3

Fiscal policy and trends

In brief

- Government will meet its budget deficit target for 2013/14.
- As a result of a weaker-than-expected economic outlook, the fiscal stance is being reinforced.
- During 2014/15 and 2015/16, spending will remain within the non-interest expenditure ceiling established in the 2013 *Budget Review*. A spending limit has also been set for 2016/17, holding real non-interest expenditure growth to an annual average of 2.2 per cent over the three-year spending period.
- Spending on key social and economic programmes will be maintained.
- Net national debt is projected to stabilise at 44 per cent of GDP in 2017/18.
- State-owned companies continue to borrow to finance capital investment. Government works with these companies to ensure they can borrow at reasonable cost while increasing their efficiency. Over the period ahead, state corporations are not expected to be funded from the fiscus.

Introduction

Fiscal framework balances consolidation with service delivery needs

South Africa's fiscal policy continues to be rooted in the principles of countercyclicality and long-term sustainability. The framework for the three-year spending period ahead strikes a balance between consolidation and support for the economy.

Over the medium term government will:

- Meet the 2013/14 fiscal deficit target of 4.2 per cent, as defined in the new format presented in the *2013 Budget Review*.
- Continue financing real increases in spending that enhance the social wage, within a clear and explicit expenditure ceiling.
- Reduce the deficit substantially to level off the public debt trajectory.
- Ensure that government's wage bill remains sustainable.

Implementing the NDP, investing in infrastructure, and combating waste and corruption

The budget framework also seeks to transform the quality of public expenditure by shifting resources to implement National Development Plan priorities, improving infrastructure allocations, and stepping up efforts to combat waste, inefficiency and corruption. Government is preparing cost-containment instructions to limit wasteful expenditure.

Reinforcing the fiscal stance

Strengths limit South Africa's fiscal vulnerability

A year ago, government underlined the need to secure the country's fiscal footing, striking a balance between fiscal consolidation and a premature withdrawal of support for the economy. The 2012 *Medium Term Budget Policy Statement* (MTBPS) pointed out that if the economic and fiscal outlook were to deteriorate, a reconsideration of expenditure and revenue plans would be warranted. It stated that "in a lower-growth scenario, an appropriate balance between spending restraint and new revenue initiatives would be necessary, taking into account the need to limit the potential impact on growth, employment and equity".

South Africa has several strengths that limit the vulnerability of its fiscal position.

- The macroeconomic policy framework remains well-grounded. The principles of countercyclicality, debt sustainability and intergenerational equity anchor fiscal policy. Credible monetary policy institutions and a flexible exchange rate enable the economy to adjust to external shocks.
- Financial markets are deep and liquid, and private-sector financial institutions are generally well managed. The agencies responsible for oversight of the financial system are well developed.
- Corporate and public balance sheets are robust, and household debt levels, though high, are declining. Levels of foreign-currency denominated debt are low, reducing exposure to exchange-rate shocks.

Policy takes account of weaker growth, lower commodity prices and rising bond yields

Nevertheless, the economic and fiscal outlook has weakened in recent months:

- Economic growth has been revised down since the 2013 Budget, leading to lower revenue projections.
- Commodity export prices, which supported buoyant revenue growth over the past decade, have retreated from their high levels, with lower prices during the first nine months of 2013.
- Historically low bond yields, in part the outcome of monetary policy interventions by the US Federal Reserve, have started to rise, putting additional pressure on interest costs.
- Reliance on foreign investors to finance the budget deficit has increased.

Current account deficit and debt-to-GDP ratio underline need to consolidate fiscal position

These vulnerabilities have emerged just as space for countercyclical policy interventions has narrowed. The deteriorating current account deficit and an increasing debt-to-GDP ratio underscore the need to continue fiscal consolidation. Yet at the same time, slower domestic demand and high unemployment require government to maintain fiscal support to the economy.

Revenue considerations

Economic growth has been weaker than expected in 2013, but tax revenue collection has shown resilience. Expected gross tax revenue for 2013/14 has been revised down by R3 billion to R895 billion. Personal income tax collection remains strong as a result of high wage settlements, and corporate income tax has been robust. Taxes on imported goods have been buoyant. The revised estimate for corporate income tax revenue is virtually unchanged, but there is a degree of uncertainty about the second half of the fiscal year. In aggregate, nominal gross tax revenues for the first six months of the fiscal year increased by 9.5 per cent year-on-year.

Table 3.1 Total tax and budget revenue, 2012/13 – 2014/15

R million	2012/13 Outcome	Budget	2013/14 Revised estimate	Difference	2014/15 Estimate
Persons and individuals	275 791	306 188	307 700	1 512	340 574
Companies	158 917	169 830	170 200	370	190 490
Value-added tax	215 840	242 990	242 500	-490	266 930
Secondary tax on companies/ dividend withholding tax	19 739	22 930	17 000	-5 930	18 750
Specific excise duties	28 459	31 265	29 200	-2 065	30 080
Fuel levy	40 320	44 970	43 500	-1 470	44 810
Custom duties	38 152	41 340	45 100	3 760	50 830
Other	36 616	38 491	39 804	1 313	42 714
Gross tax revenue	**813 834**	**898 004**	**895 004**	**-3 000**	**985 178**
Non-tax revenue[1]	27 700	23 328	29 351	6 022	20 588
of which mineral royalties	*5 015*	*5 900*	*6 189*	*289*	*6 826*
Estimate of SACU payments[2]	-42 152	-43 374	-43 270	104	-51 574
Provinces, social security funds and selected public entities	108 514	114 273	119 522	5 249	133 521
Repayment of Gautrain loan[3]	–	-1 521	-1 521	–	-1 430
Total budget revenue	**907 895**	**990 710**	**999 086**	**8 375**	**1 086 283**

1. *Includes extraordinary receipts*
2. *Estimates are based on National Treasury projections. Actual payments will be determined by outcomes of customs and excise revenue collections in line with the SACU agreement*
3. *Netting of repayment of Gautrain loan included in non-tax revenue*

In contrast, however, lower domestic VAT and excise duties point to reduced consumer demand and weaker income tax collection over the medium term. The factors driving current buoyancy in other taxes also suggest a weaker outlook. This year's sharp depreciation of the rand is unlikely to result in a sustained surge in company profits, as cost pressures increase and trade contracts are adjusted. Robust customs duties in the current year imply greater payments to South Africa's partners in the Southern African Customs Union (SACU) in the years ahead.

Tax Review Committee's recommendations will inform any policy changes

The Tax Review Committee established earlier this year is mandated to inquire into the role of the tax system in promoting inclusive economic growth, employment creation, development and fiscal sustainability. Its recommendations will inform any changes to tax policy.

Containing expenditure and curtailing waste

Government is reinforcing its commitment to contain spending

The 2013 Budget was the first since 1999 that did not add resources to previously announced spending plans. During the mid-2000s, actual expenditure in the third year of medium-term expenditure framework (MTEF) periods was typically 15 per cent higher than initial estimates, as buoyant economic growth and revenue allowed for additions. Given the outlook for economic growth and revenue, government is reinforcing its commitment to maintain spending within previously announced limits.

Expenditure limits are extended into 2016/17

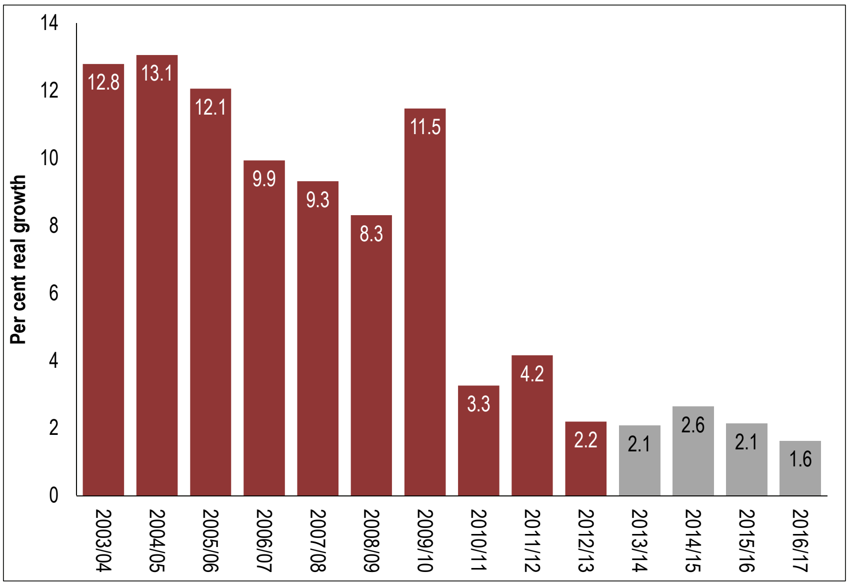
Table 3.2 contrasts the projected medium-term expenditure path with those of budget documents published since 2010 and illustrates government's disciplined approach to spending. Since the introduction of the expenditure ceiling, forecasts and outcomes have been more closely aligned. The limit on main budget non-interest expenditure is also extended in the revised MTEF to include 2016/17.

Table 3.2 Main budget non-interest expenditure, 2010/11 – 2016/17

R million	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
2010 Budget Review	746 785	799 875	860 292				
2011 Budget Review	743 353	812 345	877 324	948 992			
2012 Budget Review	738 914	814 554	879 977	953 024	1 030 539		
2012 MTBPS		811 586	878 669	953 024	1 030 539	1 118 991	
2013 Budget Review			878 642	955 333	1 029 262	1 107 564	
2013 MTBPS				949 109	1 027 762	1 106 064	1 185 110

Figure 3.1 shows the real (above-inflation) increase in government spending over the past decade. Main budget non-interest spending grew at an annual average of 8 per cent in real terms over the period 2003/04-2011/12, but is budgeted to grow at 2.1 per cent over the next three years.

Figure 3.1 Real growth in non-interest spending, 2003/04 – 2016/17



Source: National Treasury

Cost-containment instructions will restrict public-sector air travel, car hire and catering

Government is committed to eliminating wasteful expenditure. To this end, the Cabinet will decide on the details of cost-containment instructions that will be issued with the 2014 Budget. These instructions will apply to the public sector at national and provincial level, and will include restrictions on air travel, car hire, accommodation, catering, entertainment and conference budgets. Parliament and the public will be invited to help monitor compliance. Similar regulations will be applied at local government level.

Over the longer term, government is committed to rebuilding fiscal space by stabilising and then reducing the ratio of public debt to GDP. Re-establishing fiscal space will allow government to respond to future economic shocks by reducing spending on debt-service costs and creating countercyclical borrowing opportunities. This will require continued expenditure restraint beyond the MTEF period, and may also require revenue adjustments.

Fiscal framework

Table 3.3 sets out the consolidated fiscal framework.

Table 3.3 Consolidated fiscal framework, 2010/11 – 2016/17

R billion	2010/11	2011/12 Outcome	2012/13	2013/14 Estimate	2014/15	2015/16 Medium-term estimates	2016/17
Operating account							
Revenue	**764.7**	**843.5**	**907.6**	**998.9**	**1 086.1**	**1 184.0**	**1 305.8**
Current payments	**756.3**	**837.7**	**919.1**	**1 008.6**	**1 086.3**	**1 165.7**	**1 247.6**
Compensation	309.9	345.5	375.4	409.0	437.2	466.9	498.9
Goods and services	137.2	153.7	165.1	178.6	188.2	198.1	211.8
Interest and rent on land	75.3	81.8	93.2	106.6	116.6	128.8	141.0
Transfers and subsidies	233.9	256.7	285.4	314.3	344.3	371.9	395.8
Current balance	**8.4**	**5.9**	**-11.5**	**-9.6**	**-0.1**	**18.3**	**58.3**
Percentage of GDP	*0.3%*	*0.2%*	*-0.4%*	*-0.3%*	*0.0%*	*0.4%*	*1.3%*
Capital account							
Capital receipts	0.4	0.2	0.3	0.2	0.2	0.2	0.2
Capital payments	55.7	61.2	68.0	75.7	87.9	95.6	101.7
Capital transfers	45.4	49.7	52.5	55.8	63.3	70.1	72.9
Capital financing requirement[1]	**-100.8**	**-110.6**	**-120.1**	**-131.4**	**-151.1**	**-165.6**	**-174.4**
Percentage of GDP	*-3.7%*	*-3.7%*	*-3.7%*	*-3.8%*	*-4.0%*	*-4.0%*	*-3.8%*
Financial transactions[2]	22.3	2.8	3.3	3.6	3.3	3.0	0.0
Contingency reserve	–	–	–	–	3.0	6.0	18.0
Budget balance	**-114.7**	**-107.5**	**-135.0**	**-144.6**	**-157.5**	**-156.3**	**-134.2**
Percentage of GDP	*-4.2%*	*-3.6%*	*-4.2%*	*-4.2%*	*-4.1%*	*-3.8%*	*-3.0%*
Revenue	**765.0**	**843.8**	**907.9**	**999.1**	**1 086.3**	**1 184.2**	**1 306.0**
Expenditure	**879.7**	**951.3**	**1 042.9**	**1 143.7**	**1 243.8**	**1 340.4**	**1 440.2**
Non-interest expenditure[3]	*804.4*	*869.5*	*949.6*	*1 037.0*	*1 127.2*	*1 211.7*	*1 299.2*
Interest payments	*75.3*	*81.8*	*93.2*	*106.6*	*116.6*	*128.8*	*141.0*
Primary balance[4]	***-39.4***	***-25.8***	***-41.7***	***-37.9***	***-40.9***	***-27.5***	***6.8***
Percentage of GDP	*-1.4%*	*-0.9%*	*-1.3%*	*-1.1%*	*-1.1%*	*-0.7%*	*0.1%*

1. Includes payments for capital assets, receipts from the sale of capital assets and capital transfers
2. Transactions in financial assets and liabilities
3. All spending except for consolidated interest payments
4. Revenue less non-interest expenditure

Consolidated budget deficit of 4.2 per cent of GDP in 2013/14 narrows to 3.0 per cent in 2016/17

The budget deficit is expected to be 4.2 per cent of GDP in 2013/14, in line with projections made at the time of the 2013 Budget.[1] The consolidated deficit is projected to decline to 4.1 per cent of GDP in 2014/15 and 3.0 per cent in 2016/17.

[1] This figure includes extraordinary transactions, which are explained in the technical note on the following page.

Technical note: New format for the consolidated fiscal framework

Table 3.3 shows the new format for the consolidated fiscal framework. This more transparent format, announced in the 2012 MTBPS, presents core budget information in line with the International Monetary Fund's *Government Finance Statistics Manual 2001*. The format distinguishes clearly between operating activities and capital investment plans. The current balance shows how much government must borrow to run its operations. The capital financing requirement shows the difference between capital revenue and expenditure.

Extraordinary receipts and payments are brought into the budget framework in line with global standards. This category includes receipts related to transactions on loans and similar items with a direct effect on the borrowing requirement. Their inclusion "above-the-line" results in a narrower budget deficit in 2013/14, and means that there is no longer a distinction between the main budget deficit and the borrowing requirement.

Extraordinary transactions and the budget deficit, 2010/11 – 2016/17

R billion	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Budget deficit excluding extraordinary transactions	**-116.9**	**-111.3**	**-143.9**	**-155.8**	**-158.6**	**-157.1**	**-134.3**
Percentage of GDP	*-4.3%*	*-3.7%*	*-4.5%*	*-4.5%*	*-4.2%*	*-3.8%*	*-3.0%*
Extraordinary receipts	3.0	5.2	11.5	11.4	1.2	0.8	0.1
Extraordinary payments	-0.8	-1.4	-2.6	-0.2	–	–	–
Budget deficit including extraordinary transactions	**-114.7**	**-107.5**	**-135.0**	**-144.6**	**-157.5**	**-156.3**	**-134.2**
Percentage of GDP	*-4.2%*	*-3.6%*	*-4.2%*	*-4.2%*	*-4.1%*	*-3.8%*	*-3.0%*

A second change with consequences for reported budget numbers is the redefinition of non-interest expenditure in the consolidated account. Previously, non-interest expenditure was defined as total spending less debt-service costs. This meant that interest transactions of public entities were included as part of non-interest spending. From now on budget documents will report all interest-related payments as interest expenditure.

More information on these changes can be found in the 2013 *Budget Review* (page 33).

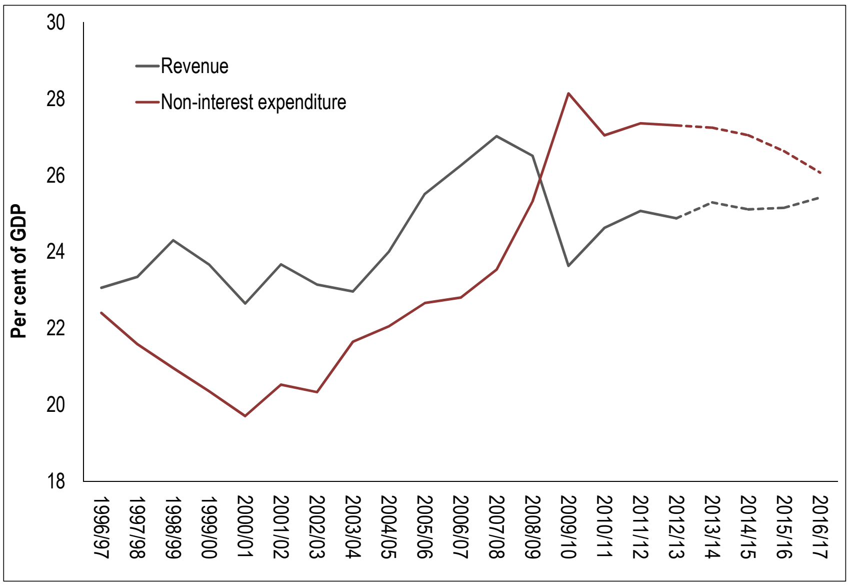
The fastest-growing expenditure item in the consolidated framework is interest payments, reflecting the substantial increase in government's debt stock in recent years. By 2016/17, more than R140 billion will be required to service public liabilities, an amount that exceeds current spending on health care.

Payments for capital assets are fastest-growing component of non-interest spending

Capital spending is the fastest-growing component of non-interest spending, exceeding inflation by 4.1 per cent in the next three years. Compensation budgets, which now account for 39.4 per cent of consolidated non-interest spending, continue to outpace inflation, but grow at a slower rate than over the past three years. Goods and services budgets are set to decline in real terms.

The consolidated budget comprises the main budget plus spending by provinces, social security funds, and expenditure by public entities financed from their own revenue. The largest component of the consolidated fiscal framework is the main budget, which covers expenditure financed from the National Revenue Fund (i.e. national departments, and transfers to provincial and local government). After stabilising in 2010/11, main budget expenditure has remained constant, at 30 per cent of GDP. As the economic growth rate picks up over the medium term, spending as a percentage of GDP will begin to decline, while the revenue-to-GDP ratio will continue to grow moderately in the outer years. By keeping spending growth below the rate of GDP growth, fiscal policy will help to stabilise debt as a share of GDP.

Figure 3.2 Main budget revenue and non-interest expenditure



Source: National Treasury

The main budget deficit is offset by surpluses expected on the accounts of provincial governments, public entities and social security funds, which are also included in the consolidated framework. Provincial surpluses are expected to be higher than anticipated in 2013/14, owing to underspending. Over the medium term, public entities will be increasing their borrowing for capital investment projects such as the Passenger Rail Agency of South Africa's rolling stock.

Payments by social security funds set to increase under proposed unemployment insurance legislation

Partly as a result of improved operations at the Road Accident Fund and compensation funds, spending by the social security funds will increase more rapidly than expected. Parliament is also considering the Unemployment Insurance Amendment Bill, which provides for more generous unemployment and risk payments for Unemployment Insurance Fund beneficiaries. These increases have been taken into account, though spending projections are provisional.

Managing risks

Government manages risks to safeguard fiscal sustainability. The risks to South Africa's fiscal path include pressures emanating from public-sector wages, the debt trajectory and the balance sheets of state-owned companies.

Wage bill

Government will ensure that compensation budget does not place expenditure ceiling at risk

Over the medium term government will ensure that growth in employment and earnings does not threaten the expenditure ceiling. Specific attention will be paid to restraining growth in administrative posts. Since 2005, more than 250 000 personnel have been added to national and provincial government payrolls, with the largest increases in education, health care and criminal justice. While most of the new positions were created for teachers, nurses and police officers, there is concern about the growth of managerial and administrative staffing across government.

Table 3.4 National and provincial government employment, 2005 – 2013

	Employees[1]			Share of total
	2005	2008	2013	2013
Education	433 370	470 438	485 370	38.8%
Health	225 900	263 113	318 756	25.5%
Criminal justice	201 109	236 071	275 154	22.0%
Economic services[2]	92 125	100 126	99 387	7.9%
General public administration[3]	26 312	34 699	39 761	3.2%
Welfare, arts, sports and other	21 178	21 074	32 897	2.6%
Total	**999 994**	**1 125 521**	**1 251 325**	**100.0%**

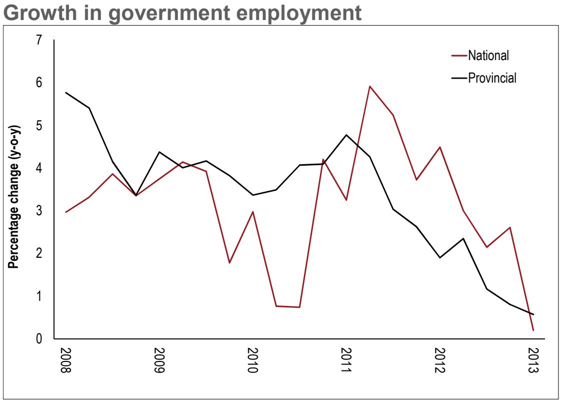
1. Numbers reflect the average number of employees registered on the Persal system over the course of the year. Persal numbers exclude employees of the departments of Defence and Military Veterans, Parliament and the legislatures of Gauteng, Mpumalanga and North West
2. Economic services includes economic, environment, infrastructure and agriculture
3. General public administration includes finance, foreign affairs, home affairs and general administration

Growth in the public-sector wage bill has exceeded the rate of inflation over the past several years. This relates partly to the implementation of occupation-specific dispensations designed to raise public-sector salaries for skilled and experienced staff to those of similarly skilled professionals in the private sector. It also reflects above-inflation annual wage settlements.

Evidence that public-sector employment growth has begun to slow

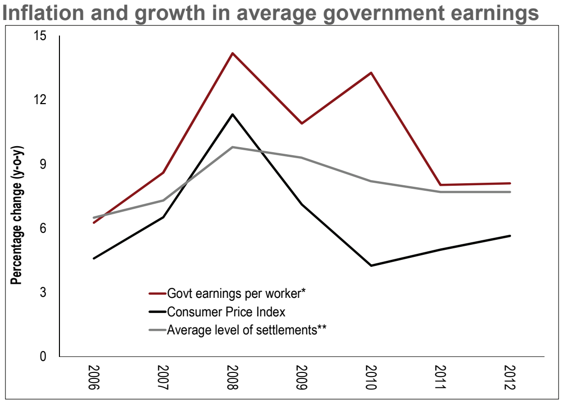
Following the conclusion of the largest occupation-specific dispensations and the three-year wage settlement reached in 2011, earnings increases have begun to align more closely with inflation. The wage agreement provided for an inflation-plus-1 per cent increase in cost-of-living adjustments. In the past two years public-sector employment growth has begun to slow.

Growth in government employment



Source: StatsSA

Inflation and growth in average government earnings



** Growth in earnings per worker employed by national and provincial government*
Source: StatsSA

*** Average settlements in public and private sector.*
Source: Andrew Levy and Associates

The National Treasury and the Department of Public Service and Administration are working to improve the monitoring of wage-bill trends and to enforce discipline in hiring of new personnel. Government aims to maintain staff numbers at a constant level over the next three years; exceptions will require a compelling explanation. Government is also committed to reaching a sustainable public-sector wage agreement.

Managing government's debt portfolio

IMF assessment shows that South Africa's debt-to-GDP ratio is sustainable

South Africa's debt-to-GDP ratio remains sustainable. In a recent assessment, the International Monetary Fund reached the same conclusion.

Government's debt management strategy works to ensure debt sustainability, keep the cost of debt as low as possible, maintain access to global capital markets and diversify funding instruments. The strategy also ensures continued bond market development, drawing on the strength of South Africa's deep and liquid capital markets. To limit external vulnerability, debt is largely denominated in domestic currency. Maturities are increasingly long term.

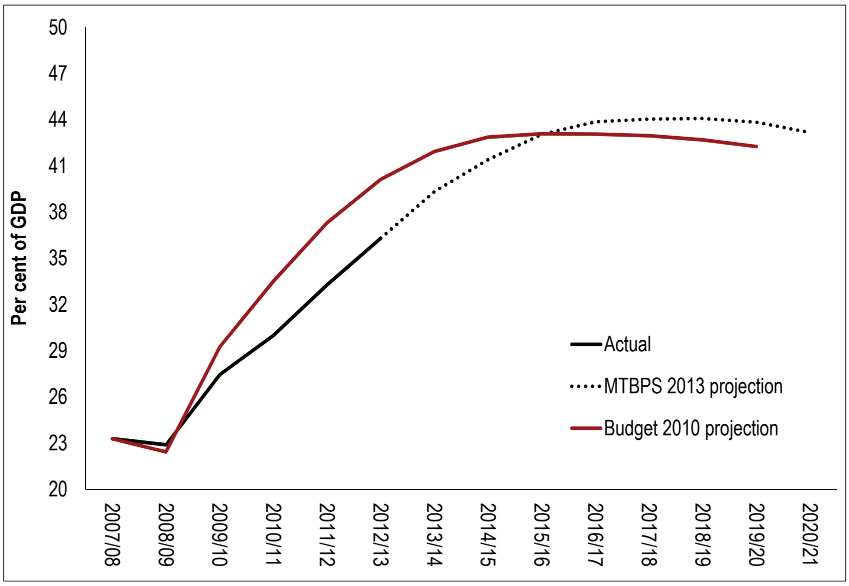
Denomination of debt mainly in domestic currency limits external volatility

The main budget net borrowing requirement is projected to increase from R168.5 billion in 2013/14 to R183.9 billion in 2014/15, before declining to R164.9 billion in 2016/17. National government net debt is projected to reach 39.3 per cent of GDP in 2013/14 and 43.9 per cent in 2016/17.

The weaker rand exchange rate has pushed up the value of foreign-denominated debt, and inflation has had the same effect on inflation-linked debt. Deterioration in the economic growth outlook has increased the debt-to-GDP ratio. Rising bond yields, which are adjusting to anticipated changes in US monetary policy, also contribute to a less benign debt-to-GDP trajectory. Over the longer term, debt is expected to stabilise, but later than previously anticipated and at a higher level relative to GDP. Figure 3.3 shows the long-term projection of net debt published by the National Treasury in 2010, alongside a revised long-term projection. The current forecast shows net debt stabilising at 44 per cent of GDP in 2017/18.

Net debt is projected to stabilise at about 44 per cent of GDP in 2017/18

Figure 3.3 Long-term projections of net debt, 2007/08 – 2020/21



Source: National Treasury

Over the medium term, government's debt management strategy will focus on minimising refinancing risk to accommodate redemptions. To mitigate this risk beyond the medium-term, government will continue to build cash reserves, and continue to switch short-term for longer-term debt if market conditions allow.

To mitigate refinancing risk, government continues to build cash reserves and switch debt

Table 3.5 Main budget borrowing requirement and financing, 2012/13 – 2016/17

	2012/13	2013/14		2014/15	2015/16	2016/17
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Main budget balance	-166 182	-178 047	-168 509	-183 949	-183 588	-164 908
of which:						
Extraordinary receipts	*11 534*	*4 992*	*11 401*	*1 150*	*800*	*120*
Extraordinary payments	*-2 587*	*-930*	*-200*	*–*	*–*	*–*
Borrowing requirement (-)	**-166 182**	**-178 047**	**-168 509**	**-183 949**	**-183 588**	**-164 908**
Domestic short-term loans (net)	22 555	23 000	23 000	24 000	25 000	26 000
Domestic long-term loans (net)	125 771	143 610	149 516	138 262	148 095	131 851
Foreign loans (net)	-11 622	-4 335	531	1 187	10 993	2 557
Change in cash and other balances[1]	29 478	15 772	-4 538	20 500	-500	4 500
Financing	**166 182**	**178 047**	**168 509**	**183 949**	**183 588**	**164 908**

1. A positive change indicates a decrease in cash balances
See National Treasury website for further detail on net borrowing and financing

Table 3.6 Total national government debt, 2010/11 – 2016/17

As at 31 March	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**
R billion	**Outcome**			**Estimate**	**Medium-term estimates**		
Total gross loan debt	**990.6**	**1 187.8**	**1 365.6**	**1 562.3**	**1 748.8**	**1 966.5**	**2 170.5**
Total net loan debt	**820.4**	**989.7**	**1 181.5**	**1 370.4**	**1 573.7**	**1 788.2**	**1 994.0**
As percentage of GDP:							
Total gross loan debt	*36.2%*	*39.9%*	*42.5%*	*44.8%*	*46.0%*	*47.3%*	*47.7%*
Total net loan debt	*30.0%*	*33.3%*	*36.8%*	*39.3%*	*41.4%*	*43.1%*	*43.9%*
Foreign debt as percentage of:							
Gross loan debt	*9.9%*	*9.8%*	*9.1%*	*8.5%*	*7.5%*	*7.1%*	*6.4%*
Net loan debt	*4.8%*	*5.0%*	*3.7%*	*4.3%*	*3.7%*	*3.8%*	*3.5%*

See National Treasury website for further detail on net borrowing and financing

Balance sheets of public entities and state-owned companies

State-owned companies are at the centre of South Africa's infrastructure expansion. State corporations are expected to borrow on the strength of their balance sheets, rather than being funded from the fiscus.

State-owned companies facing persistent difficulties will require operational restructuring

Where capitalisation of core public assets may be required, other measures, such as upfront disposal of non-core assets, will be considered. State-owned companies facing persistent difficulties will require operational restructuring to become financially sustainable and to fulfil their mandates.

Net loan debt, provisions and contingent liabilities are expected to remain well within the Southern African Development Community's macroeconomic convergence target of 60 per cent of GDP.

Conclusion

Expenditure remains well contained, and fiscal stance avoids premature consolidation that could jeopardise higher growth

Government remains committed to sustainable, countercyclical fiscal policy. The level of expenditure remains well contained, while the fiscal stance avoids a premature consolidation that could jeopardise higher economic growth, which is required to create jobs, widen the tax base and generate sufficient revenue to support government's priorities.