MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

SPEECH BY MINISTER OF FINANCE MR NHLANHLA NENE

FOREIGN CORRESPONDENTS' ASSOCIATION

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Ladies and gentlemen

Thank you for this opportunity to address you today. It is always a great pleasure to engage with the individuals who are instrumental in disseminating information and providing useful commentary. The world has become smaller; we now speak of a global village. South Africa is an open and interconnected economy so we consider the Foreign Correspondents' Association a key partner in informing the rest of the world about local developments.

It is almost three months after the tabling of the 2015 Budget. At that time, we made it clear that the Budget was being tabled at a challenging time. So, we had to make tough decisions to shore up our public finances and to change the trajectory of our economy.

For five consecutive years, growth has been revised downwards partly due to the low global growth environment. While we anticipate moderate economic growth in our economy and an improvement in the outlook over the next several years, we recognise that part of the growth challenge is largely due to structural domestic constraints. Change is therefore required to lift the South African economy to levels that will help us address poverty, joblessness and inequality.

Economic uncertainty prevails as the global outlook remains gloomy and other emerging markets face their own structural challenges. For at least three years prior to the tabling of the 2015 Budget, we as government had been saying that a deterioration of the economic environment would compel a reconsideration of expenditure and revenue plans.

We first set an expenditure ceiling in 2012 and we have consistently stuck to targets since then. This was achieved through a government-wide commitment to improving efficiency and prioritising the most essential sectors and services. But the poor performance of the economy meant further downward revisions to our revenue estimates. Lower-than-expected revenue intake for the past few years has led to a persistent structural deficit.

Our stock of national debt has grown faster than we had previously anticipated. It is now at R1.6 trillion and is expected to rise to R2.2 trillion in 2017. Interest payments are the fastest growing element of spending, taking up around 12 per cent of revenue. As the economy recovers, so too will revenues, but with a lag. In the meantime, fiscal space has continued to be eroded by rising debt, and we recognise that action needs to be taken immediately.

In the October Medium Term Budget Policy Statement, we had to rethink our fiscal consolidation plans. The plan included a reduction in spending growth, an increase in taxes, and a greater emphasis on longer-term planning – all within a fiscal framework that links aggregate expenditure and economic growth over the longer term. We have since begun to implement all of these proposals.

The Budget 2015 carried through on our MTBPS commitments. In February, we stated that 'a combination of a lower expenditure ceiling and higher taxes [would] narrow the deficit from 3.9 per cent of GDP in 2014/15 to 2.5 per cent of GDP by 2017/18.' Since then, a combination of strong revenue performance and slight underspending has reduced the 2014/15 deficit to 3.5 per cent of GDP. We expect net debt to stabilise below 44 per cent of GDP in 2017/18.

From the commentary we have read, and the regular interactions we have had with various stakeholders, the 2015 Budget was largely well-received and seen as positive.

But, this positive feedback notwithstanding, we are well aware of concerns, some of which we identified when tabling the Budget. These are: the economic growth trajectory, risks to the fiscal framework that include public-sector wage negotiations and the financing of state-owned companies.

ECONOMIC GROWTH

Government recognises that the economic growth path needs to be restored. Achieving faster sustainable growth and large-scale job creation will require structural shifts in the economy. Our plan to enable faster economic growth over the period ahead encompasses a number of initiatives.

Growth forecasts presented in the 2015 Budget were heavily interrogated. The 2017/18 growth forecast of 3 per cent received much scrutiny, with some questioning whether the energy challenge would have been resolved by then.

Allow me to outline why we think these are realistic and achievable targets. Firstly, we will continue to invest heavily in the public-sector infrastructure programme that has already begun to lift constraints to growth. Investments into Transnet and telecommunications will modernise our transport network and boost information technology access.

Also on our list is to reduce energy consumption and promote energy efficiency. Enhanced tax incentives will promote greater energy efficiency. Interventions such as the energy efficiency and demand-side management grant to municipalities will encourage households to use energy more efficiently.

Economic growth cannot happen without increases in employment and productivity. In 2013/14 the Expanded Public Works Programme created over 1 million short term jobs and so far the Jobs Fund has created over 30 000 permanent jobs. The employment tax incentive will continue to support the employment of hundreds of thousands of young workers.

Several regulatory reforms and administrative improvements have been completed and will enhance business conditions and confidence. Examples of this are the South African Revenue Service customs modernisation program, and streamlined company registration processes. In addition, the establishment of special economic zones, various tax incentives and grant funding for upgrading equipment and processes should help local firms become more competitive.

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PUBLIC SECTOR WAGE BILL

Another risk we identified to our fiscal framework is the public sector wage bill. Public-sector salary negotiations are still under way so I am sure you will understand my reluctance to comment further on the matter. Suffice to say that government's primary aim remains to ensure a sustainable cost-of-living adjustment. To slow growth in the wage bill, we are also withholding additional resources for changes to personnel numbers and we are reviewing funded vacancies.

ESKOM

The most pressing risk facing us is Eskom. We are concerned about the negative impact the electricity constraint is having on growth and potential growth. Ensuring that Eskom returns to full financial and operational sustainability is a top a top priority of Government. We have therefore invested significant time and resources in understanding Eskom's funding requirements, the options available for closing any funding gaps, and what the path back to full sustainability looks like.

A number of operational challenges have contributed to the financial challenges that Eskom is experiencing. Inadequate maintenance of the power plants and distribution networks is resulting in deteriorating and unreliable performance, which is in turn leading to higher maintenance costs.

During the MTBPS we announced a broad package for Eskom that includes a capital injection of R23 billion, governance improvements, operational cost containment and additional borrowing and support for required tariff increases. Through the disposal of non-core state assets, the fiscal allocation of R23 billion will be paid in three instalments, with the first transfer to be made in June.

As you can see, the Government Support Package is more than the R23 billion capital injection that many have focused on. The package attempts to balance a range of interventions, in recognition of the fact that there are many different stakeholders that play a role in returning the organisation to full health.

But we have also recognized upfront, that the key ingredients to addressing Eskom's funding challenges lie in interventions to contain costs. The key elements for Eskom are to fix their costs and revenues to fair and sustainable levels. Recently-seconded Eskom Acting CEO Brian Molefe has expressed his commitment to this objective. We will liaise closely with the power utility in this respect.

National Treasury has also taken steps to persuade municipalities to conclude payment plans and repay Eskom debts. This was done by withholding Equitable Share payments to municipalities that have outstanding debts to Eskom and who failed to acknowledge this debt.

Applications for tariff adjustments have been submitted to the energy regulator. Free Basic Electricity grants were increased to soften the impact of higher tariffs on low-income households.

Let me also speak in general about the financial position of public sector institutions.

Many public institutions are in a strong financial position, contributing simultaneously to fiscal sustainability and public welfare. In recent years, however, the financial and operational performance of several state-owned companies and development finance institutions has weakened. And although the overall financial position of the social security funds is strong, liabilities continue to mount at the Road Accident Fund (RAF).

Inadequate policy frameworks, regulatory uncertainty, poor operational performance and governance failures often lie behind the deterioration in financial positions. Weak financial performance is also frequently associated with a failure to define clear strategic goals.

Where an unsustainable financial position is not addressed, public institutions often turn to government to provide a lifeline using public funds. Unless underlying imbalances are resolved, however, such interventions are at odds with sustainable public finances.

Given current fiscal constraints, government will address the funding needs of public institutions in a manner that does not increase the budget deficit. The sources of such funds can include the disposal of non-strategic assets such as property, direct and indirect shareholdings in listed firms, non-strategic shareholdings in state-owned companies and surplus cash balances in public entities.

Where government support is provided in the form of funding or guarantees, public entities will be required to demonstrate sound business plans, strengthen internal governance and improve operational performance. Close monitoring will take place to promote efficient delivery on government priorities, simultaneously improving commercial performance and ensuring that government can meet its fiscal targets. Over the longer term, reforms to governance and policy frameworks are required.

In 2011 the Presidency commissioned a review to assess how well state-owned entities executed their mandates. The 2015 Cabinet Lekgotla considered the review and its recommendations to improve the contribution of these entities to national development. Key interventions under consideration include:

- Establishing an inter-ministerial committee to improve alignment and coordination between entities.

- Identifying those state-owned companies that are integral to national development, and setting out an approach to acquiring and disposing of public assets based on strategic requirements.

- Introducing overarching legislation to govern these entities.

- Costing developmental mandates more explicitly, with the financial implications set out more clearly in shareholder compacts.

•Exploring options for private investment to strengthen balance sheets, and creating opportunities for private investment in sectors dominated by state-owned companies. An example of this approach is the successful Renewable Energy Independent Power Producers Procurement Programme.

In aggregate, South Africa's public-sector institutions are solvent and many are performing well. However, poor-performing and inefficient entities are significant risks to public finances.

Government is working with these institutions to develop sustainable financial frameworks supported by turnaround plans. In the short term, many of these interventions focus on stabilising the finances of these entities – in particular bolstering liquidity. Over the longer term, in line with the recommendations of the Presidential Review Committee, government will better align its portfolio of institutions and mandates with national development requirements and develop complementary financing models.

CONCLUSION

Ladies and gentlemen, we face a tough two years ahead. Government is working to stabilise the electricity supply, narrow the fiscal deficit, and begin to realise faster growth. The risks to the outlook are significant, and managing these risks will require a fine balancing act on the part of government.

Let me thank you again for inviting me. I am told that several nationalities are represented in this meeting today. I can't think of anything better than this to illustrate the point we as Government are always making, that South Africa is open for business.

Thank you