3

Fiscal policy and trends

Fiscal policy guides government's decisions about revenue, spending and borrowing. South Africa's fiscal policy enables government to deliver on its developmental mandate by providing resources in a manner that is sustainable and that reinforces the stability of the economy.

Prudent fiscal management over the past 15 years has strengthened the public finances, with low debt stock and a broadly balanced budget leading up to the global crisis. As a result, in the face of the downturn and sharply lower budget revenues, government has been able to maintain expenditure on social priorities and support the economic recovery.

Rising expenditure, combined with a largely cyclical downturn in tax revenue, means that the consolidated government budget deficit has increased substantially, to 7.6 per cent of GDP in 2009/10. Higher borrowing to sustain investment in the economy is the correct response to our current economic challenges. Over the medium term, as tax revenues recover and spending growth moderates, the deficit will be lowered to more sustainable levels.

Overview

Healthy public finances enabled government to support growth and spending on social services

Over the past year, as the global economy experienced a sharp contraction, governments around the world have seen revenues fall rapidly, at a time when people and economies require fiscal support the most. South Africa has been similarly affected. The good health of the public finances has enabled government to respond by maintaining spending on public services and stimulating economic growth.

Fiscal and monetary policy have provided significant support to the economy during this recession. The budget deficit has increased from 1 per cent of GDP in 2008/09 to an expected deficit of 7.6 per cent in 2009/10, and interest rates have been reduced by five percentage points. The fiscal easing seen over the past year counts as one of the largest among G20 countries, measured as a percentage of GDP. The fiscus has been able to mobilise resources in support of the economy without compromising future growth or service delivery, and the space remains for government to continue to borrow to reinforce the recovery.

Higher short-term borrowing is necessary, but the deficit must be gradually reduced

Higher borrowing is, however, only a temporary solution. Over the medium term, the deficit will have to be reduced gradually. Failure to do so would mean that a higher proportion of public expenditure would go to service interest payments at the expense of social and economic priorities, or that government would have to raise taxes to meet rising interest costs. Slower growth in expenditure and a recovery in tax revenue due to higher economic growth are expected to support the fiscal recovery, with the budget deficit coming down to 4.2 per cent of GDP by 2012/13.

With this in mind, the fiscal stance is shaped by three goals:

- Ensuring that sufficient resources are available for government to meet its public service commitments, and to provide support to the economy as it moves into its next growth phase.
- Supporting development and alleviating poverty through current expenditure and investments in future capacity.
- Managing an orderly and gradual reduction of the budget deficit towards a sustainable position in a manner that does not compromise the economic recovery. Deficit reduction will result from a combination of automatic adjustments, as tax revenue increases, and a moderation in the growth of government spending.

The proposed budget framework takes into account the consolidated revenue and expenditure of national government, the social security and RDP funds, provinces and various public entities, but excludes local government and the state-owned enterprises.

Table 3.1 Consolidated government fiscal framework, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
R billion	Outcome			Estimate	Medium-term estimates		
Revenue	**546.8**	**634.1**	**692.0**	**657.5**	**743.5**	**833.4**	**921.3**
Percentage of GDP	*30.2%*	*30.7%*	*29.8%*	*27.3%*	*28.4%*	*29.1%*	*29.6%*
Expenditure	**522.9**	**599.1**	**715.4**	**841.4**	**905.6**	**975.6**	**1 052.8**
Percentage of GDP	*28.9%*	*29.0%*	*30.8%*	*35.0%*	*34.6%*	*34.0%*	*33.8%*
Budget balance	**23.9**	**35.0**	**-23.4**	**-183.8**	**-162.1**	**-142.1**	**-131.5**
Percentage of GDP	*1.3%*	*1.7%*	*-1.0%*	*-7.6%*	*-6.2%*	*-5.0%*	*-4.2%*

Contributing to economic stability

Economic stability is essential for creating an environment in which job creation can accelerate, entrepreneurial activity can flourish, and companies and households can invest with confidence. To contribute to stability, and to offset the damaging effects of boom-bust cycles, government maintains a countercyclical fiscal policy. In practice, government expenditure is protected from volatility in the economy by allowing the deficit to expand or contract in response to cyclical changes affecting the budget. This reduces debt levels when times are good and allows government to borrow to finance its expenditure when times are tough. Failure to respond in this fashion would lead to volatility in public spending, larger fluctuations in interest and exchange rates, and lower long-term economic growth.

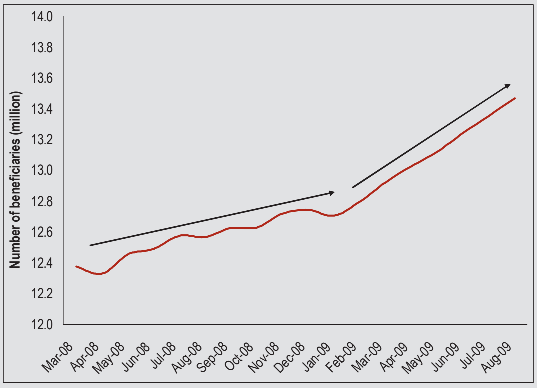
Expenditure trends

Continuing the trend that began in 2003, expenditure rises strongly, reaching 35 per cent of GDP in 2009/10. This rise in government spending during a period of economic contraction stimulates demand and partially offsets the effects of declining growth in other sectors of the economy.

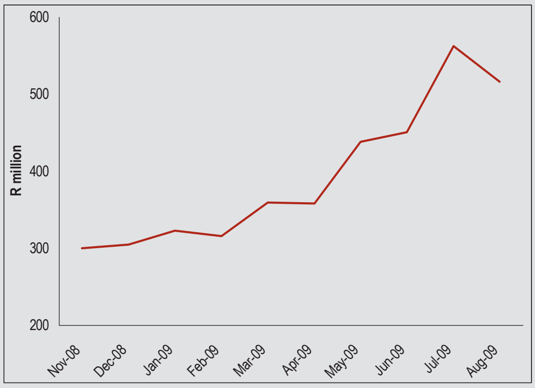
Strengthening social security, creating jobs, building for the future

During the first half of 2009/10, the social grants programme drew in an additional 600 000 people. Most of these were new recipients of the child support grant (475 000) and the older persons grant (86 000). The extension of the child support grant to children aged 14 at the beginning of 2009, and changes to the means test, have resulted in a structural change in the number of social grant beneficiaries.

Total social grant beneficiaries



Total monthly UIF payments



Government is also helping to cushion the newly unemployed from the effects of the downturn. The number of approved Unemployment Insurance Fund (UIF) claims jumped by more than 100 per cent between April 2008 and April 2009. In the first quarter of 2009/10, the UIF paid out R1.3 billion, at an average of R2 400 per payment per month.

Consolidated national and provincial government employment, 2006/07 – 2008/09

	2006/07	2007/08	2008/09
Headcount	1 057 020	1 101 484	1 149 916
Change in numbers		44 464	48 432
% Change		4.2%	4.4%

Public-sector employment has also continued to expand, with national and provincial government creating over 90 000 new positions between 2006/07 and 2008/09.

Public and private investment, year-on-year change

	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009
General government sector and public corporations	24.0%	21.0%	20.0%	14.0%	24.0%	29.0%
Private sector	10.0%	8.0%	5.0%	3.0%	-1.0%	-4.0%

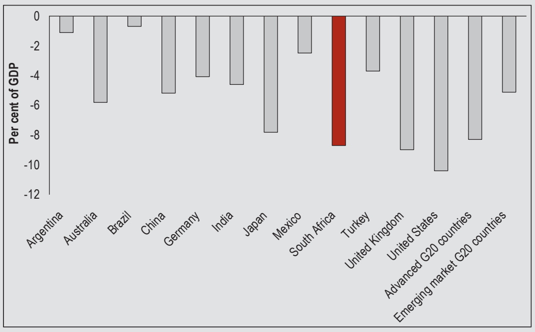
Combined investment for the public sector has continued to grow at over 19 per cent year-on-year in 2009/10, while private-sector investment has declined.

South Africa's fiscal response in a global context

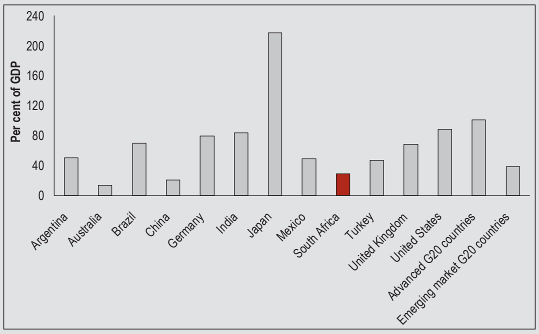
The swing in South Africa's budget balance is among the world's largest, comparable to that of the United Kingdom and the United States.

In contrast to many countries, South Africa entered the crisis with a fiscal surplus and government debt at historic lows. This has put the fiscus in a good position to continue financing the budget deficit without placing excessive pressure on interest rates.

Change in budget balance, 2007 – 2009



Government debt as a per cent of GDP, 2009



Source: IMF World Economic Outlook October 2009 except for South Africa, which is based on National Treasury estimates

As the economy recovers, growth in government expenditure is expected to moderate to more sustainable levels, with consolidated government expenditure stabilising at 34.1 per cent of GDP over the medium term. This allows for additional spending of R78 billion at the main budget level – R17 billion in 2010/11, R24 billion in 2011/12 and R37 billion in 2012/13. Savings and reprioritisation of existing allocations of R14.5 billion at national level, and R12.6 billion at provincial level, increase the amount available to fund new priorities.

Growth in consolidated government non-interest expenditure to average 1 per cent over MTEF

After growing at about 9 per cent a year in real terms over the past three years, real growth in consolidated government non-interest expenditure is expected to average about 1 per cent over the next three years.

Budget revenue trends

Budget revenue is the amount of revenue available to the fiscus to finance expenditure after taking account of tax revenue, other revenue sources and transfers to other members of the Southern African Customs Union (SACU).

Tax revenue is the largest contributor to budget revenue. Because taxes are levied on economic activity, tax revenue is highly cyclical. When the economy is performing well, more tax revenue is available to fund public expenditure, but when the economy is performing poorly, government needs to consider additional financing options.

Over past seven years, tax revenue growth averaged 7.8 per cent a year

Over the past seven years, strong economic growth, improvements in tax administration and compliance, and the broadening of the tax base have resulted in strong growth in tax revenue. While economic growth has averaged 4.2 per cent a year, tax revenue has grown by 7.8 per cent a year in real terms. However, as the economy has slowed, tax revenues have declined and it is expected that total tax revenue for 2009/10 will be R70.3 billion below the forecast presented in the 2009 Budget.

Table 3.2 Consolidated government revenue, 2009/10 – 2012/13

	2009/10				2010/11	2011/12	2012/13
R billion	**Budget**	**Revised**	**Deviation**		**Medium-term estimates**		
Personal income tax	207.5	203.0	-4.5	-2.1%	226.3	264.1	304.5
Corporate income tax	160.0	139.0	-21.0	-13.1%	148.0	163.3	181.2
Value added tax	168.8	138.0	-30.8	-18.2%	157.6	176.5	198.8
Fuel levy	30.1	28.6	-1.5	-5.0%	31.5	33.4	35.4
Custom duties	24.6	17.0	-7.6	-31.0%	18.1	19.9	21.6
Excises - specific	22.6	21.0	-1.6	-7.1%	22.9	23.7	24.8
Other tax revenue	45.7	42.4	-3.3	-7.2%	46.8	52.1	50.4
Gross tax revenue	**659.3**	**589.0**	**-70.3**	**-10.7%**	**651.0**	**732.9**	**816.7**
Percentage of GDP	*26.6%*	*24.5%*	*-2.9%*		*24.8%*	*25.5%*	*26.2%*
Departmental revenue	11.6	9.8	-1.8	-15.3%	10.7	11.3	11.8
Mineral royalties	–	–	–	–	3.5	4.2	4.9
Estimate of SACU payments[2]	-27.9	-27.9	–	–	-19.2	-20.9	-22.5
Other[3]	97.4	86.6	-10.8	-11.1%	97.4	105.9	110.4
Budget revenue	**740.4**	**657.5**	**-82.8**	**-11.2%**	**743.5**	**833.4**	**921.3**
Percentage of GDP	*29.9%*	*27.3%*	*-3.4%*		*28.4%*	*29.1%*	*29.6%*

1. *Includes ad valorem excise, transfer duties, STC, STT, SDL and electricity levy.*
2. *Estimates are based on National Treasury projections. Actual payment will be determined by outcomes of customs and excise revenue collections in line with the revenue sharing formula contained in the SACU agreement.*
3. *Includes provinces, social security funds and selected public entities.*

Most of this decline is the result of lower VAT and company income tax receipts in line with reduced business activity and lower household spending.

As economic growth picks up, tax revenue will begin to recover automatically. Tax revenue is expected to reach 26.2 per cent of GDP by 2012/13, driven by a recovery in household consumption and corporate profits, and supported by measures to broaden the tax base.

South African Revenue Service is increasing penalties for tax evasion

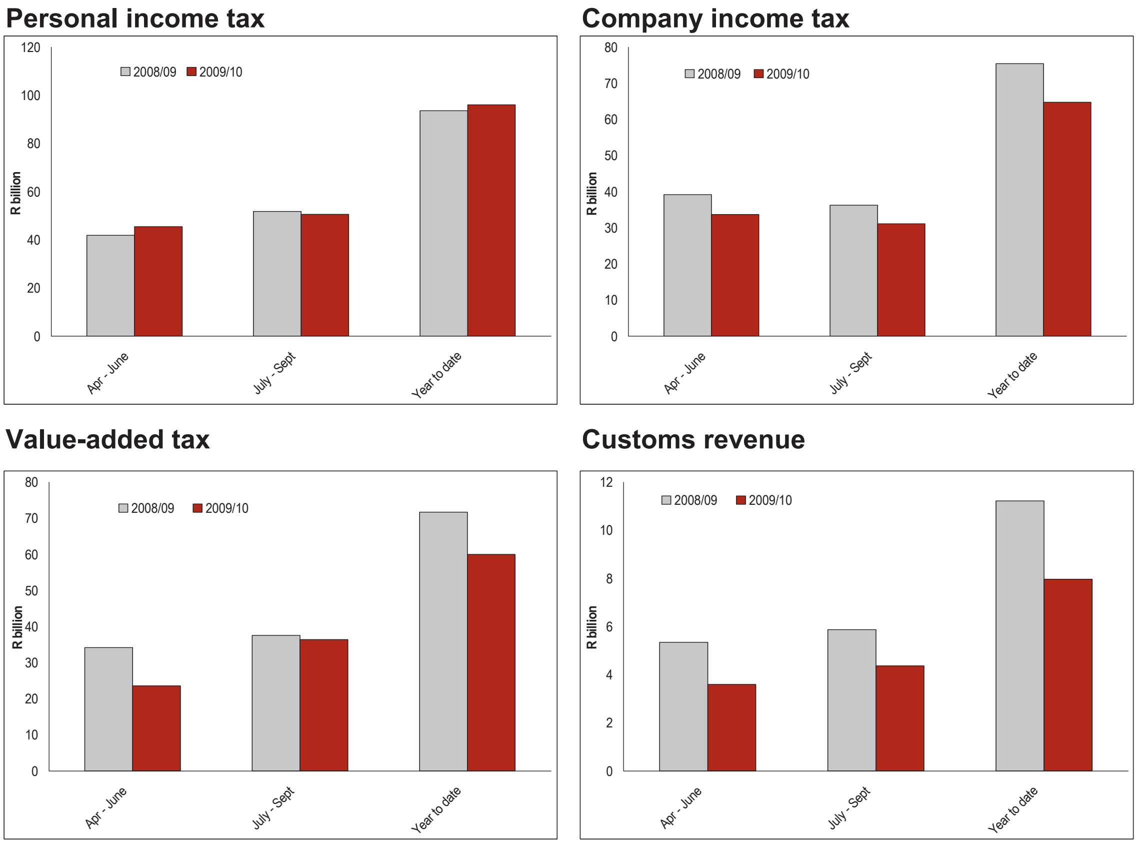
To ensure fairness and equity in the tax system, the South African Revenue Service is increasing penalties for those who do not pay their fair share of taxes. Sustaining the compliance culture built up over the past decade is necessary for government to meet its developmental objectives, and to ensure that the population as a whole believes that the tax system is fair. The present penalty regime is too lax and has been revised, requiring higher penalties on people with higher taxable earnings.

Improved budget revenue partly results from downward revision of estimated SACU transfers

The improvement in budget revenue over the forecast period is supported by downward revisions in the estimates of transfers to South Africa's SACU partners, which share customs revenue. As a result of declining imports, customs revenue was lower than expected in 2008/09 and is also likely to be weaker in 2009/10. This trend will also have a negative impact on Botswana, Lesotho, Namibia and Swaziland. SACU members reliant on customs revenue will have to take into account the impact on their budgets.

The decline in other revenues is mainly the result of lower receipts from departments and interest earned on cash balances.

Figure 3.1 Performance of main revenue categories, year to date



Borrowing trends

Consolidated budget deficit of 7.6 per cent of GDP expected in 2009/10

Government borrows to finance the shortfall between revenue and expenditure. In 2009/10 the increase in expenditure, combined with the decline in budget revenue, results in a projected consolidated budget deficit of 7.6 per cent of GDP. This must be financed through raising debt. The stabilisation of expenditure growth in combination with a recovery in budget revenue is expected to result in the deficit declining to 4.2 per cent of GDP by 2012/13.

Table 3.3 Total government debt, 2006/07 – 2012/13

As at 31 March	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
R billion		Outcome		Estimate		Medium-term estimates	
Domestic debt[1]	471.1	480.8	529.7	709.3	884.3	1 049.1	1 218.6
Foreign debt[1]	82.6	96.2	97.3	100.2	117.1	140.6	167.5
Gross loan debt	**553.7**	**577.0**	**627.0**	**809.5**	**1 001.4**	**1 189.7**	**1 386.1**
Less: National Revenue Fund bank balances	-75.3	-93.8	-101.3	-106.1	-106.1	-106.1	-106.1
Net loan debt[2]	**478.4**	**483.2**	**525.7**	**703.4**	**895.3**	**1 083.6**	**1 280.0**
As percentage of GDP :							
Total net loan debt	*26.4*	*23.4*	*22.6*	*29.2*	*34.2*	*37.8*	*41.1*
of which foreign debt	*4.6*	*4.7*	*4.2*	*4.2*	*4.5*	*4.9*	*5.4*
As percentage of gross loan debt:							
Foreign debt	*14.9*	*16.7*	*15.5*	*12.4*	*11.7*	*11.8*	*12.1*

1. Forward estimates are based on National Treasury's projections of exchange and inflation rates.

2. Net loan debt is calculated with due account of the bank balances of the National Revenue Fund (balances of government's accounts with the Reserve Bank and commercial banks).

In financing the consolidated government deficit, national government borrowing is projected to reach R175.8 billion in 2009/10, declining gradually to R145.1 billion by 2012/13. As a result, public debt rises from 22.6 per cent of GDP in 2008/09 to 41.1 per cent of GDP by 2012/13. Foreign debt remains a small share of government's debt because South Africa maintains deep and liquid domestic capital markets.

As a result of deep domestic capital markets, foreign debt accounts for a small share of government's debt

Table 3.4 Main budget net borrowing requirement and financing, 2008/09 – 2012/13

R million	2008/09 Outcome	2009/10 Budget	2009/10 Revised	2010/11	2011/12	2012/13
				Medium-term estimates		
Main budget balance	**-27 715**	**-95 573**	**-181 588**	**-167 635**	**-155 611**	**-145 075**
Extraordinary payments	-4 284	-900	-553	–	–	–
Extraordinary receipts	8 203	6 100	6 297	–	–	–
Borrowing requirement	**-23 796**	**-90 373**	**-175 844**	**-167 635**	**-155 611**	**-145 075**
Domestic short-term loans (net)	**12 225**	**15 400**	**49 700**	**21 000**	**20 000**	**20 000**
Domestic long-term loans (net)	**23 059**	**61 522**	**115 829**	**128 896**	**116 459**	**104 172**
Market loans	42 354	70 500	129 500	142 500	130 000	129 000
Redemptions[1]	-19 295	-8 978	-13 671	-13 604	-13 541	-24 828
Foreign loans (net)	**-3 954**	**3 837**	**11 457**	**14 139**	**15 552**	**17 303**
Market loans	–	9 800	16 098	15 013	17 529	29 364
Arms procurement loan agreements	3 059	3 872	3 845	2 361	1 914	1 360
Redemptions (including revaluation of loans)	-7 013	-9 835	-8 486	-3 235	-3 891	-13 421
Change in cash and other balances[2]	**-7 534**	**9 614**	**-1 142**	**3 600**	**3 600**	**3 600**
Financing	**23 796**	**90 373**	**175 844**	**167 635**	**155 611**	**145 075**

1. Redemption figures are net of anticipated switches, reducing redemptions by R8 billion in 2011/12 and by R35 billion in 2012/13.

2. A negative change indicates an increase in cash balances.

The difference in the financing requirements of consolidated government and national government will be raised by provinces and extra-budgetary institutions.

The significant increase in debt stock means debt-service costs also rise, from 2.3 per cent of GDP in 2008/09 to 2.5 per cent in 2009/10. While the deficit improves over the medium term, debt-service costs continue to rise to 3.2 per cent of GDP by 2012/13.

Debt-service costs rise to 3.2 per cent of GDP in 2012/13

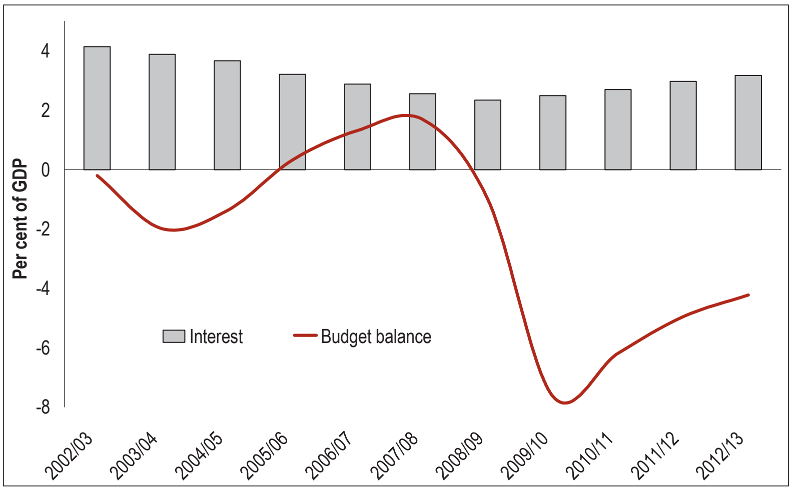
At a broader public sector level, the borrowing of the non-financial public enterprises, such as Transnet and Eskom, is expected to continue to increase in support of their capital expenditure programmes. While the revenues of these enterprises should recover strongly over the forecast period, continued growth in their capital programmes contributes to their high borrowing levels. Eskom will have to borrow about R120 billion over the next three years, though this number may change depending on the level of tariff increases.

Eskom will have to borrow about R120 billion over the next three years

The development finance institutions will expand their role in financing public-sector infrastructure investment. To support this process, government is providing additional support to the major development finance institutions. By increasing the callable capital of the Development Bank of Southern Africa, the bank is able to increase lending by about R102 billion over the next five years. The Land

Bank will be recapitalised to allow it to focus on the extension of development lending.

Figure 3.2 Consolidated government budget balance, 2002/03 – 2012/13



Public enterprises and development finance institutions should be financially sustainable

Both public enterprises and development finance institutions need to operate on a financially sustainable basis. Improving coordination, oversight and governance of these entities, as well as enhanced monitoring of their financial performance and development impact, is a policy priority.

As a result of the higher financing requirement of government and the non-financial public enterprises, the public-sector borrowing requirement is expected to widen to 11.8 per cent of GDP in 2009/10. While government's borrowing moderates somewhat over the medium term, the significant infrastructure programme of the non-financial public enterprises means that public-sector borrowing will average about 9.7 per cent over the next three years.

Table 3.5 Public-sector borrowing requirement, 2008/09 – 2012/13

	2008/09	2009/10		2010/11	2011/12	2012/13
R billion	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Main budget balance[1]	**27.7**	**95.6**	**181.6**	**167.6**	**155.6**	**145.1**
Extraordinary payments	4.3	0.9	0.6	–	–	–
Extraordinary receipts	-8.2	-6.1	-6.3	–	–	–
Financing requirement	**23.8**	**90.4**	**175.8**	**167.6**	**155.6**	**145.1**
Other government borrowing[2]	12.0	16.0	11.5	5.5	-1.1	-0.1
General government borrowing	**35.8**	**106.4**	**187.3**	**173.1**	**154.5**	**145.0**
Percentage of GDP	*1.5%*	*4.3%*	*7.8%*	*6.6%*	*5.4%*	*4.7%*
Plus: Non-financial public enterprises	53.2	91.4	97.2	121.3	115.6	115.8
Public sector borrowing requirement	**88.9**	**197.8**	**284.5**	**294.4**	**270.1**	**260.8**
Percentage of GDP	*3.8%*	*8.0%*	*11.8%*	*11.2%*	*9.4%*	*8.4%*
Gross domestic product	*2 321.2*	*2 474.2*	*2 405.1*	*2 620.1*	*2 868.7*	*3 111.3*

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

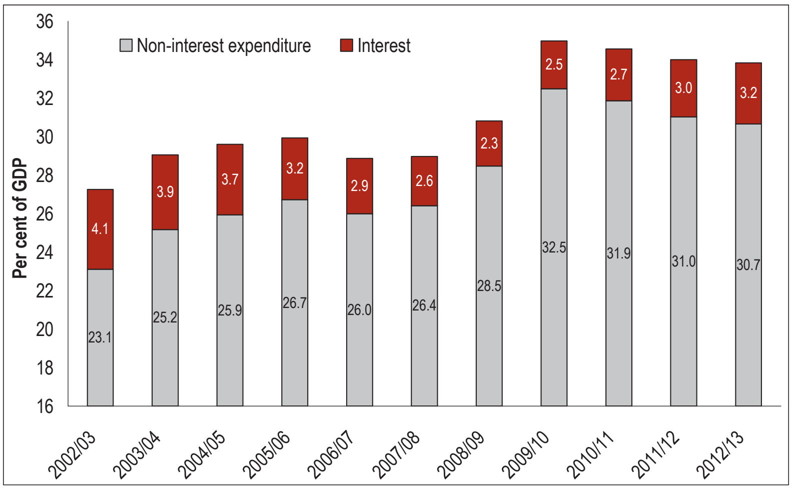
2. Includes social security funds, provinces, extra-budgetary institutions and local government.

Contributing to development

Over the past 10 years government has contributed substantially to social and economic development. Non-interest expenditure by consolidated government is estimated to have grown from 26 per cent of GDP in 2006/07 to 32.5 per cent in 2009/10.

Consolidated government's non-interest expenditure has grown to 32.5 per cent of GDP in current year

Figure 3.3 Consolidated government expenditure, 2002/03 – 2012/13



Growth in expenditure has stimulated economic activity and has been strongly redistributive, contributing to GDP growth and improvements in welfare for all South Africans. The magnitude of this increase was made possible by prudent management of the fiscus, leading to reductions in the deficit, low debt levels and declining debt-service costs.

Strong public spending trend has bolstered economic activity and contributed to welfare

Spending growth has been complemented by reprioritisation of expenditure away from consumption towards welfare transfers and payments for capital assets. In the proposed framework, the compensation of government employees receives a higher proportion of resources than in recent years. To accommodate this expenditure, growth in welfare transfers and capital expenditure moderates, but remains positive.

Growth in government consumption in 2008/09 and 2009/10 is driven by higher public-sector employment, larger salary increases and the introduction of occupation-specific salary dispensations, mainly in education and health. In a constrained fiscal environment these funding pressures are partially offset through slower growth in government employment, savings and reprioritisation of expenditure. The rapid increase in the wage bill in 2009/10 is a permanent cost to the fiscus that cannot be financed through borrowing. If future growth in the wage bill does not moderate, a permanent increase in tax revenue or lower expenditure on other items will be required.

Growth in government consumption is driven by public-sector employment and salary increases

One of government's successes over the past 10 years has been the extent to which it has redistributed resources through transfers to households. These targeted social grants have contributed to the reduction of poverty. Since 2003/04, transfers to households have grown at an average annual real rate of 12.8 per cent, increasing from 3.9 per cent of GDP in 2002/03 to 6.1 per cent in 2009/10.

Consolidated government capital expenditure has been growing by an average real growth rate of 15.6 per cent since 2004/05. Existing capital budgets are now substantially higher than in the recent past, reaching 7.8 per cent of non-interest consolidated government spending in 2009/10. While government capital expenditure stabilises, its contribution to higher levels of investment in infrastructure remains strong.

Investments by Transnet, Eskom expand economy's productive capacity

The non-financial public enterprises – principally Transnet and Eskom – are expected to continue the strong expansion of their capital infrastructure programmes. As a result, expenditure on public sector capital is expected to reach 9.8 per cent of GDP by 2012/13. This represents a considerable investment in the productive capacity of the economy and the ability of the state to provide goods and services. Table 3.6 shows that public infrastructure expenditure remains strong over the medium term, totalling R872 billion. Major funding by government includes further investment in school buildings, public transport, housing, water and sanitation. In addition, non-financial public enterprises continue to invest in power generation, transmission, distribution, transport hubs, freight rail and pipelines.

Public enterprises' capital programmes are financed by own revenue, borrowing and investment

Table 3.6 shows the three-year infrastructure plans of the public sector. Infrastructure projects of government departments and their agencies are budgeted for, while projects of the public enterprises will be financed through their own revenue, borrowing and private investment.

Table 3.6 Infrastructure expenditure estimates, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
R million	**Outcome**			**Estimate**	**Medium-term estimate[4]**		
National departments [1, 2]	4 631	5 712	6 318	8 024	8 709	10 592	10 497
Provincial departments [2]	27 112	29 395	36 094	41 870	48 004	53 434	56 310
Local government	21 084	30 736	39 577	49 950	52 906	57 596	63 787
Consolidated government	**52 827**	**65 843**	**81 989**	**99 844**	**109 619**	**121 622**	**130 594**
Extra-budgetary institutions	3 699	3 726	6 194	7 824	8 216	8 563	8 258
Public-private partnership[3]	1 343	3 857	4 942	2 740	4 553	15 231	13 376
General government	**57 869**	**73 426**	**93 125**	**110 408**	**122 388**	**145 416**	**152 228**
Non-financial public enterprise	25 736	56 765	79 386	127 018	146 070	153 374	152 607
Public sector	**83 605**	**130 191**	**172 511**	**237 426**	**268 458**	**298 790**	**304 835**

1. *Transfers between spheres have been netted out.*
2. *Includes maintenance of infrastructure assets.*
3. *Infrastructure expenditure on PPPs overseen by the Treasury PPP Unit, South African National Roads Agency, Department of Public Works and municipalities.*
4. *National Treasury estimates.*

Efficient implementation of government's infrastructure programme requires improved planning, monitoring and evaluation to ensure that capital budgets are directed towards South Africa's priorities and achieve value for money in the services they produce.

Fiscal sustainability

Sustainability – a core principle of fiscal policy – refers to the ability of government to finance its expenditure over a long period of time. A key indicator of sustainability is debt-service costs. If such costs are expected to rise as a percentage of GDP over the long term, the position is not sustainable. An unsustainable fiscal position can be financed in the short term through higher borrowing. However, pursuing an unsustainable fiscal stance for too long will result in spiralling debt costs – and eventually a costly adjustment through lower spending on service delivery and/or increases in tax rates.

An unsustainable fiscal stance would ultimately result in high debt costs and lower social spending

Figure 3.4 Revenue and non-interest expenditure, 2002/03 – 2012/13

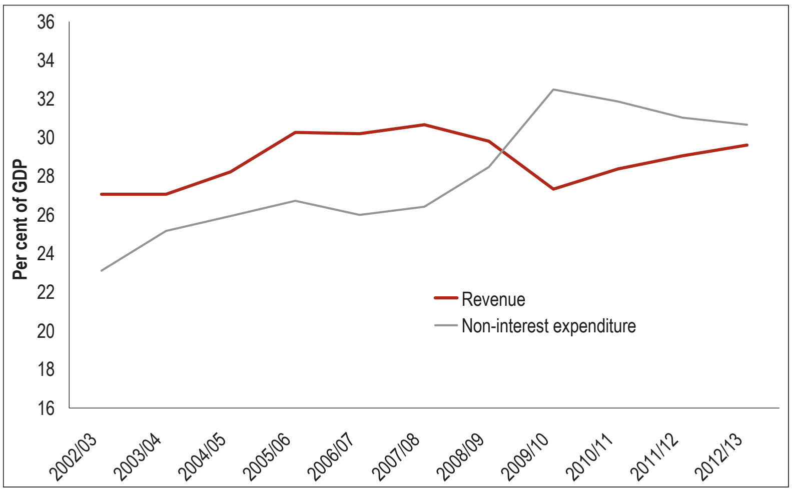


Figure 3.4 shows that strong growth in non-interest expenditure and a decline in budget revenue have resulted in a primary balance deficit. Over the medium term, the stabilisation of growth in non-interest expenditure and rising tax revenue will result in a narrowing of the primary balance deficit.

Primary balance deficit narrows over the medium term

The structural budget balance

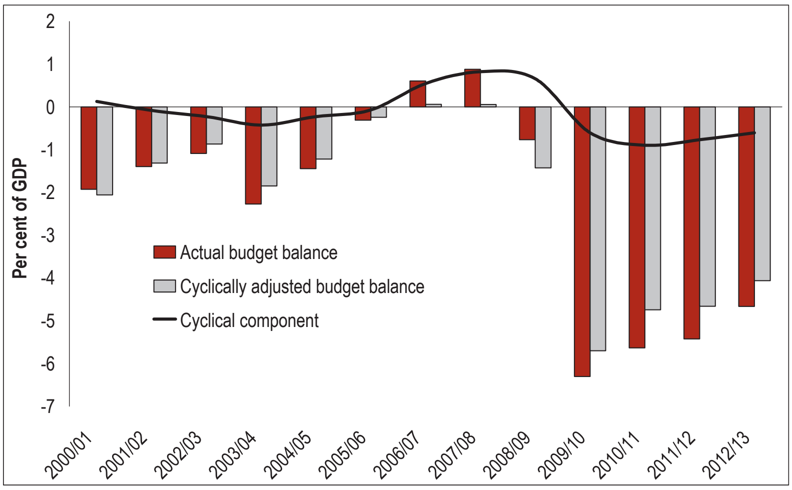
The structural budget balance (also referred to as the cyclically adjusted budget balance) takes account of temporary or cyclical factors that may make the budget deficit (or surplus) appear stronger or weaker than it actually is. In other words, it is an estimate of what the budget balance would be if the economy was performing at its potential growth level for a given set of spending and tax policies.

When the economy is performing above its potential growth level, as occurred between 2004 and 2007, higher revenue is generated and the budget deficit is lower than it would look under normal circumstances. Similarly, during the present recession, revenue has fallen, making the deficit look weaker than it would otherwise appear.

The structural budget deficit is measured at the main budget level, and is projected to be 5.7 per cent of GDP in 2009/10. The increase in the deficit is a result of a permanent increase in some categories of public spending, as well as a recognition that tax revenue is unlikely to

Structural budget deficit is projected to be 5.7 per cent of GDP in 2009/10 recover to pre-2007 levels over the medium term given slower projected economic growth.

Figure 3.5 The structural and main budget balances, 2000/01 – 2012/13



Other means of increasing budget revenue need to be considered in future

Analysis of future trends in the primary and structural budget balance indicates that stabilisation of debt-service costs as a percentage of GDP will require continued improvement in the fiscal balance beyond the forecast period. Combined with the stabilisation in expenditure growth, other means of increasing budget revenue will need to be considered. These include broadening the tax base, improving tax compliance and the introduction of new taxes (such as environmental taxes, to achieve both environmental and revenue objectives). This will permanently raise the level of tax revenue, resulting in a decline in the structural budget deficit and further improvements in the budget balance.