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Levers of development: opportunities and challenges

In brief

- The proposed framework for the 2013 Budget has been prepared in an environment of continued economic uncertainty. Growth has slowed in both advanced and developing economies, and recent domestic events have underlined the urgent need to accelerate South Africa's social transformation.
- Despite this challenging environment, South Africa's economy has continued to grow, supported by sound monetary and fiscal policies grounded in a stable institutional framework.
- Gross domestic product (GDP) growth is projected at 2.5 per cent this year – slightly lower than the 2.7 per cent forecast in the 2012 Budget. Growth is expected to improve to about 4 per cent in 2015.
- The proposed fiscal framework presents a disciplined spending trajectory, partially financed through a budget deficit of 4.5 per cent of GDP in 2013/14, which narrows to 3.1 per cent of GDP in 2015/16 as the economic recovery gains momentum.

■ Introduction

South Africa faces a confluence of difficult global and domestic challenges over the period ahead. These reflect the stage of development at which we find ourselves. The mining sector needs to modernise and industries have to compete. Labour needs the skills to function in the global economy. Communities need to overcome barriers to social cohesion. And the state must improve its ability to promote inclusive development in a highly unequal society.

Confronting the challenges of development in a highly unequal society

The *Medium Term Budget Policy Statement* sets out government's view of the fiscal and economic dimensions of these imperatives.

Achieving the inclusive society envisioned in the Constitution depends on bringing about an efficient developmental state that helps to build capabilities throughout the economy and society, while intervening to redress historical inequalities. It requires a growing economy that generates jobs and economic opportunities for all. And it will take

commitment, hard work and resilience to radically improve the prospects of all South Africans.

National Development Plan provides a clear, progressive approach for long-term development

The National Development Plan, endorsed by Cabinet in September of this year, sets out an approach to development leading up to 2030. It provides government with a clear and progressive foundation on which to develop the work of the state and align the public finances.

The medium-term expenditure framework (MTEF) proposed for the 2013 Budget takes the National Development Plan as a point of departure. Government recognises that choices have to be made within prudent fiscal limits shaped by the current circumstances, while laying the foundations on which to build in future budgets.

Critical actions to promote growth and development

The National Development Plan sets out 10 “critical actions” on which government policy can proceed in partnership with the private sector, trade unions and civil society:

- A social compact to reduce poverty and inequality, and raise employment and investment.
- A strategy to address poverty and its effects by broadening access to employment, strengthening the social wage, improving public transport and raising rural incomes.
- Steps by the state to professionalise the public service, strengthen accountability, improve coordination and prosecute corruption.
- Boost private investment in labour-intensive areas, competitiveness and exports, with adjustments to lower the risk of hiring younger workers.
- An education accountability chain, with lines of responsibility from state to classroom.
- Phase in national health insurance, with a focus on upgrading public health facilities, producing more health professionals and reducing the relative cost of private health care.
- Public infrastructure investment to reach 10 per cent of GDP, financed through tariffs, public-private partnerships, taxes and loans and focused on transport, energy and water.
- Interventions to ensure environmental sustainability and resilience to future shocks.
- New spatial norms and standards – densifying cities, improving transport, locating jobs closer to where people live, upgrading informal settlements and fixing housing market gaps.
- Reduce crime by strengthening criminal justice and improving community environments.

Policies, plans and actions for change

South Africa’s record of sound macroeconomic and fiscal management means that government is able to confront the complexities of the present economic environment from a position of strength. The long-term structural reforms outlined in the National Development Plan are complemented by the nearer-term goals set out in the New Growth Path and the Industrial Policy Action Plan, and the work of the Presidential Infrastructure Coordinating Commission.

Arrangements for planning, cooperation and implementation are being strengthened

Strengthening the arrangements through which planning, cooperation and implementation are achieved will be a key determinant of progress in implementing these plans. An initiative by the President has recently brought together government, business and labour representatives to respond with urgency to the underlying causes of worker discontent and civil unrest, and to find collaborative solutions to address the country’s longer-term economic and social needs.

In the near term, the global economic context is not expected to be supportive of more rapid domestic growth. Following the initial recovery

from the 2008-2009 recession, growth has slowed in both advanced and developing economies. Yet there are clear opportunities for expansion and realignment in the period ahead. Trade and investment in many sub-Saharan African economies are buoyant, world food demand is increasing, and industrial production linkages and service sectors are becoming more globally integrated.

South Africa has plans and programmes to address the structural impediments to more rapid participation in these developments, including:

- Construction of new power plants to provide adequate electricity.
- Expansion of rail lines serving export markets and improvements of the efficiency of transport logistics.
- Efforts to promote skills development.
- Programmes to boost agricultural production.
- Initiatives to overcome deficiencies in land and housing markets.
- Approaches to eliminate hurdles to small business development.

These initiatives will take place within a disciplined spending trajectory partially financed through a budget deficit of 4.5 per cent of GDP in 2013/14, narrowing to 3.1 per cent of GDP in line with improved economic growth by 2015/16.

Infrastructure investments, skills development address growth constraints

Budget deficit of 4.5 per cent of GDP in 2013/14 and 3.1 per cent of GDP by 2015/16

Sound institutional framework

South Africa has a sound institutional framework built on the foundation of the Constitution. It has proven resilient and capable of mediating the contradictions that accompany development in an unequal and sometimes fractious society. Four successful national elections have given practical expression to the country's commitment to democracy. Vigorous contest between political parties has enabled diverse communities to express themselves in the national debate. The Chapter 9 institutions established by the Constitution, such as the Public Protector and the Auditor-General, regularly assert their independence in safeguarding democratic practice. The judiciary pursues its mandate with vigour. A free media and civil society organisations play a vital role in keeping South Africans informed and empowered to make their own choices.

Sound institutions capable of mediating the contradictions of development

Government's record of sound fiscal management and transparent budget practices has been strengthened by legislative reforms that enhance the contribution of Parliament to public finance management. Fiscal guidelines ground the management of revenue and expenditure in a sustainable countercyclical policy framework. Building on these guidelines, the National Treasury is preparing a long-term fiscal report to enhance the policy debate and make explicit the implications of new public finance initiatives for future generations.

A record of prudent fiscal management and transparent budget practices

Developmental role of the state

The state has a critical role to play in development. In South Africa's circumstances, this is partly a consequence of historical legacies that have to be addressed. But it is also shaped by forward-looking imperatives. Good-quality public services, economic infrastructure and investment in

human resources are crucial to achieving growth and broad-based development. Such services are needed to ensure that poor communities can participate in a modernising economy. It is also the role of the state to ensure that the interests of all South Africans – including those without effective voice – are balanced constructively, within an inclusive vision of our shared future.

Over the MTEF period, further steps will be taken to strengthen the capacity and efficiency of government departments. Particular attention will be paid to implementing reforms in provincial and municipal infrastructure planning and delivery.

New steps to combat waste, inefficiency and corruption in the state

Government will also step up its efforts to combat waste, inefficiency and corruption. Reforms will focus on procurement systems that prioritise value for money and strengthening the anti-corruption system as a whole.

Overview of the 2012 policy statement

Proposing government's spending framework for the next three years

The *Medium Term Budget Policy Statement* is a part of South Africa's institutional framework. It broadly serves four purposes:

- To outline the economic context in which the forthcoming government budget is being formulated.
- To explain fiscal policy in the context of the economic outlook.
- To present the division of nationally collected revenue between national, provincial and local government.
- To propose government's spending framework for the next three years.

This information is presented to Parliament and for public debate to ensure that the processes by which the government arrives at its budget are transparent, aligned with economic circumstances and address policy priorities within a sustainable financial framework.

Economic outlook

Chapter 2 discusses the economic outlook.

Since 2008, private- and public-sector deleveraging in many advanced economies has acted as a brake on growth, affecting many developing economies – including China, India and Brazil. Likewise, the South African economy has yet to recover to the higher levels of growth and broadening participation achieved in the years leading up to the recession.

Stronger recovery depends on resolution of global challenges and progress in addressing structural constraints at home

Sustaining a stronger economic recovery will require both a resolution of global economic challenges – particularly the crisis in Europe and weak growth prospects in the United States – and greater progress in addressing South Africa's structural and economic policy challenges.

The South African economy is projected to grow by 2.5 per cent in 2012. By 2014, GDP growth is expected to reach 3.8 per cent, supported by expanding public-sector investment in infrastructure, the activation of new electricity-generating capacity, improving private-sector confidence, relatively low inflation and interest rates, and strong growth in the southern African region.

Table 1.1 Macroeconomic projections, 2011 – 2015

Calendar year	2011 Actual	2012 Estimate	2013	2014 Forecast	2015
<i>Percentage change unless otherwise indicated</i>					
Final household consumption	5.0	3.4	3.5	4.0	4.2
Gross fixed capital formation	4.4	5.2	4.5	5.1	5.8
Real GDP growth	3.1	2.5	3.0	3.8	4.1
GDP at current prices (R billion)	2 964.3	3 202.5	3 513.5	3 868.9	4 263.9
CPI inflation	5.0	5.7	5.5	5.1	4.9
Current account balance (% of GDP)	-3.3	-5.9	-5.8	-5.5	-5.5

To improve confidence in the economy, expand trade and investment, increase employment and broaden participation in the economic recovery, government will target progress in several areas:

- Re-establishing orderly labour relations
- Investing in strategic infrastructure programmes, including energy generation and transport capacity needed to open up new mining and industrial opportunities
- Strengthening municipal finances, and investing in residential development and urban infrastructure
- Promoting special economic zones with industrial and export development potential
- Accelerating youth employment opportunities
- Improving living conditions for miners and upgrading informal settlements
- Shifting the export mix towards emerging markets, with particular focus on expanding trade and investment on the African continent
- Providing agricultural support and promoting small business development.

Prudent fiscal management, a flexible exchange rate and an effective inflation targeting regime serve as the macroeconomic foundation for these reforms. Sectoral strategies and priorities identified in the National Development Plan will, over time, be translated into practical programmes and policies, drawing on the capacity and initiative of both the public and private sectors.

Prudent fiscal management, flexible exchange rate and inflation targeting provide solid foundation for reforms

Fiscal policy and trends

Chapter 3 discusses fiscal policy and trends.

South Africa's fiscal framework remains grounded in a sustainable, countercyclical approach to managing revenue and expenditure. Spending growth will be well contained over the medium term. Key social and economic programmes will be continued, complemented by efforts to improve the quality of spending.

Spending growth will be well contained over the medium term

Fiscal policy will narrow the budget deficit from a projected 4.8 per cent of GDP in 2012/13 to 3.1 per cent of GDP in 2015/16, enabling government to rebuild fiscal space. In addition, three policy objectives will be targeted:

- Ensuring that expenditure grows at a moderate pace. Government has decided that there will be no upward adjustment of the spending projection set out in the 2012 Budget over the first two years of the MTEF, with moderate growth in the outer year.
- Stabilising public debt. This will require a significant reduction in the deficit. The combination of slower spending growth and recovery in revenue as economic growth gathers pace will stabilise debt as a percentage of GDP by 2015/16.
- Improving the impact of spending, including by shifting the balance of resource allocation towards investment in infrastructure.

Sustainable budget structure will continue to promote growth, equity and employment

As the economic context changes over the medium term, government will realign its policy stance, firmly grounded in a sustainable budget structure that promotes growth, equity and employment.

If the economic environment deteriorates, government will need to reconsider current expenditure and revenue growth plans. In a lower-growth scenario, an appropriate balance between spending restraint and new revenue initiatives would be necessary. In either case, the necessary adjustments will avoid an unwarranted early withdrawal of fiscal support.

Table 1.2 Consolidated government fiscal framework, 2011/12 – 2015/16

	2011/12	2012/13	2013/14	2014/15	2015/16
R billion	Outcome	Estimate	Medium-term estimates		
Revenue	837.0	900.6	986.1	1 092.1	1 205.0
Percentage of GDP	27.7%	27.5%	27.5%	27.6%	27.6%
Expenditure	964.4	1 057.1	1 147.4	1 238.1	1 339.0
Percentage of GDP	32.0%	32.3%	32.0%	31.3%	30.7%
Budget balance	-127.4	-156.5	-161.3	-146.0	-134.0
Percentage of GDP	-4.2%	-4.8%	-4.5%	-3.7%	-3.1%

Medium-term expenditure framework and division of revenue

Chapter 4 discusses the MTEF and the division of revenue.

Progress in delivery of services requires greater focus on effective use of existing allocations

Government's ability to support accelerated growth and employment, and to reduce poverty and inequality, is not primarily limited by the quantity of funds available. Over the past decade, government spending excluding inflation has doubled, significantly expanding access to education, health, basic services and social grants. However, there has not always been a commensurate increase in the quality of public services or in the performance of the public sector itself. Making progress in the delivery of public services requires greater focus on the use of existing allocations, and a shift in the composition of spending from current consumption towards capital investment. These changes are particularly important given current fiscal constraints.

Fiscus does not increase available funds beyond the budget baseline

The proposed spending framework approved by Cabinet takes account of the need to control growth in spending while increasing the efficiency of existing allocations to improve public services. As a result, the fiscus does not increase available funds beyond the 2012 budget baseline.

Table 1.3 Division of revenue, 2012/13 – 2015/16

R billion	2012/13	2013/14	2014/15	2015/16
National allocations	412.3	446.6	481.4	510.4
Provincial allocations	388.9	417.9	447.5	477.9
<i>Equitable share</i>	313.0	335.3	357.3	378.8
<i>Conditional grants</i>	75.9	82.7	90.2	99.1
Local government allocations	77.5	84.5	91.6	100.7
Total allocations	878.7	949.0	1 020.5	1 089.0
Changes to baseline				
National allocations	-0.1	0.3	2.6	13.5
Provincial allocations	4.4	6.8	10.5	20.8
<i>Equitable share</i>	4.0	6.3	8.0	13.4
<i>Conditional grants</i>	0.5	0.5	2.5	7.4
Local government allocations	0.1	0.7	0.9	5.8
Total	4.5	7.9	14.0	40.1

Departments have reprioritised spending away from programmes that are not meeting performance requirements or that are not closely aligned to departmental mandates. Government has also asked national and provincial departments to reduce expenditure where possible over the medium term so that these funds can be reallocated to infrastructure and other priorities.

Table 1.4 Consolidated government expenditure, 2012/13 – 2015/16

	2012/13	2013/14	2014/15	2015/16	Average annual growth
R billion	Revised estimate	Budget estimate			2012/13 – 2015/16
General public services	53.3	56.0	59.6	62.1	5.2%
Defence and state security	42.0	44.7	47.4	50.2	6.1%
Public order and safety	99.7	107.0	113.2	119.7	6.3%
Transport, energy and communication	83.5	91.5	98.8	105.1	7.9%
Economic services	44.6	48.1	50.4	52.6	5.6%
Local government, housing and community amenities	121.7	132.5	144.5	157.5	9.0%
Health and social protection	246.2	267.8	287.5	306.4	7.6%
Education and related functions	220.0	234.0	250.5	268.9	6.9%
Employment and social security	43.0	48.6	53.9	55.9	9.1%
Science and technology	14.1	14.5	15.4	16.0	4.1%
Contingency reserve	–	4.0	10.0	30.0	
Non-interest expenditure	968.3	1 048.8	1 131.3	1 224.2	8.1%
State debt cost	88.8	98.6	106.8	114.8	8.9%
Total expenditure	1 057.1	1 147.4	1 238.1	1 339.0	8.2%

Over the next three years reprioritisation of funds by departments amounts to about R40 billion. This money, combined with drawdowns in the contingency reserve, will allow for the revision of budget baselines without any increase in government spending. Funds are shared between national, provincial and local government, enabling them to meet the higher costs of the public-sector wage settlement and give effect to government priorities.

Reprioritisation and drawdowns on contingency reserve allow for revisions to budget baselines without increased spending

Government plans and programmes are addressing the structural impediments to more rapid growth

Conclusion

Challenging times require South Africans to unify and give effect to the sound plans that we have developed. While the global outlook is not expected to improve markedly in the short term, there are many areas of opportunity. A range of plans and programmes is addressing the structural impediments to more rapid participation in these developments, including expansion of economic infrastructure, and efforts to grow trade and investment on the African continent.

The proposed framework for the 2013 Budget recognises the need for a further shift in the composition of spending to contribute to these reforms. This will take place within a disciplined spending trajectory consistent with long-term fiscal sustainability.