison with the 2024 Budget Review Annexure F forward estimate for 2025/26 of R215 820 million.

In effect, the Treasury's efforts to contain expenditure growth and stabilise debt has been undermined by unexpectedly large increases in spending of extra-budgetary funds and entities, drawing on accumulated reserves, off-budget borrowing or non-tax revenue.

These uncontrolled spending trends range across many entities and various categories of expenditure. Notable trends include:

- Board remuneration and executive salaries that often substantially exceed remuneration levels in the regulated public service,
- Diversion of funds to address budget programme shortfalls, for example in the use of National Skills Fund and SETA surpluses to finance student financial assistance,
- Allocation of social security funds for unregulated discretionary purposes, such as the use of UIF surpluses to bail out failing businesses and to supplement departmental personnel budgets,
- A substantial expansion of expenditure by the National Roads Agency, financed by drawing on cash reserves and an implausibly large increase in toll revenue estimates,
- Increased operating costs of PRASA, accommodated mainly by larger transfers from the main budget,
- Large increases in borrowing and expenditure by the extra-budgetary water resource agency, TCTA.

In several cases, there have been extraordinarily large increases in recent years.

- The UIF spent R23.7 billion in 2023/24 and plans to spend R43.9 billion in 2025/26. The increase is mainly because "labour activation programmes" increase from R676 million in 2023/24 to R11.1 billion in 2025/26. This is entirely unrealistic.
- Sector education and training authorities (SETAs) have increased their aggregate spending by 22% a year over the past three years, from R14.9 billion to R24.7 billion, now nearly double the DHET allocation for Technical and Vocational Education and Training.
- SANRAL has increased its expenditure by 18% a year over the past three years and plans a further 26% increase to R37.5 billion in 2025/26.

Whatever the merits of these and other off-budget programmes, it seems clear that stronger executive and parliamentary oversight is necessary. In the envisaged review of expenditure over the months ahead, it is vital that the Treasury's reach should extend to the full consolidated expenditure envelope.

On debt

For fiscal policy purposes, it is the consolidated framework that counts – not just the main budget. It is tempting to think that if the UIF or SETAs can finance expanded activities by drawing on their accumulated reserves, of if SANRAL can borrow more, this need not be a concern because it would not directly affect main budget borrowing. But it is the consolidated deficit that must be financed, and financing through increased debt is fiscally equivalent to financing through drawdowns on accumulated funds.

The consolidated budget deficit was 4.8% of GDP in 2024/25 – up from an average of 4.2% over the previous three years. In the revised May budget estimates, the consolidated deficit will again be 4.8% of GDP in 2025/26, before falling to 3.8% and 3.4% in the subsequent years. The wider public sector borrowing requirement (including state-owned companies and municipalities) was 5.3% of GDP in 2024/25, projected to rise to 5.9% of GDP. Eskom and Transnet are still financially stressed. Public debt is growing faster than the economy, at interest rates substantially higher than inflation.

The Treasury projects gross national debt to “stabilize” at 77.4% of GDP by the end of 2025/26, up from 74.2% at the end of 2023/24. The rise in debt has been partially contained by drawing R100 billion into the fiscus from the accumulated balance of the Gold and Foreign Exchange Contingency Reserve Account in 2024/25, with two further drawdowns of R25 billion a year in 2025/26 and 2026/27. The Eskom debt-settlement commitment for the year ahead has been reduced by R30 billion. The now-rejected tax increase would also have contributed to moderating the rise in debt.

Special measures have been needed to contain the debt increase last year and for the year ahead. But interest rates remain elevated, debt service costs continue to rise as a share of revenue, and the commercial ratings agencies still classify South Africa’s sovereign debt as below investment-grade.

With the outlook for economic growth now weaker than anticipated in February or March, and without the planned VAT increase, deeper spending adjustments will be needed if the debt-GDP ratio is to be sustainably reduced over the period ahead.

Concluding note: budget reform and institutional change

Macro-fiscally, South Africa’s growth outlook remains bleak and the debt-GDP ratio has not yet reached an inflection point.

The 2025 Budget has again deferred the tough decisions that are required. A necessary VAT increase has been rejected, at least some of the latest spending cuts are likely to be reinstated, infrastructure allocations are still inadequate to stimulate growth and obviously excessive spending plans of extra-budgetary funds and entities have not yet been revisited.

For many years, a “comprehensive expenditure review” has been under discussion, but decisive measures to curtail unproductive activities, rationalise the macro-organisational structure of the state or reverse the growth in service delivery and programme commitments have not yet been taken. Although there have been more than 200 programme-targeted expenditure reviews, their focus has been on improving programme design rather than identifying savings.

In his budget speeches of 12 March and 21 May this year, Minister Godongwana emphasised that a budget reform process is underway, provincial and local government grant frameworks are under review, and systematic expenditure reviews will be undertaken under guidance of the Presidency. This must include stronger oversight of extra-budgetary accounts and funds, a more disciplined approach to public-sector salary determination, reconsideration of the balance between public and private sector responsibilities, and improved cost recovery in several sectors.

Better analysis and public engagement on trade-offs and priorities might contribute to better budgeting and more sustainable public finances. The Parliamentary Budget Office and the Financial and Fiscal Commission have statutory responsibilities in this regard. The Presidential Economic Advisory Council could usefully play a role. Both the Treasury’s budget reform initiatives and reconsideration of parliamentary processes present opportunities for constructive institutional change. If economic growth is to be restored alongside infrastructure investment and improved service delivery, a far sharper focus on expenditure priorities and effectiveness is needed.