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Securing inclusive growth

In brief

- The budget policy framework for the next three years is designed to manage risk in a constrained fiscal environment, while building a foundation for faster and more inclusive long-term growth.
- Gross domestic product (GDP) growth of 2.1 per cent is expected in 2013, rising to 3.5 per cent in 2016.
- The expenditure ceiling set out in the 2013 Budget forward estimates will be maintained for the period ahead, and the budget deficit will narrow from 4.2 per cent in the current year to 3.0 per cent in 2016/17.
- Non-interest expenditure will continue to grow in real terms, averaging 2.2 per cent a year over the medium term.
- Measures to support faster growth include investing in electricity and transport capacity, promoting industrial competitiveness, and broad social cooperation to address challenges in mining and community development.
- Distribution of resources is in line with the National Development Plan (NDP). Health and education continue to receive the largest allocations, while budgets related to infrastructure, jobs, local government and community development grow strongly.

Introduction

The 2013 *Medium Term Budget Policy Statement* (MTBPS) sets out a framework for sustainable public finances, while managing vulnerability to economic and fiscal risks. It outlines key steps in South Africa's transition to faster, more inclusive growth.

South Africa is adapting to changing patterns of global opportunity and pressing development challenges

In adjusting to somewhat lower economic growth, South Africa is also adapting to changing patterns of global opportunity and pressing development challenges. A competitive, diversified and more inclusive economy is essential to improve trade performance, expand and sustain job creation, and strengthen revenue generation. South Africa's strategy for increased employment and growth and lower income inequality is set out in the NDP, and elaborated in a wide range of government programmes and policy documents. The budget gives practical expression to these plans for the three-year period ahead.

Effective cooperation between government, business, labour and civil society will anchor national development

While much has been achieved in transforming South Africa's social and developmental landscape since 1994, there is considerable scope for improving programme implementation and the pace of reform. There is also much to gain from more effective partnerships and cooperation between government, business, labour and civil society. The MTBPS indicates steps to be taken to strengthen government performance, and to promote an enabling environment for investment and enterprise development.

Smoothing volatility during a period of global turbulence

Macroeconomic policy has provided support to the economy and reduced exposure to volatility

It has been five years since the start of the global financial crisis. Over this period, macroeconomic policy has focused on providing support to the economy, minimising South Africa's exposure to volatility, and encouraging domestic and international investment.

Countercyclical fiscal policy resulted in a widening budget deficit and increased borrowing as South Africa was faced by recession and then a period of slow growth. In the period ahead, spending on infrastructure, health, education and social assistance will continue to grow, while the deficit will narrow to protect long-term sustainability.

Monetary policy has provided a low interest rate environment to encourage capital investment and assist households. The inflation-targeting framework continues to protect savings, wages and social benefits from being more rapidly eroded by inflation.

Foreign reserves have risen from US$34.1 billion at the end of 2008 to US$47.9 billion at the end of August 2013. Effective regulatory oversight of the financial system contributes to stability and confidence in South Africa as an investment destination.

Continued growth for three years despite unfavourable global and domestic circumstances

South Africa's economy has expanded over the past three years, but the rate of growth has steadily declined, from 3.5 per cent of GDP in 2011 to a projected 2.1 per cent in 2013. This trend reflects a confluence of unfavourable global and domestic circumstances.

Over the past year, economic growth in emerging economies has slowed, while the outlook has improved somewhat in industrialised economies. The intention to phase out the US Federal Reserve's asset purchase programme, which has flooded global markets with liquidity, has contributed to turbulence in capital flows and currencies. Commodity prices have declined from historically high levels. South Africa's economy has also been affected by the limited availability and rising cost of electricity, labour disputes, rising unemployment and lower household consumption, weak business confidence and lower private sector investment.

South Africa faces a widening current account deficit and rising borrowing costs

In combination, these developments have contributed to a widening current account deficit, rising costs of borrowing in bond markets and a significant weakening of the rand exchange rate.

South Africa's current account deficit will be about 6.5 per cent of GDP this year, which reflects both the low level of domestic savings and considerably higher imports than exports. This means the economy is reliant on foreign savings to fund the gap between government revenue and spending, and the cost of infrastructure expansion.

South Africa's policy choices provide flexibility in the face of uncertain capital inflows

In recent years, the current account deficit has been comfortably financed by capital inflows, signalling the broad confidence of international investors in South Africa's economic prospects. Investor sentiment is volatile, however, and global capital allocation is likely to shift as the US monetary authorities taper their asset purchase programme. Government's supportive macroeconomic, fiscal and monetary policies provide the economy with flexibility to adjust and to weather short-term volatility.

South Africa's clear articulation of a credible growth strategy, and effective implementation of programmes to broaden participation and reduce inequality, are important foundations of both domestic confidence and continued financial stability.

Table 1.1 Macroeconomic projections, 2012 – 2016

Calendar year	2012 Actual	2013 Estimate	2014	2015 Forecast	2016
Percentage change unless otherwise indicated					
Final household consumption	3.5	2.5	2.9	3.2	3.4
Gross fixed capital formation	5.7	4.1	5.0	5.5	6.3
Real GDP growth	**2.5**	**2.1**	**3.0**	**3.2**	**3.5**
GDP at current prices (R billion)	**3 155.2**	**3 411.7**	**3 720.2**	**4 061.7**	**4 443.7**
CPI inflation	5.7	5.9	5.6	5.4	5.4
Current account balance (% of GDP)	-6.3	-6.5	-6.4	-6.2	-6.1

Across all tables in the MTBPS, the use of "0" refers to a value of small magnitude that is rounded up or down to zero. If a value is exactly zero, it will be denoted by "–". If data is not available it is denoted by "N/A"

Realising our long-term economic potential

Government policy is ultimately focused on increasing South Africa's long-term economic growth and reducing inequality.

Capital investment in transport, electricity and water infrastructure boosts future growth prospects

South Africa has a sound institutional framework underpinned by the authority of the Constitution. The economy is supported by a sophisticated, stable financial system and liquid capital markets. Global firms continue to see the country as a platform to expand throughout the African continent, particularly the fast-growing sub-Saharan region. The public-sector infrastructure programme is broadening the capacity of the economy to grow by reducing bottlenecks in transport, electricity, water and other sectors. Mineral resources will continue to be a source of growth for many years to come. Worker rights are entrenched in law, with a strong voice for labour in social dialogue. An expanding social wage protects low-income and vulnerable households. A substantial technical and industrial base supports research, development and innovation. Our young population is eager to work, gain new skills and make its own productive contributions.

Structural reforms required for a faster-growing economy

To give effect to this potential, government is working to implement the NDP, manage medium-term risks and enact structural reforms to the economy.

Implementing the National Development Plan

Government recognises that South Africa cannot rely on global growth to put the economy on a new footing

While the global economic outlook has improved moderately, South Africa cannot rely on external developments to alleviate domestic growth constraints. Progress will require more collaborative partnerships across our society.

The NDP provides a strong platform for such collaboration and the transition to a faster-growing, more inclusive economy. The plan promotes enhanced competitiveness, expanded infrastructure, greater spatial efficiency in growing cities and accelerated rural development. It prioritises measures to build a capable, effective state that delivers services to citizens while encouraging business investment and growth.

Several interrelated sectoral and developmental programmes give greater content to the outcomes envisaged in the NDP. These include the work of the Presidential Infrastructure Coordinating Commission, the Industrial Policy Action Plan, the National Education Collaboration Trust and the new phase of the expanded public works programme.

Addressing short-term constraints in key economic sectors

Government is working with business, labour and state-owned companies to address both short-term sectoral challenges and longer-term constraints. Key initiatives include:

- An agreement aiming to secure more rapid and peaceful resolution of labour disputes in the mining sector.
- Building consensus on the future development of the mining sector.
- Addressing gaps in the social wage and working conditions that contribute to lengthy labour disputes.
- Investing in freight capacity to help alleviate supply bottlenecks.
- Improving pricing, efficiency and competitiveness at local ports.
- Developing the clothing and textiles competitiveness programme.
- Helping manufacturers to modernise production processes to meet international standards.
- Tariff protection in response to unfair trade practices by importing firms and exporting countries.
- Supporting the motor industry through grant-based incentives and tax offsets.
- Introducing designated products for local production as part of government procurement policy.
- Broadening access to finance and support services for small (particularly black-owned) businesses.

Repositioning the economy in a changing world

The economy has begun to adapt to a sea change in world trade and investment

The world economy has changed dramatically over the past five years. The sea change signalled by the growth of emerging markets in world trade and investment poses challenges and opportunities for South Africa. Our economy has begun to adapt to these changed patterns.

At the same time, global financial and monetary trends, new technologies, urbanisation, climate change and demographic shifts pose complex challenges for both industrialised and emerging economies. Macroeconomic policy, industrial development, the role of state enterprises, economic regulation, tax structure and spending programmes all confront difficult trade-offs and uncertainties in seeking to improve livelihoods, lower the cost of doing business and improve government performance.

Many South African firms have begun to adapt to changes in the world economy. Such companies are adjusting to changing cost structures and patterns of demand, integrating into global and regional value chains, and expanding their African operations. Further implementation of well-targeted sectoral initiatives will promote greater competitiveness and balanced growth.

The NDP points out that rebalancing and transforming the economy will take time. Complementary policies are needed to boost employment and economic participation, basic education, and skills acquisition. Greater competitiveness will enable local firms to access new markets and hire more people.

Over the medium term, several developments will support the transition to more rapid growth:

Over the next three years, South Africa will have more electricity, rail and roads to support growth

- Additional electricity supply, with Eskom's Medupi plant set to come on line in late 2014
- Increased investment in economic infrastructure, including rail, water, roads, ports and broadband communication
- Clear policy frameworks for new gas and oil exploration, improving South Africa's ability to meet its future energy requirements
- Business support programmes and special economic zones that encourage industrialisation and improve local competitiveness
- Improved urban planning and more efficient public transport
- Collaboration between public- and private-sector agencies in agricultural development and support for emerging farmers.

Work under way to boost production and employment

Government's initiatives to relieve energy supply constraints include:

- Publication of draft regulations for shale gas exploration in October 2013, with a view to processing exploration applications in 2014.
- Progressive implementation of the renewable energy independent power producer programme, now in its third round of contract awards.
- Publication of blending regulations for biofuels, with pricing arrangements to be finalised by mid-2014.
- Requests for proposals to procure the next coal-fired power station and for co-generation of electricity to be issued by mid-2014.
- Amendments to the Mineral and Petroleum Resources Development Act are being discussed in Parliament. These should reduce ambiguity, streamline administration, clarify governance concerns and encourage beneficiation.

Initiatives to bolster employment and address scarce skills constraints include:

- Revision of regulations relating to the immigration of skilled workers.
- Drafting of an employment tax incentive, now under consideration by Parliament.

Other steps to promote investment and lower the costs of doing business include:

- Centralising all steps to acquire mining licenses, including environmental approvals and water licences, in the Department of Mineral Resources.
- Strengthening the capacity of the competition authorities.
- A draft Promotion and Protection of Investment Bill to reinforce property rights.
- A bill to establish two new financial sector regulatory authorities will soon be submitted to Cabinet.

Regional integration has provided a new growth opportunity for South African businesses. South Africa is the second-largest developing-country source of foreign direct investment in Africa (ahead of China and India) and the largest recipient of private equity on the continent. South Africa is also well placed to support infrastructure development and strengthen regional economic collaboration within the Southern African Development Community and the Southern African Customs Union.

Reinforcing the fiscal stance

The 2013 MTBPS takes account of South Africa's greater vulnerability to economic shocks by reinforcing the fiscal stance, which balances consolidation with support to the economy.

Table 1.2 Consolidated government fiscal framework, 2012/13 – 2016/17

	2012/13	2013/14	2014/15	2015/16	2016/17
R billion	Outcome	Estimate	Medium-term estimates		
Revenue	**907.9**	**999.1**	**1 086.3**	**1 184.2**	**1 306.0**
Percentage of GDP	*28.3%*	*28.7%*	*28.6%*	*28.5%*	*28.7%*
Expenditure	**1 042.9**	**1 143.7**	**1 243.8**	**1 340.4**	**1 440.2**
Percentage of GDP	*32.5%*	*32.8%*	*32.7%*	*32.3%*	*31.7%*
Budget balance	**-135.0**	**-144.6**	**-157.5**	**-156.3**	**-134.2**
Percentage of GDP	*-4.2%*	*-4.2%*	*-4.1%*	*-3.8%*	*-3.0%*

Since 2008, government and state-owned enterprises have issued more than R1 trillion in debt to invest in infrastructure and maintain core social and economic programmes. At the same time, government has adopted a budget framework to ensure that public finances remain sustainable, and that expenditure growth does not outpace revenue growth.

To reinforce this stance, the framework for the 2014 Budget:

- Continues to support programmes that enhance the social wage
- Maintains the spending ceiling announced in the 2013 Budget and reduces the budget deficit over the medium term to stabilise the trajectory of public debt
- Limits the growth of government's wage bill by curtailing growth in personnel spending
- Takes steps to reduce waste and inefficiency in government spending
- Closes the gap between revenue and consumption, so that borrowing can increasingly finance capital and investment spending.

Slower growth in expenditure and debt stabilisation needed to rebuild fiscal space

Expenditure will continue to grow in real terms, averaging 2.2 per cent a year over the medium term (excluding interest on debt). The fiscal stance will contribute to a narrowing of the deficit, from 4.2 per cent in the current year to 3.0 per cent in the outer year. This will enable government to stabilise debt and begin rebuilding fiscal space to fund new priorities.

Government's contribution to improved performance in the economy and in the provision of public services is strongly focused on better use of existing resources, rather than higher expenditure.

Table 1.3 Division of revenue, 2013/14 – 2016/17

R billion	2013/14	2014/15	2015/16	2016/17
National allocations	452.5	487.9	520.4	550.1
Provincial allocations	415.8	444.7	478.2	507.8
Equitable share	*338.9*	*362.5*	*388.0*	*412.0*
Conditional grants	*76.9*	*82.3*	*90.2*	*95.8*
Local government allocations	84.8	91.9	101.4	106.7
Total allocations	**953.1**	**1 024.5**	**1 099.9**	**1 164.6**
Changes to baseline				
National allocations	–	-1.6	-1.4	2.2
Provincial allocations	1.7	3.0	3.8	4.4
Equitable share	*1.4*	*2.5*	*4.3*	*5.1*
Conditional grants	*0.3*	*0.5*	*-0.5*	*-0.7*
Local government allocations	0.1	0.3	-0.1	-0.1
Total	**1.8**	**1.7**	**2.4**	**6.5**

Building an efficient developmental state

The NDP recognises that a more efficient state is needed to increase levels of delivery. Steps to promote greater state efficiency include improvements to policy formulation, procurement and management systems; developing mechanisms for sharing skilled personnel in critical delivery areas; and minimising waste. Many of these improvements do not require additional budget allocations and will enable government to provide services that can be a catalyst for growth.

Targeted reforms to make the state more efficient by increasing capacity and streamlining administration

The Presidential Infrastructure Coordinating Commission has been established to improve planning and decision-making to speed up delivery of infrastructure projects. Levels of coordination have improved across different spheres of government, skills gaps have been assessed and incorporated into project planning cycles, and the long-term economic impact of projects is beginning to be reviewed.

Strengthening procurement to obtain value for money

A large share of the national budget is spent to build infrastructure, and to procure goods and services. This expenditure contributes to production and jobs throughout the economy. Government must ensure that its procurement processes are prudent, deliver value for money and help to improve service delivery.

The Office of the Chief Procurement Officer, created in April 2013, will minimise waste and corruption, and ensure that government derives maximum social and economic benefits from every rand spent.

Over the next six months, the office will pilot reference pricing. The following steps are being taken as part of developing the pilot programme:

- Fair values of targeted products have been determined.
- Guidelines are being developed.
- Discussions with key spending departments and agencies are under way to prepare for implementation.

The Office of the Chief Procurement Officer works in tandem with the South African Revenue Service, the Accountant-General and Auditor General of South Africa to decrease corruption and minimise waste.

Over the medium term, efforts continue to focus on strengthening the capacity of existing state employees and to attract required skills into the public service, as well as streamlining and simplifying administrative procedures. The budget process is a mechanism through which some of the required reforms take place.

Table 1.4 Consolidated government expenditure, 2013/14 – 2016/17

R billion	2013/14 Revised	2014/15	2015/16 Budget estimate	2016/17	Average annual growth 2013/14 – 2016/17
Defence and state security	44.9	47.5	50.4	53.6	6.1%
Economic services	47.3	48.7	51.1	53.4	4.2%
Education and related functions	233.6	250.2	267.8	286.5	7.0%
Employment and social security	50.6	60.0	66.7	74.6	13.8%
General public services	62.1	65.3	69.4	71.0	4.6%
Health and social protection	266.0	289.2	308.6	328.4	7.3%
Local government, housing and community amenities	128.1	141.2	153.8	163.2	8.4%
Public order and safety	109.6	116.0	122.3	130.7	6.1%
Science and technology	16.8	18.1	19.5	19.5	5.2%
Transport, energy and communication	84.3	94.1	102.7	105.8	7.9%
Total expenditure by function	**1 043.2**	**1 130.4**	**1 212.3**	**1 286.8**	**7.2%**
State debt cost	100.5	110.4	122.2	135.4	10.4%
Contingency reserve	–	3.0	6.0	18.0	
Total expenditure	**1 143.7**	**1 243.8**	**1 340.4**	**1 440.2**	**8.0%**

Conclusion

The MTBPS sets the economic context for the next budget, explains fiscal policy and presents a three-year spending framework

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 and improve alignment with the outcomes set out in the NDP.

The subsequent chapters of the MTBPS are as follows:

- Chapter 2 discusses the economic outlook.
- Chapter 3 discusses fiscal policy and trends.
- Chapter 4 discusses the MTEF and the division of revenue.

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.