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Act together for a better future

The aim of the National Development Plan is to create a virtuous circle of growth and transformation to eliminate poverty and reduce inequality. But since the plan's adoption, economic circumstances have changed. Sustaining progress towards the vision of national development requires a new approach and a greater sense of urgency.

The 2016 *Medium Term Budget Policy Statement* (MTBPS) assumes that the economic cycle has reached its lowest point. Necessary adjustments have been painful, but a recession has been avoided and a recovery is emerging. Rapid implementation of decisions to promote faster growth will boost confidence, investment and employment. Without decisive action, the recovery is likely to be weak and ineffectual.

Difficult decisions will be made to ensure sustainable public finances. The MTBPS puts forward measured proposals to narrow the budget deficit and stabilise debt. Without taking these steps, we risk opening the door to rapid capital outflows and further economic disruption, setting back transformation, and leading to higher unemployment and social distress.

Citizens are registering their concerns. They want government to talk less and achieve more, act decisively against corruption and waste, contribute to growth and job creation, and speed up inclusive transformation and social justice. Much depends on joint action to restore confidence and mobilise private investment to avoid a low-growth trap.

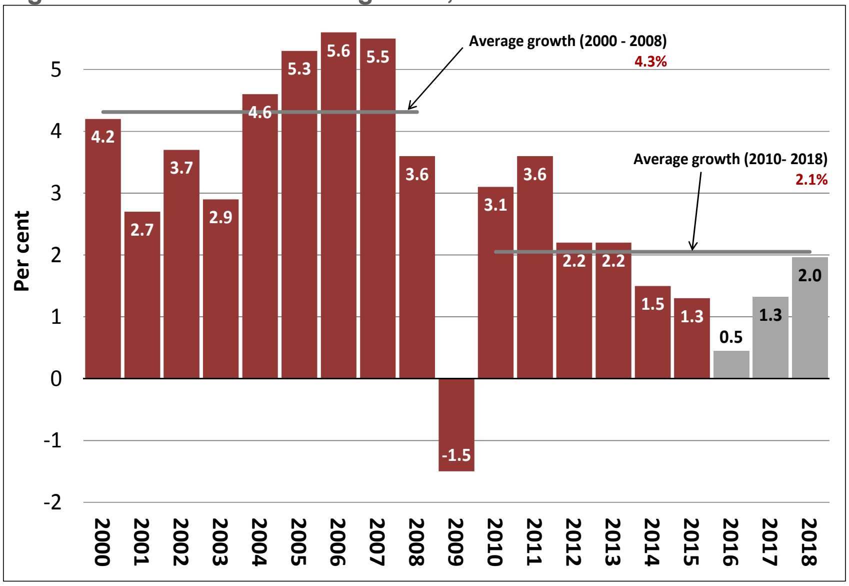
Introduction

South Africa is undergoing a difficult economic transition. The trend growth rate – that is, the long-term average rate of GDP growth – has fallen from 4 per cent a decade ago to 2 per cent today.

Structural constraints and low levels of investor confidence hold back economic growth

This partly reflects global realities – a protracted slowdown in trade, lower commodity prices and a high risk of external volatility. It is also the result of continued structural constraints and low levels of investor confidence in the domestic economy, which have led to rising unemployment. Perceptions of elevated political risk, and concerns about the ability of public institutions to make decisions on difficult trade-offs and manage change, have undermined confidence.

Figure 1.1 Trend economic growth, 2000 – 2018



Source: National Treasury

Opportunity for new growth cycle exists, with green shoots reflected in new investment plans

However, positive indicators are emerging. Several factors that have limited GDP growth are receding, creating an opportunity for a new growth cycle. Additional sources of electricity supply are being connected to the grid. Agriculture is expected to recover as the drought comes to an end. Exports and tourist receipts are once again growing. A real, sustained depreciation in the exchange rate has created opportunities for export growth. Inflation has moderated. Working days lost to strikes have fallen. The green shoots of an economic recovery are reflected in new investment plans.

These positive developments are not yet evident in revenue collection, and fiscal limits have been reached. To grow faster, the economy needs higher levels of private investment. Government remains committed to working with the private sector, labour and civil society to promote inclusive growth and economic transformation. This agenda is guided by the National Development Plan (NDP) and, over the short term, the 9-point plan announced in February 2015. These efforts aim to create a more just society and ensure that the benefits of transformation are shared broadly.

Building a coalition for faster growth

Global economy

Global economic recovery marked by weakness and uncertainty

Economic recovery from the 2008 financial crisis is marked by weakness and uncertainty. Global growth is projected at 3.1 per cent in 2016 and 3.4 per cent in 2017. In many countries, low levels of GDP growth and rising inequality are feeding into political tension. Risks to the global outlook are magnified as new fractures appear in the international order.

In developed economies, the combination of weak economic growth, low or negative interest rates, and elevated asset prices has increased the likelihood of renewed financial volatility. Risks include record-high debt levels, a further slowdown in trade and political uncertainty in several major economies. The outlook for developing economies is mixed. Strong

GDP growth is projected in India and China, but there is a risk that China's difficult economic transition could lead to lower growth, with global repercussions. The outlook for sub-Saharan Africa is marked by low commodity prices and falling export revenues. Growth of only 1.4 per cent is expected in the region for 2016.

Economic weakness on the African continent is of particular concern for South Africa's growth prospects

Small, open economies like South Africa are vulnerable to global shocks. Insufficient fiscal policy space and inability to address financial weaknesses could expose them to sudden capital flow reversals. Economic weakness on the African continent affects South Africa directly. Slower growth in the region and global trade weakness limit export potential.

Restoring domestic confidence

South Africa's economic performance continues to reflect low levels of business and consumer confidence. The GDP forecast has been revised down to 0.5 per cent for 2016. Public investment remains relatively buoyant, but private investment has fallen across all sectors, and capital formation is expected to contract in 2016 for the first time since 2010.

Table 1.1 Macroeconomic projections, 2015 – 2019

	2015	2016	2017	2018	2019
Calendar year	**Actual**	**Estimate**		**Forecast**	
Percentage change unless otherwise indicated					
Final household consumption	1.7	0.6	1.3	1.9	2.3
Gross fixed capital formation	2.5	-2.9	1.1	2.6	3.1
Real GDP growth	**1.3**	**0.5**	**1.3**	**2.0**	**2.2**
GDP at current prices (R billion)	**4 013.6**	**4 300.0**	**4 616.9**	**4 981.1**	**5 385.3**
CPI inflation	4.6	6.4	6.1	5.9	5.8
Current account balance (% of GDP)	-4.3	-3.9	-3.9	-3.8	-3.8

Source: Reserve Bank and National Treasury

Several emerging factors, however, support an economic recovery. Since 2010, the real exchange rate has depreciated by 20.9 per cent, creating an opportunity for South Africa to increase exports. Over the medium term, a moderate recovery in commodity prices is expected. Lower inflation, real wage growth and improved household balance sheets are expected to boost consumer spending. Low borrowing costs and higher capacity utilisation point to a recovery in fixed investment. An easing of drought conditions and new electricity generating capacity should also contribute to faster growth. Over the next three years, public-sector infrastructure spending is projected at R987.4 billion, with substantial investments in energy, transport, housing, water and sanitation.

Actions to restore confidence include finalising a regulatory framework for private-sector participation

Maximising the benefits of these developments for the economy depends on decisive actions to restore confidence. Government is creating conditions for higher confidence and investment by:

- Finalising a regulatory framework for private-sector participation in infrastructure projects, including initiatives in partnership with state-owned companies.
- Addressing legislative and regulatory uncertainties that hold back investment in mining, agriculture and key technology sectors.

- Rationalising, closing or selling off public assets that are no longer relevant to government's development agenda, and strengthening those that are central to achieving NDP objectives.
- Concluding labour market reforms.

Presidential Business Working Group and CEO Initiative are generating support for economy

Government is working in partnership with business and labour to build a foundation for faster growth. This work is directed at encouraging investment in network infrastructure, streamlining investment approvals and improving policy certainty. The Presidential Business Working Group and the CEO Initiative are generating targeted support to the economy by creating funds to support small business and offering internships to 1 million young work seekers. The Independent Power Producer Programme in renewable energy has attracted investments of R194 billion. The programme, which will continue and expand, is an example of the kind of partnerships needed for national development.

Over the medium term, public-sector infrastructure investment will continue to support domestic demand, bolster productive capacity and contribute to social inclusion. It is essential that private investment is encouraged to complement these efforts.

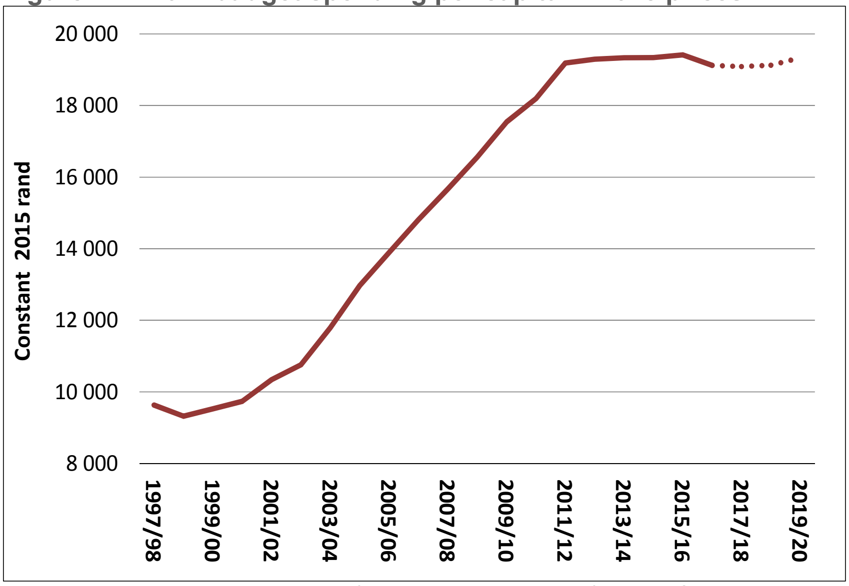
A measured fiscal consolidation

Budget exceeds R1 trillion per year, but quality of public expenditure needs to be improved

Real government spending per capita doubled in the first two decades of democracy. The national budget now includes commitments of public resources exceeding R1 trillion per year. Yet the quality of spending needs to be improved. Too much public spending is regarded as wasteful, too much is ineffectively targeted and too little represents value for money.

Moreover, since 2009, a growing portion of spending has been funded by borrowing. Government debt now exceeds R2 trillion, and rising debt-service costs are crowding out expenditure on priorities like infrastructure and education. Low economic growth has limited government's ability to finance its existing commitments and sustain higher levels of debt.

Figure 1.2 Main budget spending per capita in 2015 prices*



**Non-interest expenditure, excluding financial transactions, deflated by CPI*
Source: National Treasury

Table 1.2 Consolidated government fiscal framework, 2015/16 – 2019/20

R billion/Percentage of GDP	2015/16 Outcome	2016/17 Revised	2017/18 Medium-term estimates	2018/19	2019/20
Revenue	**1 220.9**	**1 301.0**	**1 416.9**	**1 537.9**	**1 670.4**
	29.9%	*29.7%*	*30.1%*	*30.3%*	*30.4%*
Expenditure	**1 373.1**	**1 451.5**	**1 564.0**	**1 676.0**	**1 809.4**
	33.6%	*33.1%*	*33.3%*	*33.0%*	*33.0%*
Budget balance	**-152.2**	**-150.5**	**-147.1**	**-138.2**	**-139.0**
	-3.7%	*-3.4%*	*-3.1%*	*-2.7%*	*-2.5%*
Total net loan debt	**1 804.6**	**2 004.4**	**2 209.2**	**2 417.1**	**2 632.4**
	44.2%	*45.8%*	*47.0%*	*47.6%*	*47.9%*

Source: National Treasury

Medium term: avoiding a low-growth trap

Fiscal and monetary policy have been supportive of economic recovery

Since the 2009 recession, fiscal and monetary policy have been supportive of the economic recovery. Over the medium term, fiscal policy aims to stabilise debt, so that higher levels of spending can be sustained.

But further deterioration of the economy could lead South Africa into a low-growth trap. In this scenario, weak GDP growth produces less tax revenue. Aggressive fiscal consolidation – in other words, steps to contain the deficit and stabilise debt – may bolster confidence, but can undermine the economy. Taking no action could result in ratings downgrades, capital flight, rapid exchange rate depreciation and a spike in interest rates. Such developments would throw up greater challenges for private and public investment plans, and could result in even lower growth outcomes.

Expenditure ceiling will be reduced and tax measures introduced to raise additional revenue

To avoid this trap, government proposes a balanced consolidation. Proposals include a combination of tax policy measures that will raise an additional R43 billion over the next two years, and a reduction in the expenditure ceiling of R26 billion. These steps follow consolidation measures announced in the 2015 and 2016 Budgets. If these necessary trade-offs are accompanied by higher levels of economic growth – which is possible if fresh impetus is given to private investment – it will create more space for flexibility on fiscal targets over the medium term. Conversely, continued uncertainty on major factors that affect the economy will narrow fiscal room to manoeuvre.

Long term: realistic trade-offs required

The Constitution requires government to pursue a progressive expansion of access to public services within its available resources. To realise these aspirations, South Africa needs to accelerate the pace of economic growth. The National Treasury's modelling indicates that if the trend rate of economic growth remains below 2 per cent for an extended period, government may not be able to sustain its current policy commitments. Choices will need to be made about which programmes can be maintained.

Fiscal resources do not match long-term policy aspirations

At the same time, proposals have been tabled for a substantial expansion of spending commitments in health, education, defence, social development and infrastructure. There are clear benefits associated with each of these proposals. However, if implemented simultaneously, the costs would be incompatible with fiscal sustainability. The limited space available to increase taxation cannot accommodate all of these aims. Even in the most optimistic growth scenario, a phased approach to implementation based on a clear choice of priorities is required.

Difficult trade-offs are needed to resume the expansion of public resources available for social and economic development. For now, however, long-term policy aspirations far exceed available resources.

Table 1.3 Consolidated government expenditure, 2016/17 – 2019/20

R billion	2016/17 Revised	2017/18 Medium-term estimates	2018/19	2019/20	Average annual growth 2016/17 – 2019/20
Basic education	228.4	244.8	261.9	280.6	7.1%
Health	169.3	184.4	198.9	214.2	8.2%
Defence, public order and safety	189.5	197.9	210.7	224.6	5.8%
Post-school education and training	68.6	76.6	81.1	89.3	9.2%
Economic affairs	207.6	216.4	225.8	239.6	4.9%
Human settlements and municipal infrastructure	181.1	197.6	212.1	228.3	8.0%
Agriculture, rural development and land reform	26.3	26.9	28.4	30.3	4.8%
General public services	67.8	69.8	73.0	76.4	4.1%
Social protection	165.1	180.0	193.3	208.9	8.2%
Total expenditure by function	**1 303.8**	**1 394.3**	**1 485.2**	**1 592.2**	**6.9%**
Debt-service costs	147.7	163.6	180.8	197.2	10.1%
Contingency reserve	–	6.0	10.0	20.0	**–**
Total expenditure	**1 451.5**	**1 564.0**	**1 676.0**	**1 809.4**	**7.6%**

Source: National Treasury

Funding post-school education and training

The movement of university students demanding "fees must fall" has placed the issue of education funding at the centre of the policy debate. It has also generated welcome suggestions on how to fund tertiary education.

Financial hardship affects ability of many students to succeed academically

Two concerns lie at the heart of the issue. First, despite massive increases in allocations to the National Student Financial Aid Scheme (NSFAS), the enrolment of academically deserving students from poor communities has grown faster than available funding. Second, there is no clear national framework for financing students who – although not affluent – are above the modest threshold established by the NSFAS means test. As a result, many students face financial hardships that undermine their ability to succeed academically.

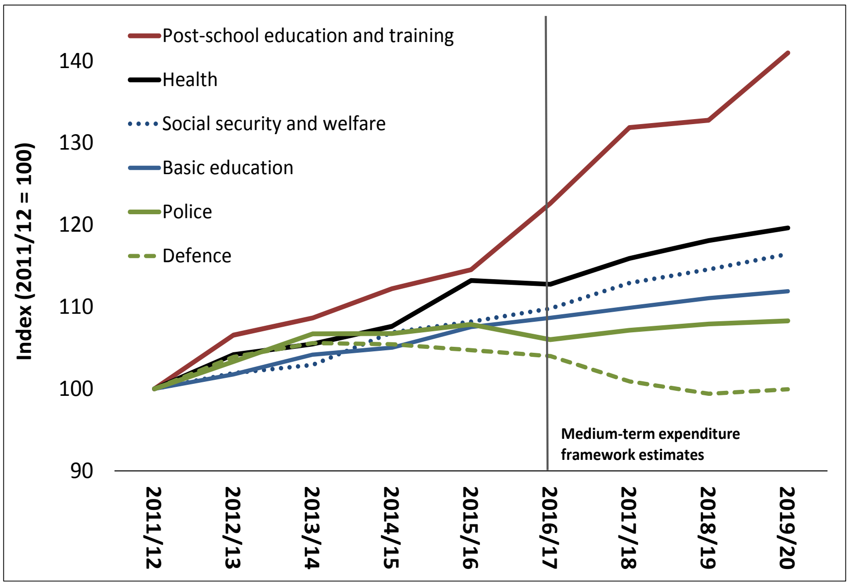
Interventions needed to improve vocational and technical education

Government has significantly expanded funding of education over the past 20 years. Basic education is the largest item in the national budget. But the education system is not achieving the desired outcomes. Priorities for government in the years ahead include expanding access to and the quality of early childhood development, overcoming institutional weaknesses in basic education, broadening access to effective vocational and technical skills, and improving the impact of resources devoted to vocational training. In all these areas, additional resources may be needed – and strong interventions to unblock institutional constraints are required.

Government's current policy framework calls for the progressive expansion of post-school education within available resources. The largest gains in student access are envisaged in technical and vocational colleges.

Improving the quality of teaching at these colleges and building stronger links with industry – so that skills are relevant and can support economic growth – are policy imperatives.

Figure 1.3 Index of budget allocations in real terms,* 2011/12 – 2019/20



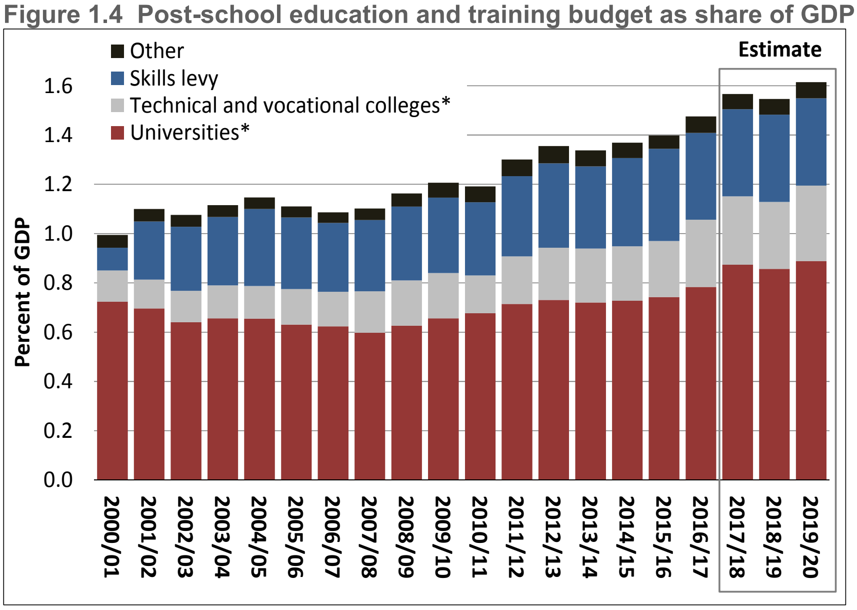
**Deflated by CPI inflation*

Source: National Treasury

Over the past five years, expenditure on post-school education and training has grown much faster than other budgets. Allocations have increased from 1 per cent of GDP in 2008 to 1.5 per cent today. But most of this increase benefited vocational colleges, sector education and training authorities and the National Skills Fund, rather than universities. The 2016 MTBPS proposes to accelerate the growth of spending on post-school education. Despite fiscal constraints, subsidies to universities grow at 10.9 per cent each year and transfers to NSFAS grow at 18.5 per cent.

Spending on post-school education and training has grown faster than other budgets in recent years

Figure 1.4 Post-school education and training budget as share of GDP



** Includes direct subsidies and allocations through NSFAS*

Source: National Treasury

Clear roadmap needed to finance study costs of poor and working-class students

Building on the successful expansion of access to higher education, government acknowledges the need to correct its course and increase the number of graduates, while improving teaching and research. A roadmap is needed to fully finance the costs of study for students from poor and working-class families. The plan needs to consider the impact of different education interventions to maximise social and economic transformation.

University education benefits society. It also improves graduates' income and employment prospects. Those who go on to become affluent citizens have a responsibility to contribute a share of these gains to the next generation. In higher education, as in all areas of public policy, decisions and trade-offs are required to ensure balanced, sustainable development that meets the vast needs of the population using available resources.

Institutions and inclusive transformation

Basic values and principles of public administration include transparency, efficiency and impartiality

South Africa's ability to sustain social and economic progress is supported by the sound institutional framework established by the Constitution and a vibrant civil society. The Auditor-General, the Reserve Bank, the Independent Electoral Commission, the Public Protector and the courts are among the many institutions that are effective and independent. Policy-making is rooted in the Constitution, which sets out the basic values and principles of public administration, including:

- A high standard of professional ethics
- Efficient, economic and effective use of resources
- An orientation toward development
- The impartial, fair, equitable and bias-free provision of services
- Transparency.

Public perception is that state corruption and rent seeking have grown

The Constitution assigns the National Treasury with the responsibility to ensure transparency and expenditure control in each sphere of government, and to enforce compliance with these objectives. It also states that public procurement must be fair, equitable, transparent and cost-effective. While corruption has always existed in the public and private sectors, there are perceptions that state corruption and rent seeking have grown in recent years. Such practices, if not combated with vigour, threaten to corrode trust in institutions and set back national development. Government is committed to promoting inclusive economic transformation through fair, transparent processes. The benefits of empowerment should be accessible on an equal basis, not limited to connected insiders.

Forthcoming procurement regulations will support this objective, while balancing transformational imperatives with the need for efficient, rapid delivery. Over the past year, the Office of the Chief Procurement Officer has strengthened reforms aimed at ensuring greater value for money and combating corruption across the public sector. During 2017, new national procurement legislation will be tabled in Parliament.

Conclusion

With decisive action, South Africa will emerge from a period of economic weakness. This will enable government to provide greater support to the economy and boost employment.