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Sustaining progress in a low-growth world

The world economy is experiencing a lengthy period of low growth marked by slower global trade, volatile capital flows, weak commodity prices and heightened geopolitical tensions. All countries – particularly developing nations – are grappling with the changes required to promote economic growth.

At home, electricity constraints, weak business confidence and low household demand have limited growth. Without a stronger effort to overcome domestic constraints and speed up the pace of structural change, South Africa will not be able to substantially reduce unemployment, poverty and inequality.

Government has taken two crucial steps to adapt to this low-growth world. It has identified the broad structural reforms needed to put the economy on a much higher growth path. And it has reduced South Africa's vulnerability by implementing fiscal policy measures to maintain the health of the public finances.

Continuing to make social progress and building a more competitive economy, however, will require more rapid implementation of the National Development Plan, a stabilisation of public debt, greater efficiency in public spending, and a sustainable approach to public-sector remuneration.

This policy statement builds on the commitments made last year to stabilise debt levels and improve the effectiveness of spending. A long-term fiscal guideline will align spending growth closely with GDP growth, ensuring that all South Africans can enjoy the benefits of future economic expansion.

Adapting to global uncertainty

During 2015 the global and domestic economic outlooks have weakened

Last year's *Medium Term Budget Policy Statement* (MTBPS) signalled a shift in fiscal policy. Spending limits were reduced and tax rates adjusted to stabilise the growth of public debt. These commitments were implemented with the 2015 Budget. Since then, the global economy has deteriorated and domestic GDP growth has again been revised down.

Slower, more volatile growth has become an enduring feature of the world economy, raising concerns of a protracted period of weakness in global trade, investment and commodity prices.

South Africa's priorities are to reduce high levels of unemployment, poverty and inequality

All developing countries face this difficult environment with their own unique circumstances. South Africa's priorities are to reduce high levels of unemployment, poverty and inequality. Over the medium term, government will continue to limit the country's external vulnerabilities and address domestic structural constraints to faster growth.

In today's turbulent global environment, prudent macroeconomic policies provide an important anchor for stability. Sustainable fiscal policy protects the social gains made since 1994. And a resilient, flexible financial system helps the economy adjust to rapid change. The National Development Plan (NDP) lays the basis for much-needed economic and policy reforms to establish a platform for faster growth. Its objectives are embedded in government's medium-term strategic framework.

Government is maintaining the fiscal course announced last year. To ensure sustainable public finances that are not overwhelmed by debt and interest payments, spending limits will remain in place. Within these limits, funds will be shifted to accommodate the three-year public-sector wage agreement reached in 2015. Scarce resources will also be targeted to meet pressing social needs.

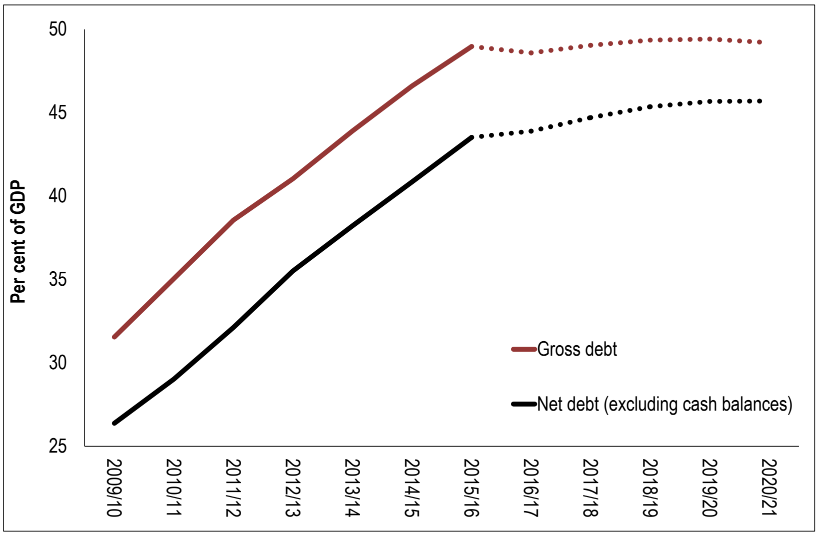
Tax proposals to be approached with caution given economic outlook

The MTBPS proposes a new long-term fiscal guideline to align the spending ceiling explicitly with the long-term path of economic growth. The guideline builds on government's countercyclical approach to sustain development over the long term. Given the weak economic outlook, proposals for additional taxes – which are essential to fund government's ambitious policy agenda – will be approached with caution. Over the medium term, government will continue to explore reforms that promote an efficient and progressive tax system, taking into account the recommendations of the Davis Tax Committee. Initiatives already under way include measures to combat base erosion, profit shifting and the misuse of transfer pricing.

Ratio of government debt to GDP continues to stabilise over medium term

The ratio of government debt to GDP continues to stabilise, as shown in Figure 1.1. However, owing to weaker economic performance, projections of the debt level are revised marginally higher, and there is some slippage in the budget deficit compared with 2015 Budget projections.

Figure 1.1 National government debt as a share of GDP



Source: National Treasury

Revenue growth will continue to outpace spending growth, narrowing the budget deficit from 3.8 per cent in the current year to 3.0 per cent in the outer year of the medium-term expenditure framework (MTEF). Over this period, government will restore the primary balance – the gap between revenue and non-interest spending – ensuring a sustainable fiscal path.

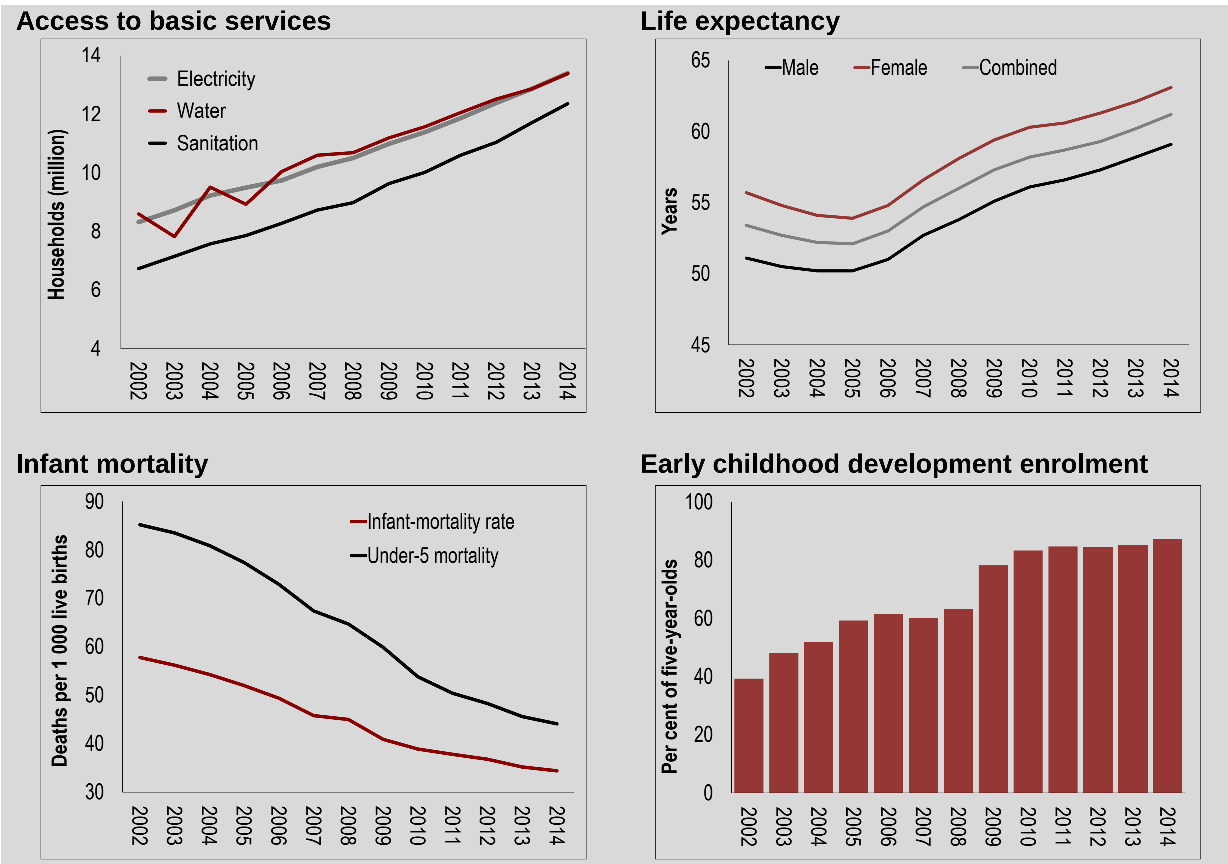
Over next three years, government will restore primary balance, ensuring a sustainable fiscal path

Sustaining social progress

South Africa remains a society marked by high levels of long-term unemployment, widespread poverty and extreme inequality. Active citizens continue to challenge these conditions, which can be overcome by speeding up national development. Creating work and improving education to eliminate poverty and build a more equitable society are at the heart of the long-term reforms set out in the NDP.

Yet despite continuing economic and social hardship, the lives of millions of South Africans have improved markedly over the past decade. Access to social infrastructure – formal housing, potable water, sanitation and electricity – has increased substantially. Social grants continue to make a meaningful contribution to reducing extreme poverty. With 15 per cent of the budget going to public education, there is universal access to basic education. Enrolments in early childhood development and post-school education continue to expand. Life expectancy has risen from 52 years in 2006 to 61 years in 2014, as public health interventions limit the consequences of the HIV/AIDS pandemic. Child mortality has been halved over the past decade, and there has been a substantial reduction in cases of severe malnutrition among children.

South Africa has reduced poverty and expanded access to water, housing, sanitation and electricity



Source: Development Indicators, 2014; Department of Planning, Monitoring and Evaluation

Good fiscal planning supports government's ability to act on its constitutional mandate

These achievements were made possible by government's sustainable approach to allocating public funds. Good fiscal planning supports government's ability to act on its constitutional mandate to realise fundamental social and economic rights in a progressive and affordable manner. Over the past decade, public spending has doubled in real terms, funding a large expansion of social and capital budgets.

The proposed medium-term fiscal framework will enable government to continue supporting social and economic development in a weak economic environment. Expenditure growth will outpace inflation by about 1.6 per cent. The framework builds on the commitments made last year to stabilise debt levels, close the primary balance and improve the effectiveness of spending.

Table 1.1 Consolidated government fiscal framework, 2014/15 – 2018/19

	2014/15	2015/16	2016/17	2017/18	2018/19
R billion/Percentage of GDP	**Outcome**	**Revised**	**Medium-term estimates**		
Revenue	**1 091.9**	**1 220.8**	**1 306.4**	**1 416.0**	**1 540.9**
	28.4%	*29.8%*	*29.4%*	*29.3%*	*29.3%*
Expenditure	**1 228.8**	**1 378.7**	**1 451.7**	**1 568.8**	**1 699.1**
	32.0%	*33.6%*	*32.7%*	*32.5%*	*32.4%*
Budget balance	**-136.9**	**-157.9**	**-145.3**	**-152.8**	**-158.2**
	-3.6%	*-3.8%*	*-3.3%*	*-3.2%*	*-3.0%*
Total net loan debt	**1 584.2**	**1 785.7**	**1 947.4**	**2 158.0**	**2 382.0**
	41.2%	*43.5%*	*43.9%*	*44.7%*	*45.4%*

Source: National Treasury

Quantity, quality and composition of public spending

South Africans should highlight waste, inefficiency and corruption wherever it occurs

Spending over the MTEF period totals R4.7 trillion. This represents a large commitment of resources to support social progress and economic change. Yet the *quantity* of public expenditure is frequently let down by the *quality* of spending. Government is intensifying its efforts to improve value received for money spent. All South Africans can support this goal by highlighting waste, inefficiency and corruption wherever it arises.

The National Treasury, working with the Department of Planning, Monitoring and Evaluation in the Presidency, will make greater use of expenditure reviews and evaluations in the allocation of resources. Procurement reforms have already begun to make tender awards more transparent and less susceptible to corruption, and will achieve savings.

South Africa, a leader in open budgeting, takes new steps to strengthen transparency

South Africa ranked third out of 102 countries in the 2015 release of the Open Budget Index by the International Budget Partnership. The survey measures the quality of budget transparency, public participation in the budget process and institutional oversight. South Africa was one of only four countries that performed solidly across all three categories. It was in the top five on measures of transparency and oversight by the legislature and audit institutions, but came out sixth for public participation.

In recent years, the National Treasury has worked to improve public dialogue with citizens on the budget process, making regular presentations at universities and civil society forums. The executive, Parliament and audit institutions all need to consider how to deepen citizen engagement on the public finances.

Additional steps to strengthen budget transparency are being taken. For the first time, key assumptions underlying the macroeconomic and revenue forecasts presented in the fiscal framework are published in the MTBPS (see the technical annexure). In addition, the National Treasury is working with civil society organisations to make budget data more accessible and understandable to citizens through an internet portal.

South Africa's public servants make an important contribution to the country's development goals, and government is committed to fair and sustainable levels of public-sector remuneration. The 2015 public-sector wage agreement resulted in a 10.1 per cent increase in the wages and benefits of government employees this year – well beyond the inflation-related adjustment that had been budgeted for. Without commensurate improvements in the quality of public services, such increases are not sustainable.

The wage agreement has consequences for the composition of spending, as salary requirements put pressure on capital and other critical inputs. Government recognises that there is a need to radically change the manner in which future negotiations are conducted, and is considering proposals to reform remuneration in the public sector.

Debt-service costs remain the fastest-growing spending category

Allocations for compensation increase growth in budgets for employment-intensive public services, such as health, education and policing. However, debt-service costs remain the fastest-growing spending category.

Table 1.2 Consolidated government expenditure, 2015/16 – 2018/19

R billion	2015/16 Revised	2016/17 Medium-term estimates	2017/18	2018/19	Average annual growth 2015/16 – 2018/19
Basic education	213.9	228.6	249.8	270.0	8.1%
Health	157.7	169.7	184.7	200.6	8.3%
Defence, public order and safety	172.0	183.7	198.9	211.8	7.2%
Post-school education and training	63.7	66.2	71.0	76.6	6.3%
Economic affairs	187.6	202.3	208.5	222.5	5.9%
Human settlement and municipal infrastructure	178.7	189.9	204.2	222.6	7.6%
Agriculture, rural development and land reform	25.6	26.5	28.3	30.0	5.4%
General public services	72.5	71.8	75.8	79.8	3.3%
Social protection	154.0	168.0	181.3	195.7	8.3%
Total expenditure by function	**1 225.7**	**1 306.6**	**1 402.6**	**1 509.5**	**7.2%**
Special appropriations: Eskom and New Development Bank	25.0	–	–	–	**–**
Debt-service costs	127.9	142.6	157.2	174.6	10.9%
Contingency reserve	–	2.5	9.0	15.0	**–**
Total expenditure	**1 378.7**	**1 451.7**	**1 568.8**	**1 699.1**	**7.2%**

Source: National Treasury

Investing for social and economic change

Funds to accommodate expansion of social grant beneficiaries and rising cost of free basic services

There is little room for new spending priorities over the next three years. Nevertheless, government proposes to allocate additional resources to core areas of need, including projects that address urgent social priorities:

- Provision has been made to increase social grants to accommodate higher-than-expected growth in grant beneficiary numbers.
- The local equitable share has been bolstered to support the rising cost of free basic services.
- Resources have been added to social development budgets for substance-abuse centres and early childhood development.

- Funds are set aside to improve the quality of public-order policing.
- Financial support for health information systems will alleviate problems in the management of medicine stocks, and help lay a foundation for national health insurance. Additional resources have been provided to support treatment of HIV/AIDS and tuberculosis.
- Agencies that support science and innovation have received additional resources to bolster research and development.

Investments in roads, public transport, housing, water, education and health infrastructure

General government has made a large contribution to investment growth over the last two years, while private-sector investment has remained muted. Government continues to invest in public infrastructure and housing. Proposed medium-term budget allocations of R542 billion include:

- R130 billion in roads and public transport
- R60 billion in public housing
- R55 billion in water infrastructure
- R50 billion in other municipal infrastructure
- R43 billion in school buildings
- R11 billion in tertiary education capital projects
- R30 billion in health facilities and equipment
- R20 billion to extend the electricity grid to poor households.

In addition, infrastructure plans by large state-owned companies exceed R400 billion over the next three years.

Reforms to capital budgeting framework

Spending reforms include capital project appraisal tools and strengthened procurement regulations

In recent years, better coordination, the introduction of targeted incentives and efforts to build municipal financial capacity have improved capital project planning and execution. Local government spent 91 per cent of allocated infrastructure budgets in 2014/15, up from 86 per cent in 2013/14 and 77 per cent in 2012/13. To build on this progress, and improve value for money in infrastructure investment, government will introduce a medium-term capital budgeting framework. It will include:

- New appraisal tools for capital projects
- Strengthened procurement regulations
- Measures to lock in resources for operations and maintenance
- More transparency on the full life-cycle costs of large capital projects.

Funding South Africa's capital contribution to the New Development Bank

Government proposes to use R2 billion from its sale of Vodacom shares for South Africa's initial capital contribution to the New Development Bank. The share sale is expected to yield total receipts of R25.4 billion, of which R23 billion has been provided to recapitalise Eskom.

The purpose of the New Development Bank is to mobilise resources for infrastructure and sustainable development projects in BRICS (Brazil, Russia, India, China, South Africa) and other developing countries. The bank's headquarters are in Shanghai and the first regional office will be established in Johannesburg. Initially, BRICS countries will be the only members, each with a shareholding of US$10 billion and equal voting power. Subscribed capital is made up of 20 per cent paid-in capital and 80 per cent callable capital. In time the bank will be open to all members of the United Nations.

Restoring the momentum of economic growth

Given the global and domestic outlook, the fiscal resources required to sustain development will become increasingly strained unless government and the private sector work together to restore the momentum of economic growth. The resources available to the fiscus – which depends directly on revenues generated by the economy – are expanding too slowly to meet the country's development requirements. High levels of poverty and inequality persist despite the redistributive character of the budget.

GDP growth of 1.5 per cent expected in 2015 and 1.7 per cent in 2016

Economic growth is expected to be only 1.5 per cent in 2015 – the same as in 2014 – and to remain subdued, rising marginally to 1.7 per cent in 2016. The slowdown in economic growth is taking a toll on ordinary South Africans. Unemployment remains persistently high, fluctuating at about 25 per cent, or at about 33 per cent using the expanded definition.

Table 1.3 Macroeconomic projections, 2014 – 2018

Calendar year	2014 Actual	2015 Estimate	2016	2017 Forecast	2018
Percentage change unless otherwise indicated					
Final household consumption	1.4	1.5	1.7	2.5	2.8
Gross fixed capital formation	-0.4	1.2	1.5	3.2	3.8
Real GDP growth	**1.5**	**1.5**	**1.7**	**2.6**	**2.8**
GDP at current prices (R billion)	**3 796**	**4 031**	**4 349**	**4 726**	**5 143**
CPI inflation	6.1	4.8	6.2	5.9	5.8
Current account balance (% of GDP)	-5.4	-4.1	-4.4	-4.6	-4.8

Source: Reserve Bank and National Treasury

Faster growth is both a key objective of the NDP and a necessary condition to raise the resources needed to support social and economic transformation. To overcome the economic inertia it currently faces, South Africa needs to reconstruct social consensus behind a path of accelerated economic growth. This is the opportunity presented by the NDP.

Addressing the electricity constraint and long-term energy requirements

Government's plan to reduce electricity shortages has made substantial progress. In August 2015, the first unit of Eskom's Medupi power station began operating, adding 800 MW of energy to the national grid. Government has stabilised Eskom's financial position with a R23 billion equity investment financed from the sale of Vodacom shares.

The state has built partnerships with the private sector to address the electricity-supply gap, making additional capacity available through the renewable energy programme. This initiative is being extended to include investment in base-load coal generation plants.

Government is revising its integrated resource plan, which maps out the country's future energy mix, including options for renewables, coal, gas and nuclear power. With respect to the latter, the National Treasury is working with the Department of Energy to consider the costs, benefits and risks of building additional nuclear power stations. Over the medium term, R200 million will be allocated to support preparatory work for nuclear procurement.

Medium-term actions to support the economy

Infrastructure investment, labour-market reforms and private-sector partnerships can boost growth

Government is acting to alleviate the most binding constraint to growth – inadequate electricity supply – and has set out a series of urgent economic reforms to build a more competitive economy. These include:

- Continuing to invest in economic infrastructure, especially in the transport, logistics and energy sectors.

- Reforming the governance of state-owned entities, rationalising state holdings and encouraging private-sector participation.
- Effecting labour-market reforms that can help avoid protracted strikes.
- Expanding the independent power producer programme.
- Encouraging affordable, reliable and accessible broadband access.
- Promoting black ownership of productive industrial assets.
- Finalising amendments to the Mineral and Petroleum Resources Development Act (2002), and continuing dialogue with the industry.
- Reviewing business incentive programmes in all economic sectors to ensure that resources support labour-intensive, job-creating outcomes.

Investment and partnerships for growth

Greater role for private finance as a complement to public funds in social provision to be considered

The macroeconomic approach of the NDP includes sustaining high levels of public investment, increasing private investment and reducing consumption. The plan identifies export growth and maintaining a real competitive exchange rate as important drivers of economic output and job creation. There have been varying degrees of success in these areas. Efforts to improve the composition of government spending have been set back by the wage settlement. But the public sector has sustained high levels of investment, with over R800 billion of infrastructure spending projected over the medium term in energy, transport and social infrastructure.

Government recognises that national development requires expanded partnerships with the private sector. For example, a greater role for private finance as a complement to public funds in social provision will also be explored in the housing, tertiary education and health sectors.

During 2015, exports benefited from the weak rand and reduced labour-market tensions. To sustain this improvement in the face of a weak global outlook requires South Africa to maximise the benefits of real exchange-rate depreciation and build on its comparative advantages. This include boosting tourism receipts and services exports into the rest of Africa.

Socioeconomic impact assessment for all future legislation and regulations

Government is also working to strengthen policy certainty. Cabinet has decided that all future legislation and regulations will be subject to a socioeconomic impact assessment to mitigate unintended consequences.

Urban strategy for economic growth and social inclusion

South Africa’s cities are a platform for faster economic growth. A young, urban population is the greatest untapped resource the country can draw on to expand the economy. Although rapid urbanisation puts pressure on resources to expand housing and basic services, government’s integrated urban growth strategy can reduce poverty and inequality. Reforms to conditional grants address the different needs of urban and rural areas.

Conclusion

In the context of the uncertain world economic outlook and domestic constraints, the MTBPS builds on the commitments made last year to stabilise debt levels and improve the effectiveness of spending. Continuing to make social progress and building a more competitive economy require further adaptation to ensure more rapid implementation of the NDP.