3

Fiscal policy and trends

Overview

The 2012 budget framework supports growth and employment, while strengthening government's commitment to fiscal sustainability. The fiscal stance is framed by a period of exceptional global economic volatility, centred on concerns about sovereign debt levels and financial stability in advanced economies.

Support for growth, employment and fiscal sustainability in a period of global volatility

In this context, the 2011 *Medium Term Budget Policy Statement*:

- Maintains government's countercyclical fiscal stance. Expenditure continues to grow in real terms, encouraging a stronger recovery with an economic support package, measures to bolster job creation and continued public investment in infrastructure. The budget deficit rises to 5.5 per cent in 2011/12 as a result of lower-than-projected revenue, and moderates towards 3 per cent by 2014/15.
- Recognises the need to shift the composition of spending towards the creation of long-term public assets through infrastructure investment. A precondition for this objective to be met is moderation in the growth of the government wage bill and recurrent expenditure generally.
- Strengthens the sustainability of the fiscus by adopting a clear path towards the stabilisation of public debt. By 2014/15, a moderation in spending growth, combined with a recovery in tax revenue, will reduce the deficit sufficiently to stabilise debt-service costs as a percentage of GDP. This will allow government to rebuild fiscal space to address future economic downturns and provide resources for development in a sustainable manner.

The fiscal guidelines proposed in the 2011 *Budget Review* are the foundation of the fiscal stance. Applied consistently, the principles of countercyclicality, long-term debt sustainability and intergenerational equity will enable government to improve social conditions in a

Countercyclicality, debt sustainability and intergenerational equity underpin fiscal policy sustainable manner, and strengthen South Africa's fiscal sovereignty in a turbulent global environment.

Long-term fiscal report to encourage public discussion and parliamentary oversight

The fiscal guidelines published in the 2011 *Budget Review* establish the principles of intergenerational equity, debt sustainability and countercyclicality as the foundation of South Africa's fiscal policy.

Ensuring that our social commitments are affordable requires government to consider demographic and economic trends, alongside the costs of current programmes, over the long term. The public finance implications of South Africa's development plans need to be considered, as do decisions about how to meet current needs, respond to unforeseen economic setbacks and ensure the progressive realisation of social objectives.

To encourage public discussion and greater parliamentary oversight of revenue and expenditure trends, the National Treasury will publish a long-term fiscal review within the next 12 months.

Countercyclical fiscal policy

Moderately expansionary budget to support growth and employment, and steps towards fiscal consolidation over the medium term

In the face of a weak economic environment, government proposes a moderately expansionary budget to support economic recovery and employment. Slowing growth in the world economy, and its effect on South Africa, will result in lower-than-forecast revenues in 2011/12 and 2012/13. In these circumstances, a slightly larger budget deficit is warranted and is in line with countercyclical management of the fiscus. The deficit will widen to 5.5 per cent of GDP in 2011/12. As the economy strengthens, the deficit will narrow steadily towards 3 per cent over the next three years.

Economic support measures applied during the 2009 recession strengthened South Africa's safety net and supported the return to growth. The expenditure required for this response, however, has pushed up public debt as a proportion of GDP, diminishing the fiscal space available for responding to future events. Therefore, while expenditure grows in real (albeit moderate) terms over the medium-term expenditure framework (MTEF) period, government will ensure that fiscal sustainability is reinforced.

While shifting spending to strengthen investment, government maintains its commitment to social expenditure in real terms

Within the spending limits that this commitment establishes, the MTEF will support economic recovery by promoting competitiveness, strengthening economic development, creating work and continuing to make large-scale investments in electricity, roads, rail and water. While shifting an increasing share of expenditure towards infrastructure investment, government will maintain its commitment to social expenditure in real terms.

Safeguarding fiscal sustainability

South Africa must take into account the long-term implications of short-term spending decisions

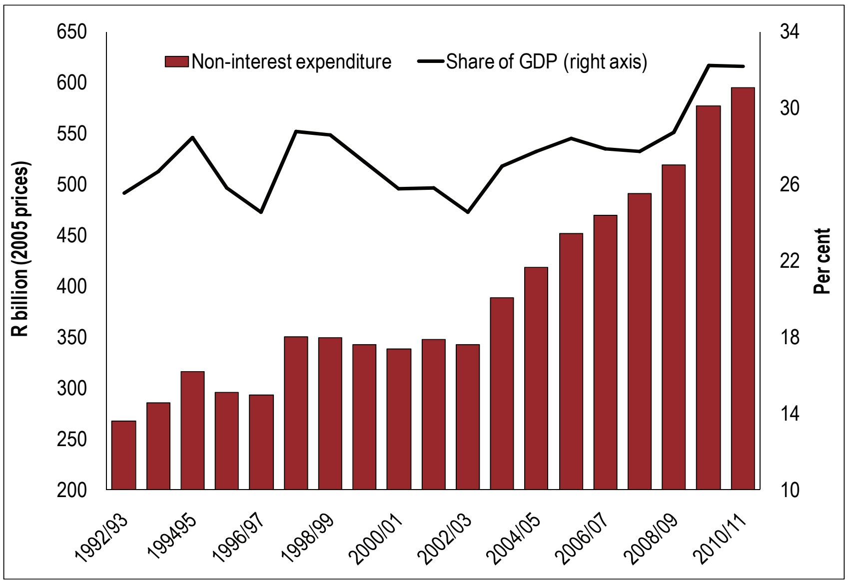
The fiscal choices that South Africa makes over the next three years will have implications for the next three decades. The principle of intergenerational equity implies that today's policy decisions should take into account how they will affect South Africans in 10, 20 or 30 years. The Constitution requires government to provide for a rising floor of socio-economic rights within its resources. Meeting the country's primary social and economic goals requires sustainable increases in real expenditure in the decades to come.

Over the long term, spending should increase at a pace commensurate with the rate of economic growth. Policy shifts that result in permanent step-changes in the level of expenditure need to be supported by corresponding changes in tax revenue.

In real terms, government spending is higher than ever before and constitutes a greater proportion of GDP than at any time since 1994. Non-interest spending rose by 8.2 per cent of GDP from 2002/03 to 2009/10. The 2012 Budget will see spending exceed R1 trillion.

Non-interest expenditure rose by about 8.2 per cent of GDP from 2002/03 to 2009/10

Figure 3.1 Real consolidated general government non-interest expenditure,* 1992/93 – 2010/11



Source: Reserve Bank and National Treasury estimates

** Includes extraordinary financial transfers*

Some of government's spending growth over the past decade was supported by structural increases in revenue, with improved compliance and administration playing a role. But higher revenue in the mid-2000s also reflected a temporary windfall associated with the commodity boom prior to the 2009 recession. To return the budget to a sustainable position over the medium term, government needs to limit spending growth in line with the capacity of the economy to generate revenue.

To return to sustainability, government will limit spending growth in line with capacity to generate revenue

Changing the composition of spending

Long-term sustainability depends partly on the composition of government spending. Governments that spend too much on consumption, or too little on building and maintaining public assets, can retard economic growth and so erode their own fiscal sustainability. Moreover, when a government borrows to finance non-capital spending, it takes on debt obligations that must be paid off years after the funds have been spent, often for little long-term gain.

Since the 2009 downturn, more than R120 billion in current spending has been financed by debt. In real terms, the fastest-growing component of current expenditure over the past decade has been government's wage bill.

Wage settlements need to be balanced against social and economic priorities

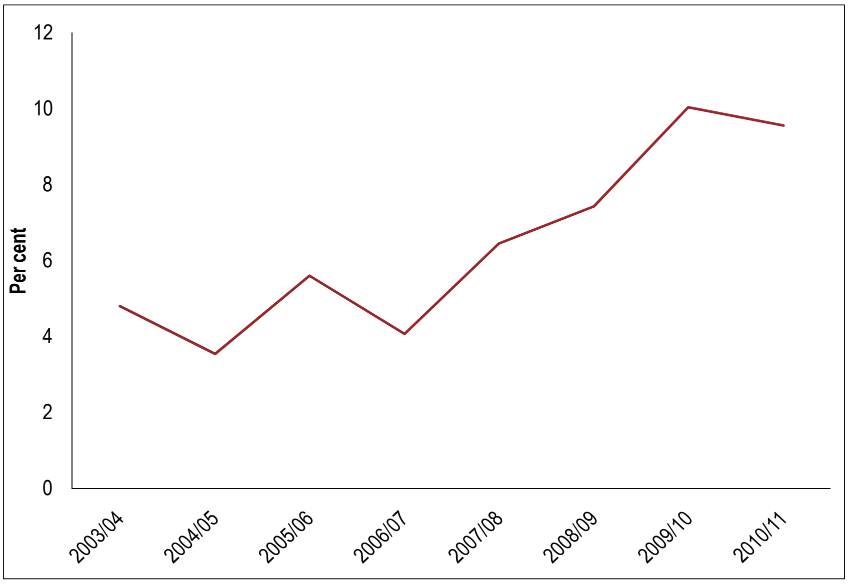
The extent of public-sector wage settlements must be balanced by the crucial consideration of the share of spending allocated to social and economic priorities, such as infrastructure and social security.

As a step towards sustainability, the 2012 fiscal framework is premised on a shift in the composition of government expenditure towards infrastructure investment. Moderation in the growth of the wage bill will see compensation as a proportion of non-interest spending decline over the MTEF period.

In general, government borrowing should finance investment

A recovery in tax revenue, more moderate growth in consumption expenditure, and additional savings from goods and service budgets will mean that by 2013/14, government will have sufficient revenue to pay for current expenditure. In general, government borrowing should be to finance investment. Priority will be given to spending that strengthens the asset base of the economy, including through capital investment, maintenance and refurbishment, and building public capacity to plan and manage infrastructure.

Figure 3.2 Real growth in compensation of employees, 2003/04 – 2010/11

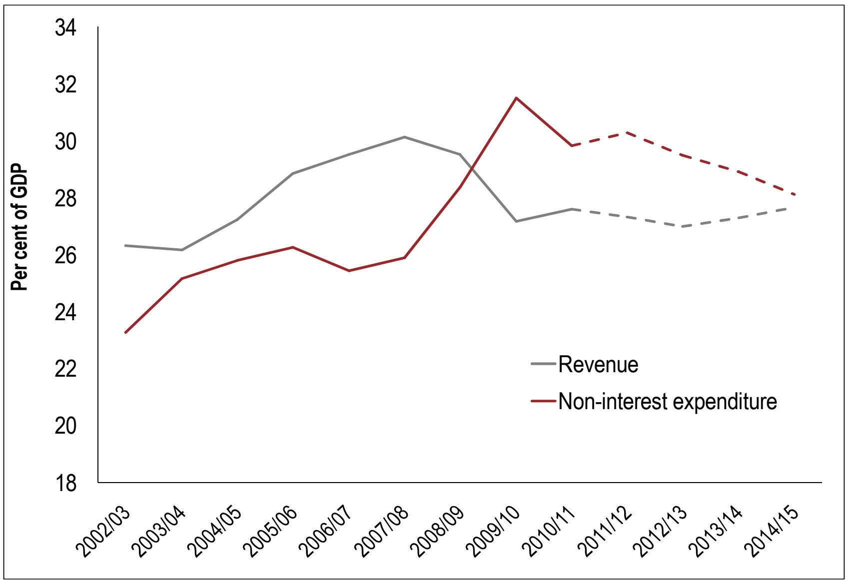


Debt sustainability

A path towards stabilisation of national debt

The acceleration in spending between 2007/08 and 2009/10, and falling revenue, resulted in a primary deficit (revenue minus non-interest spending). The moderation of spending, combined with a recovery in tax revenue, sets a clear and realistic path towards the elimination of this deficit – and stabilisation of debt as a percentage of GDP. Should the economy fail to recover as predicted, ensuring long-term fiscal sustainability would require a combination of slower spending growth and policy measures to raise tax revenue.

Figure 3.3 Consolidated non-interest expenditure and revenue as percentage of GDP, 2002/03 – 2014/15



Fiscal framework

The consolidated budget deficit is projected to narrow from 5.5 per cent this year to 3.3 per cent in 2014/15.

Table 3.1 Consolidated fiscal framework, 2009/10 – 2014/15

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
R billion	**Outcome**		**Estimate**	**Medium-term estimates**		
Revenue	**664.3**	**758.4**	**814.2**	**890.0**	**994.5**	**1 113.0**
Percentage of GDP	*27.2%*	*27.6%*	*27.3%*	*27.0%*	*27.3%*	*27.7%*
Expenditure	**826.6**	**885.8**	**978.8**	**1 062.3**	**1 157.4**	**1 247.0**
Percentage of GDP	*33.8%*	*32.2%*	*32.9%*	*32.2%*	*31.8%*	*31.0%*
State debt cost	57.1	66.2	76.9	89.1	104.1	115.1
Percentage of GDP	*2.3%*	*2.4%*	*2.6%*	*2.7%*	*2.9%*	*2.9%*
Non-interest expenditure	769.5	819.6	901.9	973.2	1 053.3	1 131.9
Percentage of GDP	*31.5%*	*29.8%*	*30.3%*	*29.5%*	*28.9%*	*28.1%*
Budget balance	**-162.3**	**-127.4**	**-164.6**	**-172.3**	**-162.9**	**-134.1**
Percentage of GDP	*-6.6%*	*-4.6%*	*-5.5%*	*-5.2%*	*-4.5%*	*-3.3%*
Primary balance (percentage of GDP)	*-4.3%*	*-2.2%*	*-2.9%*	*-2.5%*	*-1.6%*	*-0.5%*
Gross domestic product	*2 442.6*	*2 748.2*	*2 977.7*	*3 298.0*	*3 642.6*	*4 023.4*

Expenditure

Despite weaker-than-expected revenue performance, government spending will continue to grow moderately in real terms. The proposed fiscal framework makes R1.1 trillion available for spending next year. In real per capita terms, this represents a doubling of the resources available to the fiscus between 2002/03 and 2012/13.

Fiscal framework makes available R1.1 trillion for spending in 2012/13

Key spending priorities are to support job creation, maintain the real value of the social wage and support economic transformation along the New Growth Path. Allocations will also be made to pilot national health insurance in 10 districts.

Investment in new buildings and fixed structures, as well as maintenance of existing structures

Over the next three years, national departments and public entities will reprioritise and realign their budget baselines to make more effective use of resources. The fiscal framework also supports a determined effort to shift the composition of spending towards investment in long-term assets that can build the economy. Table 3.2 shows public-sector infrastructure expenditure estimates by sector over the MTEF period. Infrastructure expenditure includes spending on new buildings and fixed structures, as well as the maintenance and rehabilitation of existing structures.

Table 3.2 Public-sector infrastructure expenditure estimates by sector, 2010/11 – 2014/15

R billion	2010/11	2011/12	2012/13	2013/14	2014/15	MTEF total	% of total
Economic services	**161.9**	**197.3**	**217.8**	**228.2**	**230.1**	**676.0**	**84.3%**
Energy	52.5	71.7	90.4	98.8	102.7	292.0	36.4%
Water and sanitation	14.4	17.8	20.6	19.9	19.8	60.4	7.5%
Transport and logistics	69.1	79.5	76.3	76.9	72.3	225.6	28.1%
Other economic services[1]	25.8	28.4	30.4	32.5	35.2	98.0	12.2%
Social services	**17.2**	**26.6**	**26.8**	**32.5**	**35.2**	**94.5**	**11.8%**
Health	6.7	10.0	9.6	13.9	15.2	38.8	4.8%
Education	6.0	9.1	9.8	11.2	11.2	32.2	4.0%
Community facilities	3.5	5.2	4.7	4.8	6.2	15.7	2.0%
Other social services[2]	1.0	2.4	2.6	2.6	2.7	7.9	1.0%
Justice and protection services	**3.8**	**4.1**	**4.4**	**5.1**	**5.8**	**15.2**	**1.9%**
Central government and administrative services	**2.1**	**4.2**	**8.0**	**3.5**	**2.5**	**14.0**	**1.7%**
Financial services	**0.3**	**0.7**	**0.7**	**0.7**	**0.8**	**2.2**	**0.3%**
Total	**185.3**	**232.9**	**257.6**	**269.9**	**274.4**	**802.0**	**100.0%**
Percentage of GDP	*6.7%*	*7.8%*	*7.8%*	*7.4%*	*6.8%*		

1. Includes agriculture and environmental, telecommunications, housing, IDZ, etc.
2. Includes labour centres, heritage institutions, national libraries, etc.

The budgets for national and provincial government infrastructure spending have been revised upwards by more than R10 billion since the 2011 Budget, and a projected R71 billion will be spent on health and education infrastructure over the MTEF period.

Government is working to overcome obstacles to infrastructure planning and implementation

The main challenge associated with increased fiscal support for the recovery lies in overcoming obstacles to the implementation of infrastructure and job-creating programmes, rather than budgeting for higher levels of expenditure. These challenges are particularly striking in municipalities and state-owned enterprises, both of which have spent below budgeted amounts over the past three years. Government has implemented stricter monitoring of these institutions. Efforts to improve the capacity to plan, contract and execute infrastructure budgets are a discussed in Chapter 4.

Revenue

Tax revenue responds automatically to changes in the economic cycle

Tax revenue responds automatically to changes in the economic cycle. Weaker economic conditions have had an impact on revenue collection.

During 2007/08 gross tax revenue increased year-on-year by 15.6 per cent, reflecting strong economic conditions. This rate of increase slowed to 9.1 per cent during 2008/09 and, following the 2009 recession, gross tax revenues declined by 4.2 per cent. Sharp falls in corporate income tax, value-added tax (VAT), secondary tax on companies and customs duty revenues led the decline.

As conditions improved during 2010/11, nominal gross tax revenues grew by 12.6 per cent year-on-year, with significant increases in personal income tax, VAT, customs duty and fuel levy revenues. Despite the recovery in GDP growth, the lagged effects of the economic downturn meant that corporate income tax revenues continued to decline.

Table 3.3 Total tax and budget revenue, 2010/11 – 2012/13

	2010/11	2011/12			2012/13
R million	Outcome	Budget	Revised Estimates	Difference	
Persons and individuals	226 925	252 750	252 750	–	292 150
Companies	132 902	144 165	144 165	–	160 193
Value-added tax	183 571	200 880	187 464	-13 416	212 560
Secondary tax on companies/dividend tax	17 178	18 100	19 000	900	12 840
Specific excise duties	22 968	25 085	24 840	-245	25 610
Fuel levy	34 418	36 900	36 900	–	38 040
Custom duties	26 637	29 860	31 000	1 140	35 740
Other	29 584	33 880	32 473	-1 407	35 377
Total tax revenue	**674 183**	**741 620**	**728 592**	**-13 028**	**812 510**
Non tax revenue	12 893	10 001	11 713	1 642	12 357
of which mineral royalties	*3 555*	*4 890*	*4 890*	–	*5 140*
Less: SACU payments	-14 991	-21 763	-21 763	–	-38 983
Other adjustments[1]	-2 900	–	–	–	–
Provinces, social security and selected public entities	89 228	94 609	95 704	1 095	104 075
Total budget revenue	**758 413**	**824 466**	**814 246**	**-10 291**	**889 959**

1. Payments to SACU partners in respect of a previous error in calculation of the 1969 agreement

Since the publication of the 2011 *Budget Review*, economic performance has weakened, and this is reflected in slowing tax collection. Gross tax revenues are expected to increase by 8.1 per cent in nominal terms during 2011/12.

Estimated gross tax revenue is revised downwards by R13 billion

Estimated gross tax revenue is revised downwards by R13 billon to R728.6 billion. This is largely the result of a downward revision in net VAT receipts to R187.5 billion, R13.4 billion below the 2011 Budget estimate, owing to an underestimation of VAT refunds for 2011/12 at the time of the budget. The higher VAT refunds during 2011/12 appear to be mainly a result of increases in nominal imports, exports and gross fixed investment during 2010/11 and 2011/12.

Revenue collection for the current year and the forecast for 2012/13 reflect weaker economic conditions

Revenue collection for the current year and the forecast for 2012/13 reflect weaker economic conditions. Overall, budget revenue has been revised down by R10.3 billion in 2011/12 and by R18.8 billion in 2012/13. This takes into account a revision to the Southern African Customs Union (SACU) payment in 2012/13, which will include an adjustment for an over-collection in 2010/11. As the business cycle turns in the outer years, the fiscal framework envisages improved revenue performance.

Non-tax revenue, provincial revenue, social security fund revenue, and revenue for the public entities included in the consolidation have increased marginally over the 2011 Budget forecast.

Debt financing

Medium-term financing strategy

Cash balances will ensure that borrowing requirement does not result in higher bond issuance

South Africa's bond markets, which will be the primary source of financing over the medium term, remain healthy, liquid and deep. As a consequence of the wider deficit, the main budget borrowing requirement increases to R181.2 billion in 2012/13, before decreasing to R150.4 billion in 2014/15. Nevertheless, debt issuances over the medium term will be maintained at current levels by drawing on cash balances and exchanging debt maturing within the next several years for longer-dated debt. Debt issuance in the broader public sector will be closely monitored.

Table 3.4 Total government debt, 2008/09 – 2014/15

As at 31 March	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
R billion		Outcome		Estimate		Medium-term estimates	
Domestic debt							
Gross loan debt[1]	529.7	705.5	892.7	1 069.6	1 249.0	1 432.6	1 599.9
Cash balances	-101.3	-106.6	-111.4	-114.8	-107.2	-102.2	-102.2
Net loan debt[2]	428.4	598.9	781.3	954.8	1 141.8	1 330.4	1 497.7
Foreign							
Gross loan debt[1]	97.3	99.5	97.9	101.7	105.4	104.0	104.3
Cash balances	–	-25.2	-62.1	-50.4	-35.6	-18.3	-4.3
Net loan debt[2]	97.3	74.3	35.8	51.3	69.8	85.7	100.0
Total gross loan debt	**627.0**	**805.0**	**990.6**	**1 171.3**	**1 354.4**	**1 536.6**	**1 704.2**
Total net loan debt	**525.7**	**673.2**	**817.1**	**1 006.1**	**1 211.6**	**1 416.1**	**1 597.7**
As percentage of GDP :							
Total gross loan debt	*27.1*	*33.0*	*36.0*	*39.3*	*41.1*	*42.2*	*42.4*
Total net loan debt	*22.7*	*27.6*	*29.7*	*33.8*	*36.7*	*38.9*	*39.7*
Foreign debt as percentage of:							
Gross loan debt	*15.5*	*12.4*	*9.9*	*8.7*	*7.8*	*6.8*	*6.1*
Net loan debt[2]	*18.5*	*11.0*	*4.4*	*5.1*	*5.8*	*6.1*	*6.3*

1. Forward estimates are based on National Treasury's projections of exchange and inflation rates

2. Net loan debt is calculated with due account of the bank balances of the National Revenue Fund (balances of government's accounts with the Reserve Bank and commercial banks)

Borrowing in the international capital markets will continue to finance government's foreign currency commitments. While accounting for only a small proportion of government's debt portfolio, foreign borrowing has useful benefits, such as setting benchmarks for borrowing by private and public-sector institutions.

Table 3.5 Main budget net borrowing requirement and financing, 2010/11 – 2014/15

	2010/11	2011/12		2012/13	2013/14	2014/15
R million	Outcome	Budget	Revised	Medium-term estimates		
Main budget balance	**-135 956**	**-159 066**	**-169 476**	**-181 167**	**-175 627**	**-150 434**
Extraordinary payments	-839	-150	-520	–	–	–
Extraordinary receipts	3 010	1 350	3 380	–	–	–
Borrowing requirement (-)	**-133 785**	**-157 866**	**-166 616**	**-181 167**	**-175 627**	**-150 434**
Domestic short-term loans (net)	**34 893**	**22 000**	**22 000**	**22 000**	**22 000**	**20 000**
Domestic long-term loans (net)	**136 850**	**135 367**	**135 067**	**134 908**	**131 261**	**113 238**
Market loans	150 386	150 400	150 400	151 319	149 554	140 777
Redemptions[1]	-13 536	-15 033	-15 333	-16 411	-18 293	-27 539
Foreign loans (net)	**2 839**	**4 999**	**-2 363**	**-1 835**	**-3 522**	**-422**
Market loans	5 151	7 150	–	7 660	7 840	7 910
Arms procurement loan agreements	470	1 009	985	183	25	–
Redemptions (including revaluation of loans)[2]	-2 782	-3 160	-3 348	-9 678	-11 387	-8 332
Change in cash and other balances[3]	**-40 797**	**-4 500**	**11 912**	**26 094**	**25 888**	**17 618**
Rand	-3 830	10 496	215	11 241	8 600	3 600
Foreign currency	-36 967	-14 996	11 697	14 853	17 288	14 018
Financing	**133 785**	**157 866**	**166 616**	**181 167**	**175 627**	**150 434**

1. Domestic loan redemption figures are net of anticipated switches, reducing redemptions by R7.5 billion in 2011/12, R45 billion in 2012/13, R15 billion in 2013/14 and R34 billion in 2014/15

2. Foreign loan redemptions are net of anticipated switches, reducing redemptions by R1.5 billion in 2012/13, R5.3 billion in 2013/14 and by R2.6 billion in 2014/15

3. A negative change indicates an increase in cash balances

Public-sector borrowing requirement

The public-sector borrowing requirement, which includes state-owned enterprises and local government, represents the funds needed by the public sector to cover any deficit in financing its own current and capital expenditure.

Table 3.6 Public-sector borrowing requirement,[1,2] 2010/11 – 2014/15

	2010/11	2011/12		2012/13	2013/14	2014/15
R billion	Outcome	Budget	Revised	Medium-term estimates		
Main budget balance	**136.0**	**159.1**	**169.5**	**181.2**	**175.6**	**150.4**
Extraordinary payments	0.8	0.2	0.5	–	–	–
Extraordinary receipts	-3.0	-1.4	-3.4	–	–	–
Borrowing requirement	**133.8**	**157.9**	**166.6**	**181.2**	**175.6**	**150.4**
Other government borrowing[3]	-3.5	4.8	1.2	-2.5	-5.9	-8.3
General government borrowing	**130.2**	**162.7**	**167.8**	**178.6**	**169.8**	**142.2**
Percentage of GDP	*4.7%*	*5.6%*	*5.6%*	*5.4%*	*4.7%*	*3.5%*
Plus: Non-financial public enterprises	47.1	113.7	73.7	79.7	78.9	63.8
Public-sector borrowing requirement	**177.5**	**276.4**	**241.5**	**258.4**	**248.7**	**206.0**
Percentage of GDP	*6.5%*	*9.5%*	*8.1%*	*7.8%*	*6.8%*	*5.1%*
Gross domestic product	2 748.2	2 914.9	2 977.7	3 298.0	3 642.6	4 023.4

1. A negative number reflects a surplus and a positive number a deficit

2. 2011/12 – 2014/15 are based on National Treasury estimates

3. Includes RDP, social security funds, provinces, extra-budgetary institutions and local government

Conclusion

Fiscal policy will support the recovery by allowing the deficit to widen in the short term, and government will implement a series of measures to support economic growth and competitiveness. Economic growth has been weaker than anticipated at the time of the 2011 Budget. Revenue continues to be depressed, resulting in a wider-than-anticipated deficit of 5.2 per cent in 2012/13.

Spending grows moderately over the medium term, and over the longer term government will reduce debt

Over the medium term, government spending continues to grow, but at a more moderate pace than in recent years. Over the longer term, government will reduce debt and restore sustainability. To consider more rigorously the intergenerational consequences of government's revenue and spending choices, the National Treasury will publish a long-term fiscal report in 2012. More prudent and targeted spending is required over the next few years.