

# BUDGET REFORM AND MEDIUM TERM FISCAL POLICY

## The Medium Term Budget Policy Statement

### What is the Budget Policy Statement?

This Statement encapsulates the policy framework for the 1999 Budget. It provides a summary of the macroeconomic context within which the budget is prepared, it sets out the priorities, objectives and goals for the budget and it gives three year projections of resources available to meet Government's policy commitments. It describes key developments and trends in spending programmes, consistent with Government's response to the challenge of creating jobs and other reconstruction and development commitments.

### Spending projections

The Medium Term Budget Policy Statement sets out the equitable division of nationally raised revenue between the three spheres of government. The Budget Policy Statement explains the rationale underlying the division of revenue and projects spending for the next three years for the main components of government's social, economic, protection and administrative functions.

### Relationship with the budget

The Budget Policy Statement provides a point of departure for Government's medium term spending plans, which give practical expression and substance to the nation's shared reconstruction and development commitments. The detailed spending plans for the next three years will be published in the Budget on 17 February 1999.

### Advantages of fiscal targets

Setting fiscal policy targets over the medium term – for the coming three years – has a number of advantages:

- ◆ policy credibility is enhanced, contributing to economic confidence and a more stable financial environment;
- ◆ a transparent fiscal policy encourages investment by enhancing the predictability of taxes, interest rates and government spending;

- ◆ a medium term fiscal framework facilitates transformation by creating an integrated planning framework, indicating broad dimensions of budget reprioritisation and providing a baseline against which policy changes can be assessed;
- ◆ by planning spending over the medium term, government improves the allocation and efficiency of public spending; and
- ◆ the medium term framework encourages public discussion and debate of policy priorities within the context of consistent macroeconomic and budget projections.

## **Budget reform**

### **The Medium Term Expenditure Framework**

The Medium Term Expenditure Framework is one of three broad reforms to the budget process. The 1999 Budget will be the second to include spending projections for the next three fiscal years. The key features of the Medium Term Expenditure Framework are:

- ◆ publication of three-year forward estimates when the Budget is tabled in Parliament;
- ◆ a focus on outputs and outcomes of government spending programmes as part of the budget review process;
- ◆ a cooperative approach to expenditure analysis and planning, involving national and provincial treasuries and spending departments;
- ◆ more detailed budget information to promote understanding and debate in Parliament and civil society; and
- ◆ a budget process aimed at informed political responsibility for budget priorities and spending plans.

### **Adjustments to forward estimates**

The three-year projections of expenditure introduced in the 1998 Budget provide the baseline estimates for planning the 1999 Budget, and allow spending implications to be properly assessed when policy options come under consideration. Reviews of expenditure during the course of the budget process or shifts in priorities may lead political office-bearers to consider changes in the forward estimates. Policy changes will thus typically lead to specific adjustments to the baseline spending plan.

This three-year rolling budget framework means that departments can plan and reprioritise with greater certainty about future resource allocations than in the past. It also provides Parliament and civil society with clear signals of Government's spending intentions.

**Evaluation of spending plans**

On Budget Day, Parliament is presented with a set of three-year spending plans, but is only asked to vote on the budget for the coming year. The three-year spending projections allow Parliament, institutions of civil society and particular interest groups to evaluate Government's reconstruction and development goals and objectives in relation to envisaged spending plans. While the vigour of public debate will no doubt remain undiminished, its substance and quality are enhanced by the transparency and extent of information Government provides in the new approach to expenditure planning.

**The Treasury Control Bill**

The second key component of the budget reform process is the Treasury Control Bill. This gives effect to the Constitutional requirement for national legislation to:

- ◆ establish a National Treasury;
- ◆ introduce generally recognised accounting practices;
- ◆ introduce uniform norms and standards;
- ◆ prescribe expenditure control in all spheres of government; and
- ◆ set the operational procedures for borrowing, procurement and oversight over the various National and Provincial Revenue Funds.

The Treasury Control Bill sets the stage for the introduction of further budget reforms by introducing an approach to the management of public finances that focuses on outputs and responsibilities. The shift in emphasis toward outputs rather than expenditure regulations will be taken further in the Budget Reform White Paper to be published early next year.

**Responsibilities of office-bearers**

The Treasury Control Bill clarifies the respective responsibilities of the political head and the official head of a department or agency.

In broad terms, the political head is responsible for policy matters, including the preparation of the Budget and ensuring that the administrative head is implementing the budget in line with policy objectives.

The administrative head is accountable to the political head for the implementation of the budget, and accountable to Parliament for financial management. The Bill includes provision for penalties or sanctions in the event of failure of accounting officers to discharge their responsibilities.

<b>Accounting officers</b>	<p>Four specific areas of responsibility of accounting officers are set out:</p> <ul style="list-style-type: none"><li>◆ operation of basic financial systems;</li><li>◆ ensuring that departments do not overspend their budgets;</li><li>◆ regular financial reporting; and</li><li>◆ publication of reports covering outputs and performance, in a prescribed format.</li></ul>
<b>Overhaul of financial management</b>	<p>The Treasury Control Bill lays the basis for phasing in a major overhaul of financial management. This will include, amongst other things, the introduction of appropriation control and accountability arrangements for the management of budgets. As these principles take root, the emphasis will increasingly turn to oversight of the efficiency and effectiveness of programmes and qualitative improvements in financial management practice.</p>
<b>The Budget Reform White Paper</b>	<p>As noted in last year's Medium Term Budget Policy Statement, a longer term budget reform strategy is to be published in the form of a White Paper. This sets out proposals for more effective budgeting and financial management, aimed at strengthening the links between resource allocation and the delivery of services consistent with social and development priorities.</p>
<b>Budget reform challenges</b>	<p>The budget reform process must deal in practical ways with the challenges of South Africa's fiscal environment:</p> <ul style="list-style-type: none"><li>◆ a cooperative governance framework, in which key policies and their implementation are managed jointly by national and provincial governments;</li><li>◆ the translation of agreed policy goals into delivery of public services;</li><li>◆ the need to make choices so that resources are used to maximise Government's reconstruction and development aims, meet basic needs and ensure redistribution;</li><li>◆ the promotion of democratic accountability and greater transparency and understanding of the nation's budget; and</li><li>◆ greater effectiveness in the management of public resources to deliver services more efficiently and fairly.</li></ul>
<b>Devolution of decision-making</b>	<p>These challenges underscore the need for a coherent vision of the budgeting system. The White Paper will set out proposals for greater devolution of powers of decision-making, empowering departments</p>

to allocate resources and manage their personnel and other inputs to improve service delivery. It will provide a clearer role for accounting officers in linking responsibility for resources to identified services, outputs and outcomes. It will outline tougher enforcement of controls, including improved financial accounting systems, more rapid audit and tougher penalties for over-spending or inappropriate use of funds.

These are inter-dependent reforms. If decision-makers are to be accountable for their actions, management responsibilities must be devolved to them. By the same token, devolution of decision-making requires a framework of accountability, and information systems to support decision-makers.

### **Medium term fiscal policy**

The budget reform initiatives discussed above are aimed at fostering a sound allocation of resources through the budget process. At the same time, Government remains committed to a sustainable overall fiscal stance, consistent with a stable macroeconomic environment that promotes investment, supports job creation and improves the standard of living for all.

- What is fiscal policy?** Fiscal policy deals with the levels and composition of taxation, spending and borrowing by government. Fiscal policy encompasses several fundamental policy issues, including the proper role and size of the state, the role of government in promoting growth, job creation, social development and redistribution, the nature and extent of public services and fairness between the present and future generations of South Africans. Government's fiscal policy has both microeconomic and macroeconomic objectives.
- Improved distribution and economic efficiency** Microeconomic objectives include an improved distribution of income and wealth, equitable access to social services, meeting the basic needs of the poor, promoting investment in public goods, and enhancing the efficiency with which the public and private sectors produce goods and services and their responsiveness to the needs of consumers.
- Promoting growth and development** Macroeconomic objectives relate to evolution of the economy as a whole – national income and output, jobs, inflation and the balance of payments.
- Microeconomic objectives of fiscal policy** Government's fiscal policy seeks to invest in public services that contribute to future productivity, employment creation and improved living standards. The reprioritisation of government spending aims to redirect public resources to spending areas that promote sustainable

growth, while also providing safety and security and promoting the efficient administration of justice.

- Investing in people** The budget includes provision for social grants targeted to protect the incomes of the poor, equitable access to schooling, support for training and higher education and an extensive public health system. By investing in people, Government seeks to extend opportunities to all and promote productivity and social well-being.
- Tax fairness** Fiscal policy must also ensure that the level and structure of taxes promote equity and redistribution, and do not interfere unduly in people's investment and consumption decisions.
- Encouraging investment** Government promotes a financial environment in which the nation's savings are directed towards productive investments, both in business enterprises and public infrastructure. By moderating the claims of the public sector on available savings, fiscal policy contributes to lower real interest rates, which in turn encourages investment, productivity and growth.
- Macroeconomic objectives of fiscal policy** Government's fiscal policy is aimed at promoting stability, jobs and growth. A sound macroeconomic environment encourages investment in the economy, both domestically and from abroad, to create more jobs and a higher standard of living. Fiscal policy also seeks to create a climate conducive to increased domestic saving, to limit the extent to which South Africa is dependent on foreign savings and investment.
- Affordable spending targets** In addition, Government recognises that public expenditure must be kept at an affordable level, and that spending must be matched by revenue – either currently or when debt obligations fall due. By keeping spending commitments in line with current and future revenue trends, fiscal policy contributes to low inflation and a sustainable balance of payments.
- Debt and interest** Against the background of relatively high public sector borrowing requirements in the past, a rising ratio of debt to national income and an excessive interest burden on the budget, Government aims to lower the annual budget deficit to 3 per cent of GDP within the next two years. This will ensure that government debt does not grow faster than government's ability to meet debt service payments.
- Government also aims to strengthen public sector investment spending as part of a broader commitment to building the productive capacity of the economy.
- These fiscal objectives are part of an integrated macroeconomic strategy, aimed at more growth and jobs, and sustainable improvements in the standard of living of all South Africans.

## **A revised budget framework**

### **Adaptation to changed economic environment**

This Statement explains several significant shifts in the macroeconomic and fiscal environment since the publication of the 1998 Budget. The revised budget framework set out in chapter 3 is part of Government's response to the dramatic changes of the last six months in the international financial context. A slowdown in economic growth has led to adjustments in spending and tax plans. Higher interest rates have impacted sharply on resources available for service delivery.

### **Budget priorities**

At the same time, chapter 4 of this Statement indicates several shifts in spending priorities in support of employment creation and stronger public investment. Government's commitment to effective policing and a revitalised justice system is outlined. Reforms aimed at better management of education, health and welfare services provided by provinces are noted.

### **Revised division of revenue**

Shifts in priorities are also reflected in the allocation of resources between the spheres of government. Chapter 5 details a revised division of revenue between national, provincial and local government. Chapter 6 outlines likely spending trends over the next three years.

In setting out these policy considerations, Government invites Parliament, citizens and the institutions of civil society to contribute to the making of sound budgets, honest evaluation of policies and programmes and steady progress in implementing improved public services.

*1998 Medium Term Budget Policy Statement*