MINISTRY OF FINANCE

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How the 2014/15 Budget Improves the Conditions for Business Investment & Strengthens Competitiveness

Good morning ladies and gentleman,

I would like to thank you for the opportunity to present this morning.

To start, let me outline the 2014 Budget. In summary, the Budget is about ensuring fiscal sustainability, protecting the social wage, and giving greater emphasis to the goals of the National Development Plan (NDP). Over the medium term, government will ensure a stable business environment by reducing the deficit to stabilise debt. Support for economic recovery will remain, with a focus on improving the quality of spending and reducing waste.

The Budget contributes to the NDP’s vision of building a capable and efficient state. Capital expenditure is the fastest growing item of non-interest expenditure. The social wage, which includes spending on health, education and social development, continues to grow in real terms. We speak of three deficits: the fiscal deficit, the deficit on the current account and the social deficit. The social deficit has a tendency to perpetuate the inequalities in our country so the growth in the social wage is meant to address this. At local government level, funding is provided to strengthen capacity-building programmes that support rural municipalities in order to address issues of service delivery.

Government is making strides in improving value-for-money and cutting wasteful expenditure. Cost-containment measures to limit expenditure on conferences, travel, and entertainment were implemented in December 2013. The Chief Procurement Officer is building a national system for the purchase of high-value goods and services commonly used across government to limit expenditure in this regard.

The fastest expenditure growth will be in the areas of employment creation and social security and local government, housing and community amenities. The Community Work Programme will expand to every municipality by 2017. We envisage that a total of 6 million jobs of varying durations will be created. The Unemployment Insurance Fund will extend its benefit payments from 238 days to 365.

In line with the NDP, government is providing cities with incentives to change the way they plan infrastructure. The improved system will ensure that development leads to more integrated, compact and efficient cities. In addition to large baseline allocations, further funding is provided to upgrade informal settlements, eradicate bucket systems, expand the commuter rail network and build bulk water infrastructure.

In the next few minutes I will detail the factors which promote business investment and competitiveness, and discuss what the 2014 budget has done to support these two areas.

Economic environment

Let me start with the economic environment. This will help us understand the conditions within which businesses must operate.

Global growth gathered momentum in 2013, led by a recovery in the advanced economies. This recovery is expected to continue into 2014. Unfortunately growth in the Eurozone, which is one of our major trading partners, remains subdued and pedestrian.

This weak export demand meant that we were unable to capitalise on the depreciated exchange rate. Import demand, however, has been resilient. As a result the current account deficit remains slightly elevated. The numbers released yesterday (South African Reserve Bank March Quarterly Bulletin) relate to the fourth quarter and show that the deficit narrowed. But we know that there isn't much activity in the fourth quarter so this is not a true reflection of the trend.[1]

South Africa is amongst those countries which struggled to reach its potential in 2013. Real GDP growth was 1.8 per cent in 2013, rising to 2.7 per cent this year, and again to 3.5 per cent in 2016.

Consumer price inflation will breach the 3 to 6 per cent target band. Higher inflation in several core categories continues to put pressure on the purchasing power of households and businesses. We forecast inflation of 6.2 per cent for 2014, with a weak rand posing further risks to this outlook.

[1] Export and import numbers on quarterly basis are generally very volatile and thus it is difficult to judge whether there is a reversal in a trend based on one data point. While National Treasury's view is that the current account will narrow in 2014, this depends on export growth accelerating, import growth moderating and the terms of trade remaining largely unchanged. If the first quarter of 2014 shows similar trend to the fourth quarter of 2013, National Treasury will be much more confident to say that the current account is narrowing at a faster pace than expected.

In light of reduced quantitative easing by the Fed, South Africa will continue to face increased financial and market volatility. Capital flows will now likely favour developed economies, given expectations of higher interest rates and a lower level of risk. We must remain aware to potential capital outflows, and manage this risk through prudent macroeconomic policies.

The real economy story is a mixed one. While some sectors prospered in 2013, others grew below potential because of production stoppages caused by strikes and maintenance delays.

I am sure many of you felt the effects of the recent labour unrest. This hurt the economy in 2013, and 2014 has also begun on an unsettled note. Government is working with business and labour to resolve these issues. Deputy President Motlanthe continues to facilitate discussions between all parties, and this process has already resulted in somewhat fewer, shorter and less-bruising strikes.

Growth in the mining sector was volatile last year. Similar is the case for manufacturing, which struggled to gain momentum. These sectors have seen significant increases in unit labour costs, and low margins of profitability threaten future investments.

The rest of the economy continued to grow in 2013 but at a slower pace than during 2012. The transport and communication sector was affected by slow growth in mining and manufacturing. The finance, insurance, real estate and business services sector remained a large contributor to growth.

A broader recovery in the economy and in business confidence depends largely on improving the operating environment in mining and manufacturing. Mining contracted on average by 0.5 per cent in each of the last three years, while manufacturing recorded average annual growth of only 1.8 per cent.

Improvements in infrastructure

Now that we know the economic environment, we can discuss how the Budget aims to support business and address the challenges. The obvious starting point, which I assume is on many of your lips, is infrastructure.

Infrastructure and maintenance spending is projected to exceed R847 billion over the next three years. These investments will address bottlenecks, promote higher levels of economic growth and job creation, and boost the country’s long-term growth potential.

Let me start with energy:

- The first unit of the Medupi power station is expected to be completed towards the end of this year, two years later than initially expected.

- Shale gas and biofuels are on the table as part of our energy mix and there are a number of things we are doing to move in that direction.

- Contracts for 47 renewable energy projects were concluded in 2012 and 2013, with most under construction.

In terms of transport:

- Transnet has increased capacity on its coal line. Plans to further expand the coal, iron ore and manganese lines are at an advanced stage of feasibility assessment.
- The Passenger Rail Agency of South Africa refurbished 500 Metrorail coaches last year and there are also a number of other investments.
- The expansion of the Gautrain is also underway.

Medium-term capital expenditure by state-owned companies is projected to reach R370 billion. Investments by Eskom, Transnet and SANRAL account for 90 per cent of this figure.

State-owned companies have improved their spending performance. In 2012/13, state-owned companies spent R109 billion on infrastructure projects. This amounts to roughly 80 per cent of their budget. This is a marked improvement from only 70 per cent the year before. We aim to improve on this outcome.

Spending on social infrastructure – which includes health, education and community facilities – is projected to increase from R30 billion in 2012/13 to R43 billion in 2016/17. Priority will be given to programmes to eradicate school infrastructure backlogs.

Government employment programmes are central to many of the infrastructure projects. The government will launch the third phase of the Expanded Public Works Programme in April 2014. Over the next five years, it aims to create 6 million jobs of varying duration and we are certain this is within our reach. By 2016/17, direct budgetary support for this programme will grow to R11 billion.

As envisaged by the NDP, the Community Work Programme will become the largest component of expanded public works. Additional resources have been made available for the programme to achieve a presence in every municipality by 2016/17. There will be an emphasis on harnessing synergies between the different employment programmes and improving the quality of work so that participants are better able to graduate into the formal economy. There will also be a concerted effort to link employment programmes with government’s initiatives to foster small enterprises and collectives.

All of this seeks to create an enabling environment, within which local businesses can prosper.

Improvements in education

Education determines the productivity of South African workers, which in turn affects the competitiveness of our companies. We are mindful of issues within the education system, and have taken measures to address challenges and enhance outcomes within the sector.

The Department of Basic Education has a new long-term plan to improve the quality of education. To assist the Department, funding will be made available through the school infrastructure backlogs grant to rebuild 433 schools.

The Funza Lushaka bursary scheme is supporting the NDP's requirement for more and better-qualified teachers: around 3 950 graduates qualified in 2013 for placement this year.

In 2013/14, 8.7 million learners benefited from the school nutrition programme. The main focus in 2014 will be on strengthening and monitoring the programme to ensure that the provision of nutritious meals meets the stipulated criteria.

The white paper for post-school education and training, released last year, also reflects NDP priorities. It envisages a significant increase in the number of students enrolled in higher education. The bursaries and loans made available to students from low income families through the National Student Financial Aid Scheme are a key enabler in this regard, and an additional R145 million has been made available over the medium-term to pilot and initiate a new administration system.

Support for small and medium sized enterprises

Small and medium-sized businesses are key drivers of the South African economy. They not only provide a large share of our growth, but they are also an integral part of government's plans to create employment opportunities. The statistic I heard quoted by the previous speaker, that 90 per cent of start-ups fail is an area we should pay attention to.

Small and medium-sized businesses face several challenges, including access to markets and funding. Government is considering options to provide tax relief to organisations, such as foundations, that promote small enterprise development. As a complementary measure it is proposed that grants received by small and medium-sized enterprises be tax exempt, regardless of the source of funds.

These businesses are critical for job creation, and deserve our support. The venture capital company tax regime is another way government aims to encourage investment into small businesses and junior mining companies. Following consultation with interested parties, government proposes to enhance the effectiveness of this tax incentive to support entrepreneurial development.

In July last year we set up a Tax Review Committee and we have accepted the Committee's recommendation to amend the turnover tax regime, to reduce the tax compliance burden of micro-enterprises. We are also giving consideration to replacing the graduated tax regime with a refundable tax compliance credit. This would provide tax relief to small business corporations with an annual turnover of up to R20 million.

Unemployment remains a challenge. We cannot afford to exclude our greatest asset, the people of South Africa, from the economy. The private sector remains the most important source of employment. Government will help the private sector to create jobs through the employment tax incentive, which was implemented in December 2013. So far 56 000 employment opportunities have been created directly as a result of this.

Harnessing African growth

We have also not ignored the massive growth potential which Africa provides to our local companies. As South Africans, we cannot sit idle and wait for a recovery in global growth. While wage and consumption growth has stagnated in South Africa's main export destinations, growth in sub-Saharan Africa is expected to exceed 6 per cent in 2014.

Growth on the continent has been especially pronounced in the technology, telecommunications, financial and retail sectors. To help firms take advantage of this growth potential, National Treasury has proposed:

- Measures to help local firms in the technology, media and telecommunications sector raise capital

- Reforms to reduce the administrative burden and the cost of doing business for South African firms, investors and individuals.

- A revised template for reporting banks' foreign exposure to streamline the investment process.

Government is committed to supporting the expansion of South African firms into Africa. The 2014 Budget extends arrangements for South Africa firms to establish a subsidiary to hold African and offshore operations.

National Treasury is also working with the DTI to produce an investment policy framework which provides safeguards for companies aiming to invest in Africa.

Plans to address structural impediments

South Africa needs to adapt to changes in the global and domestic economy. Slower growth in China has weighed down the prices of some of South Africa's key commodity exports.

But there is potential to capitalise on the weak rand and tap into new export markets, and policy will support this. As we know, exports are slow to respond while imports respond immediately.

Over the medium term, spending plans aim to address structural impediments, market failures and coordination challenges. This will help promote the stronger, more inclusive economic growth on which the NDP depends:

- Manufacturing development incentives are allocated R9.7 billion over the next three years, in addition to tax relief offered through incentive programmes.

- Government established the economic competitiveness and support package in 2011 with an allocation of R25 billion. Over the next three years, this will make R16.3 billion available to businesses to upgrade machinery and increase productivity.

- Over the next three years, special economic zones are allocated R2.3 billion to promote value-added exports and generate jobs in economically disadvantaged parts of the country. Preparatory work is under way to attract investors to the zones through tax incentives, infrastructure enhancements and other incentives.

- Government is developing an agricultural policy action plan to support the NDP's target of creating 1 million jobs in agriculture and land reform by 2030. Over R7 billion will be spent on conditional grants to provinces to support about 435 000 subsistence and 54 500 small holder farmers and to improve extension services.

- To boost domestic food production and reduce reliance on imports, the Fetsa Tlala initiative aims to bring an additional 1 million hectares into cultivation by 2019, creating 300 000 jobs. Meanwhile, the comprehensive agriculture support programme grant, which receives R1.6 billion per year over the medium term, intends to increase farm output, especially for the beneficiaries of land reform.

Improving the quality of public services

Resources are limited. This is a constraint faced by every government. But what we can do is ensure that the available expenditure is allocated efficiently to priority areas, such as education and investment in productive infrastructure.

The NDP requires an improvement in the quality of public services within a sustainable fiscal envelope. If resources are wasted or diverted, the impact of public spending is diminished. A series of related initiatives are focusing on these concerns:

- Several spending reviews are under way, conducted jointly by the National Treasury and the Presidency. The reviews aim to provide greater understanding of performance and value-for-money.

- Similar spending reviews have been conducted in provincial government, and suggest a range of efficiency improvements that can enhance value for money.

- Over the past 12 months, the Office of the Accountant-General has taken steps to strengthen the control environment of government's financial systems. It finalised 27 forensic reports, leading to 39 specific allegations. Of these allegations, 13 are under criminal investigation, 13 are in court and 13 were referred for internal disciplinary action.

- The Chief Procurement Officer is building a national procurement system for the purchase of high-value goods and services commonly used across government. Reforms will simplify procurement procedures, strengthen accountability and improve government's ability to detect corruption and maladministration.

Conclusion

It is critical for businesses in South Africa that government deliver on the National Development Plan's objectives. Priorities for the 2014 Budget therefore include:

- Improvements in infrastructure;
- Actions to draw more young people into employment; and
- Improvements in the quality of services

The NDP advocates a new approach to address policy challenges, whereby partnerships between the public and private sectors and civil society are expanded.

The competitiveness of local businesses is reliant on many factors. The budget aims to support all of these, ranging from high cost infrastructure projects to the education of students and management of our cities. Your success is our success, for without a thriving business environment government would struggle to raise the necessary resources to run an effective state.

Effort has been made in the 2014 Budget to create an enabling environment, where business is provided with all the tools necessary to succeed – both locally and internationally.

I thank you.