Medium Term

Budget Policy Statement

2015

National Treasury

Republic of South Africa

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Foreword

Sluggish growth and volatility look set to remain features of the world economy for some time to come. This has led to downward revisions of economic growth forecasts, particularly for developing countries, with knock-on effects on tax revenue projections. In South Africa's case, these difficulties are compounded by structural factors: electricity constraints, weak business confidence and low household demand have limited growth.

Government has moved to adapt to this turbulent environment. We have begun making structural reforms to boost growth. We have adopted a package of fiscal policy measures to maintain the health of the public finances. And we have protected spending on the social and economic programmes that help to transform South African society.

This *Medium Term Budget Policy Statement* builds on these commitments, setting out concrete steps to stabilise debt and improve the efficacy of spending. It proposes a new fiscal guideline that entrenches government's commitment to sound and progressive fiscal management.

In these unsettled times, growing public debt makes South Africa vulnerable to shocks that could set back our prospects for faster growth over the long term. It also diverts spending from social and economic priorities to service rising interest payments. Managing these risks in the current environment requires closing the gap between revenue and expenditure, and making the most of the resources at hand – which amount to more than R4 trillion over the next three years.

The expenditure ceiling remains in place, supplemented by reforms to improve the quality of public spending, particularly on infrastructure projects. Spending on education, health and social protection remains a priority. However, the higher-than-expected 2015 public-sector wage settlement has made it necessary to shift funds and absorb the increased cost within budget baselines. Opportunities to mobilise additional revenue remain limited and will be explored cautiously. Over the medium term, debt continues to stabilise and the budget deficit falls to 3 per cent of gross domestic product (GDP).

Moving the country closer to realising its social and economic priorities requires more rapid implementation of the National Development Plan, which is an opportunity to unite South Africans behind the common objective of faster, inclusive and sustainable economic growth. Government is committed to working with the private sector and labour to achieve a more stable industrial relations environment, improve confidence, and speed up growth and job creation.

We will focus our efforts to raise economic growth in line with national development priorities. Resolving the electricity-supply constraint remains of critical importance, as do refining the support government provides to high-growth, job-creating sectors, and building on efforts to strengthen policy coordination and certainty.

The proposals that follow were made possible through the leadership and contributions of the President and my Cabinet colleagues, as well as the hard work and dedication of officials at National Treasury and those across government. I would like to thank them all for taking on the challenges we face and doing their part to build a more prosperous and equal South Africa.

Nhlanhla Musa Nene
Minister of Finance

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What is the Medium Term Budget Policy Statement?

The *Medium Term Budget Policy Statement* (MTBPS) is a government policy document that communicates to Parliament and the country the economic context in which the forthcoming budget will be presented, along with fiscal policy objectives and spending priorities over the three-year expenditure period.

The policy statement is an important part of South Africa's open and accountable budget process. It empowers Parliament to discuss and shape government's approach to the budget.

The Money Bills Amendment Procedure and Related Matters Act (2009) requires government to table the MTBPS in Parliament at least three months before the national budget is presented. The statement must include:

- A revised fiscal framework for the current financial year and the proposed fiscal framework for the next three years.
- An explanation of the macroeconomic and fiscal policy position, and macroeconomic projections and assumptions underpinning the fiscal framework.
- The spending priorities of government for the next three years.
- The proposed division of revenue between national, provincial and local government for the next three years.
- Any substantial proposed adjustments to conditional grant allocations to provinces and local governments.
- A review of spending by each national department and each provincial government between 1 April and 30 September of the current financial year.

Parliament's finance committees consider the revised fiscal framework for the current year, the proposed medium-term fiscal framework, the explanation of the macroeconomic and fiscal policy position, and the projections and assumptions. The appropriation committees examine national spending priorities for the next three years, the proposed division of revenue and adjustments to conditional grant allocations.

These committees report to their respective houses of Parliament on the proposed fiscal framework and division of revenue. A report may include amendments to the proposed fiscal framework and division of revenue. The adopted reports serve as a mandate for government to prepare the forthcoming budget in accordance with the policy approach of the MTBPS.

1

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

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.

During 2015 the global and domestic economic outlooks have weakened

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.

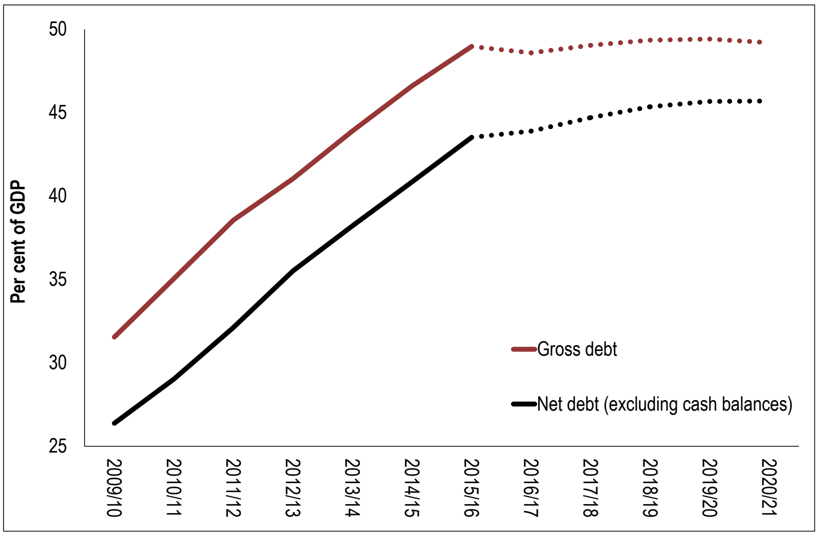
Tax proposals to be approached with caution given economic outlook

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

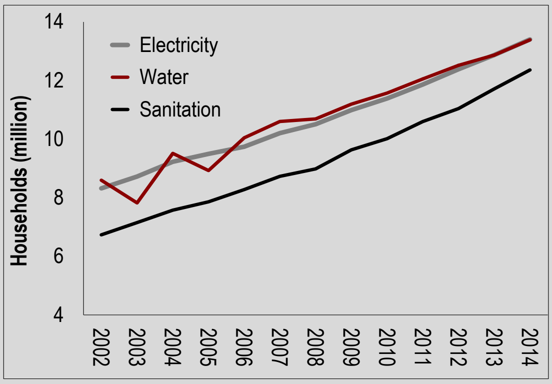
Sustaining social progress

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.

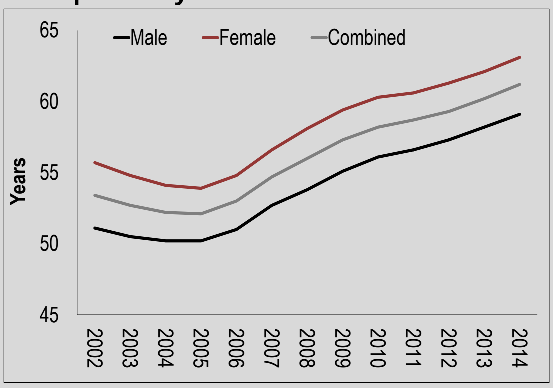
Yet despite continuing economic and social hardship, the lives of millions of South Africans have improved markedly over the past decade. Access to social infrastructure – formal housing, potable water, sanitation and electricity – has increased substantially. Social grants continue to make a meaningful 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

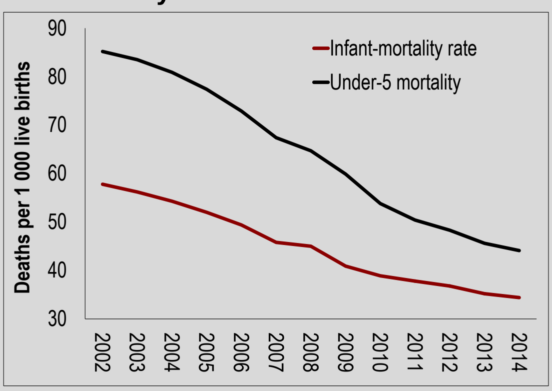
Access to basic services



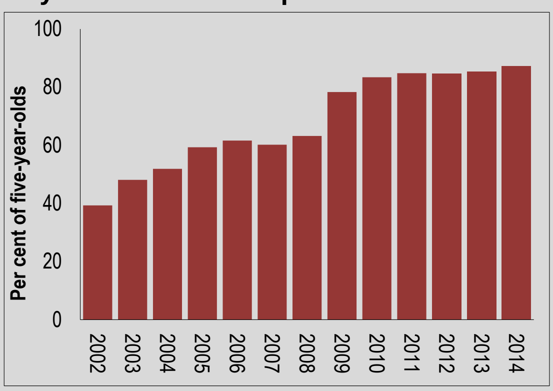
Life expectancy



Infant mortality



Early childhood development enrolment



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

R billion/Percentage of GDP	2014/15 Outcome	2015/16 Revised	2016/17 Medium-term estimates	2017/18	2018/19
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.

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.

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	2017/18 Medium-term estimates	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

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:

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

- 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.

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.

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

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

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:

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

- 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.

2

Economic outlook

In brief

- The global economic recovery has been weaker than anticipated. Growth in developing economies has moderated in response to lower commodity prices, subdued domestic demand and reduced capital inflows. Growth in some developed economies has offset this slowdown.
- The South African economy is expected to grow by 1.5 per cent in 2015, 1.7 per cent in 2016 and 2.6 per cent in 2017.
- Domestic inflation is lower, largely as a result of declining oil prices. The rand's depreciation, however, poses some risk to the inflation outlook.
- Public-sector infrastructure investment is projected to exceed R800 billion over the medium term. Private-sector investment remains muted, mainly funding capital replacement rather than new capacity.
- Efforts to reduce the electricity constraint and improve labour relations are priorities in the short term. Alongside the structural reforms set out in the National Development Plan, this will lay the foundation for faster growth as the business cycle improves.

Overview

Global developments create a difficult environment for developing countries with low domestic savings

The South African economy has grown more slowly than projected at the time of the February 2015 Budget. Electricity constraints continue to limit output and business investment has fallen. Weaker confidence at home and abroad has weighed on trade, consumption and investment. An improved performance by some developed economies has offset the slowdown in developing economies, but commodity prices continue to decline and financial markets remain volatile. Along with the prospect of slower growth in China, and higher interest rates in the United States, this creates a difficult environment for developing countries such as South Africa that have low domestic savings and rely on foreign capital to fund investment.

Rand depreciation, reduced labour-market tensions and improved demand from Europe have helped to shore up exports. The lower oil price has also provided a cushion for household spending by reducing transport costs. The inflation-targeting regime and prudent fiscal framework have supported continued capital inflows, and the flexible exchange rate has buffered the economy from the full impact of global shocks. Yet increased competition for foreign capital is reducing the extent to which the macroeconomic framework can offset the effects of the global slowdown in developing economies.

Implementing NDP lays a foundation for more rapid future growth

Moving South Africa towards the growth rates envisaged in the National Development Plan (NDP) requires diligent implementation, as outlined in the medium-term strategic framework. Progress in these areas will enable the country to take advantage of the next upturn in the business cycle in a sustainable manner.

Global developments

World economic growth has slowed. During 2015 the International Monetary Fund (IMF) revised its in-year growth forecasts downwards three times, most recently to 3.1 per cent. The forecast for 2016 is 3.6 per cent.

Table 2.1 Annual change in GDP and consumer price index, selected regions/countries, 2014 – 2016

Region / country Percentage	Average 2010-2014	2014	2015	2016	Average 2010-2014	2014	2015	2016
	GDP growth[1]				Average CPI[1]			
World	**4.0**	**3.4**	**3.1**	**3.6**	**4.1**	**3.5**	**3.3**	**3.4**
Advanced economies	**1.8**	**1.8**	**2.0**	**2.2**	**1.8**	**1.4**	**0.3**	**1.2**
US	2.1	2.4	2.6	2.8	2.0	1.6	0.1	1.1
Euro area	0.7	0.9	1.5	1.6	1.7	0.4	0.2	1.0
UK	1.8	3.0	2.5	2.2	2.9	1.5	0.1	1.5
Japan	1.5	-0.1	0.6	1.0	0.4	2.7	0.7	0.4
Emerging markets and developing countries	**5.7**	**4.6**	**4.0**	**4.5**	**6.0**	**5.1**	**5.6**	**5.1**
Brazil	3.2	0.1	-3.0	-1.0	5.9	6.3	8.9	6.3
Russia	2.8	0.6	-3.8	-0.6	7.0	7.8	15.8	8.6
India	7.2	7.3	7.3	7.5	9.0	5.9	5.4	5.5
China	8.6	7.3	6.8	6.3	3.2	2.0	1.5	1.8
Sub-Saharan Africa	**5.2**	**5.0**	**3.8**	**4.3**	**8.0**	**6.4**	**6.9**	**7.3**
South Africa[2]	2.4	1.5	1.5	1.7	5.3	6.1	4.8	6.2

1. IMF World Economic Outlook October 2015
2. National Treasury forecast

Economic growth in developed economies is expected to rise gradually. Lower energy prices, favourable interest rates, and improving confidence and labour-market conditions are expected to boost European and Japanese performance, and to support continued growth in the United States.

Growth in sub-Saharan Africa expected to decline to 3.8 per cent in 2015 from 5 per cent in 2014

By contrast, lower commodity prices, weaker domestic demand, tighter financial conditions and slower capital inflows have moderated growth in developing economies. If forecasts are realised, developing countries will experience the slowest three-year growth outcomes since the Asian financial crisis of the late 1990s. Growth in sub-Saharan Africa is expected to decline to 3.8 per cent in 2015 from 5 per cent in 2014, largely as a result of weaker commodity prices and lower demand from China.

Developing economies now produce about 58 per cent of global output, compared to just 42 per cent in the late 1990s, and there has been a corresponding shift in their influence on world financial markets. Recent exchange-rate policy changes in China, for example, prompted major market movements. The extent to which potential growth in developing countries has been lowered since the financial crisis remains unclear, with the resulting uncertainty contributing to market volatility.

Extent to which potential growth in developing countries has been lowered is unclear

For many developing economies, large debts accumulated over the past five years will constrain fiscal and monetary policy options. This is particularly true in countries reliant on foreign financing of debt, and which have elevated inflation or political risks, and large external balances. The weaknesses associated with these imbalances are expected to come into sharper focus when US monetary authorities act on their stated intention to raise interest rates. As a consequence, the speed of the global recovery is likely to depend on countries' ability to find domestic engines of economic growth.

Large debts accumulated over past five years will constrain developing countries' policy options

Domestic developments

South Africa's GDP grew by only 1.8 per cent in the first half of 2015 compared to the same period in 2014. Limited electricity supply weighed heavily on both mining and manufacturing production, and drought reduced agricultural output. Growth in the services sector (excluding government), which has supported growth by an average of 1.2 percentage points over the last five years, also slowed in the first half of the year.

Limited electricity supply continues to weigh heavily on industrial output

Domestic demand

Household consumption grew by 1.6 per cent in the first half of 2015, supported by lower petrol and food prices. However, the overall outlook is subdued, with consumer confidence below its long-term average. Employment growth remains weak. Credit conditions appear to have tightened, with both supply and demand for household credit shrinking.

Lower inflation has provided consumers with some respite. Consumer price index (CPI) inflation eased to 4.5 per cent over the first eight months of 2015, from 6.1 per cent in 2014, largely as a result of lower petrol prices. Core inflation, which represents the long-run trend of the price level and excludes temporary shocks, was unchanged at 5.7 per cent over the same period. Most upward pressure in core inflation has been generated by utilities, medical aid and education.

Inflation has remained within 3-6 per cent target band

Currency weakness and inflation risks

The effect of the exchange rate on domestic inflation has been muted over the past four years of rand depreciation. The Reserve Bank estimates that the current pass-through effect from a weak currency to goods inflation may be close to half its average longer-term level of about 20 per cent. Weak domestic demand seems to be limiting the ability of firms to pass on higher costs to consumers.

The ability of businesses to continue absorbing higher input costs may narrow if rand depreciation and shrinking profit share continue. In addition, inflation in services, which constitute 67 per cent of the core inflation basket, may be more affected by currency weakness. Given the weakness of the rand, higher global oil prices may pose a further upside risk to the outlook.

The Reserve Bank has pointed out that there are upside risks to the inflation outlook, including further currency depreciation. Given current economic conditions, however, the pace and extent of rate increases is likely to be gradual. Policy rates remain below a 15-year average of 8.3 per cent.

Private-sector investment remains muted, and contracted by 0.1 per cent in first half of 2015

Private-sector investment remains muted. After contracting by 3.4 per cent in 2014, the decline in private-sector investment moderated to 0.1 per cent in the first half of 2015. The share of private investment funding capital replacement rather than new capacity rose from 58 per cent in 2006 to 79 per cent in 2014. There is, however, notable investment in new capacity in telecoms and renewable energy.

Since 2014, general government has made the largest contribution to investment growth. This trend partially offset the slowdown in annual investment growth by public corporations to 0.6 per cent in the first half of the year owing to construction delays at Eskom.

Private investment boosts electricity-generating capacity

As of October 2015, 92 projects had been selected as part of the Renewable Energy Independent Power Producer Programme. In aggregate, these projects represent R193 billion in private-sector investment and will add 6 327 MW of capacity to the national electricity grid. To date, 37 of these facilities have been connected to the grid, supplying as much as 1 800 MW of electricity.

The Minister of Energy recently issued a determination to procure another 6 300 MW through the renewables programme. The programme is expected to boost electricity capacity by 17 000 MW by 2022.

Government is expanding the independent power producer programme to include other generation technologies. The electricity regulator has approved 1 350 MW of short-term power-purchase contracts in 2015/16. An additional 2 500 MW of coal, 3 126 MW of gas, 1 800 MW of cogeneration and 2 609 MW of imported hydro power generating capacity is expected to be connected to the grid between 2020 and 2025.

Public-sector infrastructure spending to exceed R800 billion

Public-sector infrastructure spending is projected to be over R800 billion over the medium-term expenditure framework (MTEF) period. This expenditure is expected to crowd in private investment as infrastructure constraints ease. Government continues to encourage private-sector participation in infrastructure projects such as renewable energy and transport. These investments will contribute to a more efficient enabling environment that can support higher long-term growth when the economic cycle turns.

Labour markets

Formal-sector employment down but labour relations improving

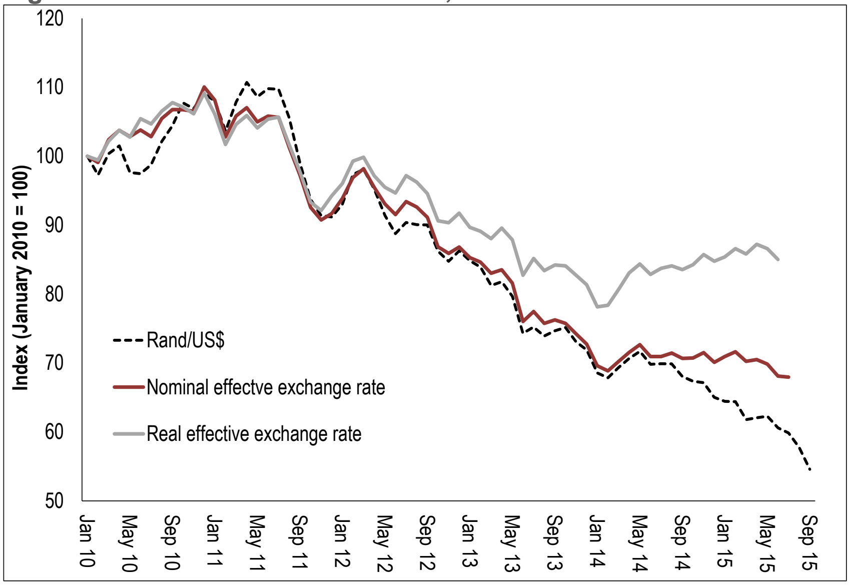
Persistently high unemployment remains one of South Africa's most pressing challenges. Labour relations have improved during 2015, with 176 000 workdays lost to industrial action in the first half of the year, down from 7.5 million in the first half of 2014. Strikes have been relatively short-lived, primarily affecting individual firms rather than entire subsectors.

Difficult trading conditions and low business confidence levels have limited hiring during 2015. According to Statistics South Africa, most of the 338 000 jobs created in the first half of the year were in the informal sector. The formal sector lost 76 000 jobs, with sharp declines in manufacturing and construction, as well as community, social and personal services. Employment is not expanding rapidly enough to absorb the estimated 659 000 new entrants into the job market in the first half of 2015. As at June 2015, there were an estimated 2.43 million discouraged work seekers.

Exchange rates, competitiveness and the current account

The prospect of weaker economic growth and higher US interest rates has weighed on global risk appetite, and in turn the performance of the rand.

Figure 2.1 Performance of the rand, 2010 – 2015



Source: Reserve Bank

All developing-country currencies have been depreciating against the US dollar

All developing-country currencies have depreciated against the US dollar during 2015. By mid-October, the Brazilian real was down 28 per cent, the Turkish lira 19 per cent and the Mexican peso 16 per cent. The rand exchange rate had weakened by 13 per cent compared to the same period in 2014, reaching R13.35 to the US dollar. By contrast, the real exchange rate of the rand – which takes into account the relative inflation and exchange rates of South Africa's main trading partners – appreciated by 5.4 per cent annually over the seven months to July. If South Africa's inflation remains persistently higher than that of its trading partners, it will erode the export benefits of currency depreciation.

Current account deficit has narrowed in response to export gains

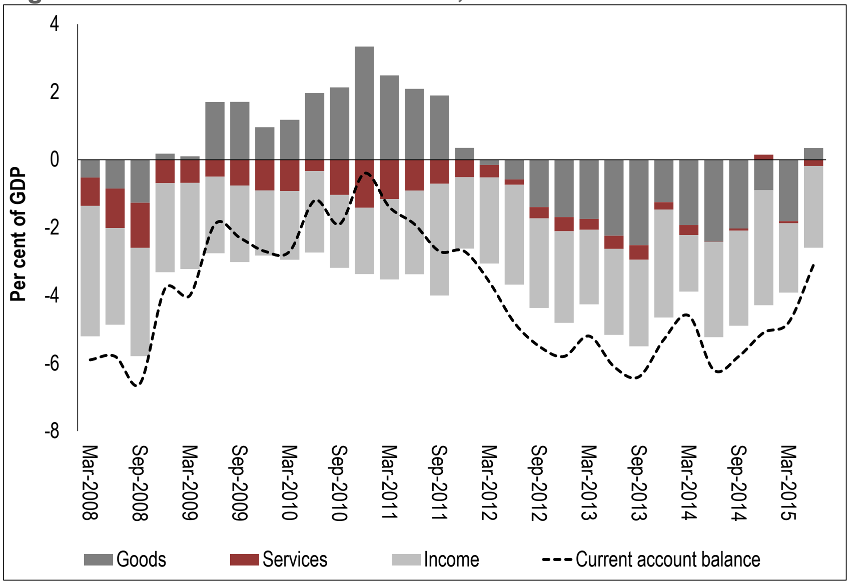
Exports grew by 9.7 per cent during the first half of 2015, up from 2.6 per cent in 2014, supported by improved European demand, capacity expansion at a major auto exporter and the cumulative effects of exchange-rate depreciation. Volume gains offset lower commodity prices. The trade deficit narrowed during the first six months of 2015, as did the deficit on the net service, income and current transfer balance. As a result, the current account deficit narrowed to 3.9 per cent of GDP in the first half of 2015 from 5.4 per cent in 2014.

Capital markets remain resilient despite heightened global volatility

South Africa's capital markets have remained resilient despite heightened global volatility. Robust net portfolio inflows of R78.7 billion in the first six months of 2015 exceeded the 2014 figure of R50 billion. Direct investment flows both into and out of South Africa have been markedly lower in 2015. The balance on the financial account fell to R36.7 billion in the first half of 2015, from R81.6 billion in the second half of 2014.

To register lasting improvements in the current account balance, South Africa needs to lower the cost of doing business and build on the comparative advantages of local exports. The competitiveness gains of the last four years from a weaker currency cannot be taken for granted given similar trends in other developing economies.

Figure 2.2 Current account balance, 2008 – 2015



Source: Reserve Bank

Sharp decline in tourism, which contributes strongly to GDP, is of concern

Efforts to boost services exports to the rest of Africa and increase tourism will be important over the medium term. The World Travel and Tourism Council estimates that the direct and indirect contribution of travel and tourism to both GDP and employment was over 9 per cent in 2014. The sharp decline in tourism, which became pronounced in the second quarter of 2015, is of great concern.

Outlook

GDP growth to improve in 2018 as electricity constraint eases and demand increases

South Africa's real GDP growth, which was 1.5 per cent in 2014, is expected to reach only 1.5 and 1.7 per cent in 2015 and 2016 respectively. Electricity supply will remain a binding constraint through 2016, limiting output and dampening business and consumer confidence. Easing electricity, transport and telecommunications infrastructure constraints, alongside improved confidence and higher demand from major trading partners, are expected to boost GDP growth to 2.8 per cent in 2018.

Estimated investment growth of 1.2 per cent in 2015 is supported by general government. Private-sector investment is expected to improve in the outer year, bringing total investment growth to 3.8 per cent by 2018. With limited investment growth over the next two years, however, there will be little support for significant employment gains. As a result, household consumption growth is expected to rise above 2 per cent only in 2017.

Demand for capital and consumer goods will see import growth outpace export growth

Exports are forecast to grow by 8.3 per cent in 2015, bolstered by relatively strong performance in the first half of the year. Growth is not expected to be as strong during 2016 due to the high base of 2015. However, easing infrastructure constraints and improved global growth will support growth of 5.5 per cent by 2018. Import growth is expected to outpace export growth over the forecast period, as domestic demand recovers, boosting imports of both capital and consumption goods.

Table 2.2 Macroeconomic performance and projections, 2012 – 2018

	2012	2013	2014	2015	2016	2017	2018
Calendar year		**Actual**		**Estimate**		**Forecast**	
Percentage change unless otherwise indicated							
Final household consumption	3.4	2.9	1.4	1.5	1.7	2.5	2.8
Final government consumption	3.4	3.3	1.9	0.7	1.6	1.2	1.1
Gross fixed capital formation	3.6	7.6	-0.4	1.2	1.5	3.2	3.8
Gross domestic expenditure	3.9	1.4	0.6	0.6	2.0	2.7	2.8
Exports	0.1	4.6	2.6	8.3	3.2	5.0	5.5
Imports	6.0	1.8	-0.5	5.3	4.3	5.4	5.5
Real GDP growth	**2.2**	**2.2**	**1.5**	**1.5**	**1.7**	**2.6**	**2.8**
GDP inflation	5.5	6.0	5.8	4.6	6.0	5.9	5.8
GDP at current prices (R billion)	3 263	3 534	3 796	4 031	4 349	4 726	5 143
CPI inflation (Dec 2012 = 100)	5.7	5.8	6.1	4.8	6.2	5.9	5.8
Current account balance (% of GDP)	-5.0	-5.8	-5.4	-4.1	-4.4	-4.6	-4.8
Fiscal year	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19**
GDP inflation	5.8	6.1	4.8	5.4	6.0	5.9	5.8
GDP at current prices (R billion)	3 328	3 610	3 844	4 103	4 437	4 827	5 252
CPI inflation (Dec 2012 = 100)	5.6	5.8	5.6	5.5	6.0	5.8	5.8
Real GDP growth	**2.1**	**2.2**	**1.6**	**1.2**	**2.1**	**2.7**	**2.8**

Source: Reserve Bank and National Treasury

The current account deficit is expected to narrow to 4.1 per cent of GDP in 2015, owing to healthy export performance and terms of trade gains in the first half of the year. Import growth, however, is expected to widen the current account deficit to 4.8 per cent of GDP by 2018.

CPI expected to breach 6 per cent in 2016

Inflation has been in line with 2015 Budget forecasts. Upward pressure on food prices and higher petrol inflation are expected to push CPI inflation above the 6 per cent target ceiling in the first half of 2016. The forecast takes into account a 12.7 per cent per year increase in electricity prices. Upside risks to the inflation forecast revolve around additional exchange rate depreciation, the extent to which businesses can continue to absorb higher input costs from the weaker rand and electricity price increases.

Further slowdown in global economy, higher oil prices and electricity supply are risks to economic forecast

External risks to the economic forecast include a further slowdown in the global economy (especially among South Africa's main trading partners), higher oil prices, lower export commodity prices and increased financial market volatility resulting in capital outflows. Electricity supply shortages pose the largest domestic risk to growth.

Key assumptions underpinning the economic forecast are provided in the technical annex.

Charting a path to higher growth

Persistent weakness in global economy underlines need for structural reforms set out in NDP

Persistent weakness in the global economy underlines the importance of structural reforms in South Africa. Economic performance will depend on how well interventions to boost growth are coordinated and implemented within government and with private-sector partners. Government is guided in this regard by the medium-term strategic framework – which serves as the five-year implementation framework of the NDP. A synopsis of short and long-term actions to boost growth is provided below.

Action on binding constraints

Electricity supply

Progress in stabilising electricity grid and promoting measures to manage demand

Constrained electricity supply remains the single largest drag on economic activity, estimated to cost close to one percentage point of annual GDP growth. Over the past nine months, progress has been made in stabilising electricity supply, promoting measures to manage demand and contracting additional supply from the private sector.

The first unit of the Medupi power station was fully commissioned in August 2015, adding 794 MW to the national grid. Once the Koeberg power station returns from planned maintenance in December, there will be an additional 900 MW available to the grid. The Sere wind farm added 100 MW of capacity in February. The Majuba plant has been returned to service and work to repair the damaged boiler at the Duvha plant is in progress. Eskom has been taking steps to improve the efficiency of its maintenance programme.

Labour relations

Government, business, labour and community representatives working to address disruption caused by large, protracted strikes

In 2014, labour-related work stoppages reduced growth by at least 0.6 percentage points. Government has prioritised stability in labour relations. The Commission for Conciliation, Mediation and Arbitration is taking an active role in settling disputes, and has cut the duration of arbitration proceedings by more than 75 per cent since 2003. A National Economic Development and Labour Council task team is working to address the disruption of the economy caused by large, protracted strikes, and discussing a minimum wage. In September 2015, parties to the mining framework agreement declared their intention to limit job losses.

Policy coordination, certainty and implementation

Future legislation and regulations subject to socioeconomic impact assessment

Building a capable state requires government to improve the effectiveness of the public sector, expand partnerships with the private sector and strengthen the governance of state-owned entities.

Government has decided that from 1 September 2015 all future legislation and regulations will be subject to a socioeconomic impact assessment before being passed. This process will promote greater policy coordination, highlight potential implementation risks or unintended consequences, and allow for the development of mitigation strategies or alternative solutions before the legislative process begins. The Department of Planning Monitoring and Evaluation is also taking steps to strengthen monitoring and evaluation across government.

Operation Phakisa has been extended to improve coordinated planning by government, industry and other interested parties.

Operation Phakisa

Government launched the Phakisa programme, modelled on Malaysia's system for delivering results in key sectors of the economy, in mid-2014.

The **oceans economy** Phakisa focused on expanding trade in oil and gas, servicing maritime equipment, and oil and gas exploration off the South African coast. Projects include the following:

- Construction began on Saldanha Bay's liquefied petroleum gas terminal in February 2014, and civil works to support the 13.2 million barrel commercial crude oil blending and storage terminal began in 2015. In Cape Town, construction of the R660 million Burgan fuel storage facility should get under way soon.
- Port infrastructure upgrades of R9.7 billion have been announced to support trade and large-rig repair. Public-private partnerships were invited and projects should be commissioned by December 2017.
- A R30 million programme to rehabilitate ship-repair facilities in the Port of Durban is under way.

The **health** Phakisa identified interventions to raise standards of primary health care clinics. Progress to date includes the use of cellphone technology in 1 200 clinics to improve supply of antiretroviral medication. The **education** Phakisa to enhance basic education with technology has begun. A **mining** Phakisa to take place in late October 2015 will examine next-generation mining techniques that build on South Africa's expertise and allow for upstream opportunities for domestic producers, as well as other topics.

Long-term reforms

Investment in infrastructure

Competitiveness improves as result of broadband investment

Major state-owned companies continue to roll out infrastructure:

- Investments in water and telecommunications infrastructure are taking place. South Africa's ratings in the World Economic Forum's *Global Competitiveness Report* improved seven places to 49 out of 140 countries, thanks largely to increased bandwidth.
- Projected capital investment by Eskom to expand electricity generating capacity totals R157 billion over the medium term. This includes the Medupi and Kusile power stations to augment generation capacity, and strengthening of the transmission and distribution grids.
- Transnet's R336 billion investment programme continues to expand rail infrastructure and renew rolling stock. Transnet recently secured R2.8 billion from development bank KfW to finance construction of 240 electric locomotives, and R30 billion over 15 years from the China Development Bank to finance a joint locomotive build project.

Large cities are building modern rapid transit systems and upgrading commuter rail services. The metropolitan municipalities are promoting integrated development projects, helping to reshape the urban landscape.

Accelerating urban investment

Government is working with cities to promote inclusive economic growth. Considerable transformative investment activity is already under way:

- The R20 billion Cornubia project in eThekwini will include 25 000 residential units and 1.4 million square metres of commercial space. A 12 ha commercial hub is under construction and has already been sold.
- The Ekurhuleni metro has secured private investment projects worth over R20 billion, including manufacturing and mixed-use facilities.
- In Nelson Mandela Bay, the recent opening of the Baywest centre is likely to encourage greater private investment in surrounding areas.
- Johannesburg is investing R3.5 billion in its Corridors of Freedom project between now and 2017/18.
- Buffalo City's partnership approach in the tourism sector has led to the signing of a 20-year lease for motor racing facilities.

Reforms reduce port costs and turnaround times

The Ports Regulator of South Africa has begun a 10-year programme to ensure tariffs better reflect the cost of using port assets such as berths and quay walls. Cargo dues on export containers are 38 per cent lower than three years ago. The port of Durban has implemented an integrated ports management system, dramatically reducing turnaround times by replacing manual processes and improving train loading and cargo shipment.

Regional infrastructure and cooperation to promote growth

Regional infrastructure projects to improve two-way trade in SADC

Regional infrastructure projects seek to upgrade infrastructure and remove impediments to two-way trade flows. The vast majority of Southern African Development Community (SADC) trade takes place outside the region. In May, the SADC approved a US$3.5 million feasibility study for a regional project to expand and transmit Mozambique's hydro power and diversify South Africa's electricity supply. The free-trade area agreed by the SADC, East African Community and Common Market for Eastern and Southern Africa aims to bring together a market of 600 million consumers. Participants have agreed on tariff liberalisation and related rules, and the next phase will focus on trade in services.

Support for business

Government to review all incentives to business over the medium term

Government provides a range of business support incentives, including direct transfers and tax incentives. Over the medium term, government will review all incentives to assess their effects on economic growth, productivity, competitiveness, the balance of trade and employment.

To promote transformation, government has reformed the broad-based black economic empowerment legislation, as well as state procurement legislation. The Industrial Policy Action Plan remains a central component of government's strategy to diversify the economy.

The 200 businesses with high-growth potential to be selected under the Department of Small Business Development's Gazelles programme will receive financial support, as well as coaching from the private sector.

Doing Business in South African cities

The *Doing Business 2015* report for South Africa was produced by the World Bank on behalf of the National Treasury, Department of Trade and Industry, South African Cities Network and nine urban centres.

Local firms evaluated performance across six indicators. The survey found that South African entrepreneurs face different regulatory hurdles depending on where they establish their businesses.

Across the nine participating cities, it is easiest to start a business in Ekurhuleni, Johannesburg and Tshwane; deal with construction permits in Cape Town; get a commercial electricity connection and enforce a contract in Mangaung; and register property in Johannesburg. There is no relationship between the size of the city and the rankings, and no single city performs equally well on all indicators.

The results suggest that well-targeted administrative improvements that do not require legislative changes can make a difference for small or medium-sized firms. If each metro were to adopt the good practices found across the nine cities for construction permits, getting electricity and enforcing contracts, they would surpass the average performance of high-income members of the Organisation for Economic Cooperation and Development.

Conclusion

A weak growth outlook is not unique to South Africa. Diligent attention to address binding growth constraints and strengthened partnerships with the private sector will create a platform for investment, employment and development.

3

Fiscal policy

In brief

- Government's central fiscal objective over the medium term is to stabilise the growth of debt as a share of GDP. Continued revenue growth and strict adherence to the planned expenditure ceiling are projected to result in gross debt stabilising at 49.4 per cent of GDP in 2018/19. Net debt stabilises at 45.7 per cent of GDP in 2019/20.
- The projected budget deficit of 3.8 per cent for the current year is broadly unchanged from 2015 Budget expectations, and narrows to 3 per cent over the medium term.
- A proposed long-term fiscal policy guideline links expenditure and GDP growth. The spending ceiling in the outer year of the medium-term expenditure framework grows by 2.5 per cent in real terms.
- Expenditure on core social and economic programmes will be maintained, while spending on non-essential goods and services continues to decline in real terms.
- Government continues to support the capital expenditure programmes of state-owned companies, while working to improve their governance and financial sustainability.

Introduction

Spending remains well contained and budget deficit narrows over medium term

In the 2015 Budget, government announced a medium-term fiscal policy package to ensure a sustainable foundation for the public finances. Government is meeting these commitments. Main budget expenditure remained within the 2014/15 limits and is on track to stay within the spending ceiling in the current year. Debt is stabilising as a share of GDP. Despite some slippage in medium-term budget deficit projections, the deficit will continue to narrow.

In recent months, two risks identified in the 2015 Budget materialised: a public-sector wage agreement significantly above inflation and a deterioration in economic performance. The fiscal framework accommodates these developments and the fiscal trajectory remains on course to achieve government's objectives.

Long-term fiscal guideline

Countercyclicality, debt sustainability and intergenerational fairness underpin fiscal policy

Fiscal policy works to ensure the long-term health of the public finances by applying the principles of countercyclicality, debt sustainability and intergenerational fairness. This enables government to act within its available resources to progressively realise fundamental social and economic rights, as required by the Constitution.

The 2014 *Medium Term Budget Policy Statement* (MTBPS) marked a turning point for the public finances. Several measures were announced to bolster fiscal sustainability, including a reduced spending ceiling, moderate tax increases and a commitment to finance equity injections into state-owned companies without expanding the budget deficit. Government remains committed to this course.

Central medium-term fiscal objective is to stabilise growth of debt as share of GDP

The central fiscal objective over the medium term is to stabilise the growth of debt as a share of GDP. Rising debt-service payments are already crowding out spending on social and economic priorities. Failure to stabilise the growth of public debt would further erode the composition of spending and increase the risk of a shock to the economy. A ratings downgrade, for example, could induce a sudden outflow of foreign capital and sharply higher interest rates. Given South Africa's reliance on foreign lending to finance investment, such a development would compromise the country's ability to sustain growth and social progress.

Expenditure ceiling

The expenditure ceiling remains the primary tool to stabilise debt. No resources will be added to the spending ceiling over the next two years. Beginning with the 2016 Budget, government will align spending limits in the outer year of the medium-term expenditure framework (MTEF) with the long-term path of GDP growth, building on government's countercyclical and sustainable approach to fiscal management.

A guideline for debt sustainability

The National Treasury proposes a fiscal guideline to set the expenditure ceiling in the outer year of every fiscal framework.

This fiscal rule of thumb will link the spending ceiling to South Africa's long-term economic growth projections. Estimates of real long-term growth vary. Over the past 20 years, real GDP growth has averaged 3 per cent per year. The International Monetary Fund estimates real GDP growth of 2.6 per cent in 2020, while the Reserve Bank estimates potential output growth at 2.1 per cent in 2017. The expenditure ceiling has been set to grow by 2.5 per cent in real terms in 2018/19.

The long-term guideline gives expression to the fiscal principles of countercyclicality and debt sustainability. It will ensure that spending grows at a stable rate over the business cycle. In good times, spending will grow more slowly than the economy, and in bad times, spending will outpace GDP growth. All South Africans will be able to share in the benefits of economic expansion on a sustainable basis.

Over the long term, the guideline maintains spending as a stable share of national income. However, where structural improvements in revenue are apparent, through tax policy changes, improved administration or economic shifts, a corresponding increase in the spending ceiling will be considered. Over time, government's ability to properly appraise capital projects, as discussed on the next page, may also be a factor in the application of the guideline.

The expenditure ceiling should be sufficiently flexible to accommodate large shocks and structural changes to the economy. The ceiling could be adjusted in two scenarios:

- Structural improvements in revenue – Several policy proposals set out in the National Development Plan imply significant spending increases. Sustainable financing of these initiatives would require a permanent increase in revenues before adjustments to the ceiling are considered.
- Large inflation shocks – The advantage of setting the fiscal limit in nominal terms is that it can be easily understood, but unanticipated inflation could erode the real value of planned spending. Government would consider adjusting the ceiling if annual inflation were to depart significantly from the 3-6 per cent target band. There is little risk of such an outcome given the robust inflation-targeting framework.

This policy statement makes a technical modification to the spending ceiling. Payments that are directly and fully financed by dedicated revenue flows authorised by specific legislation, such as the skills development levy, will be excluded, as will payments that arise from technical adjustments to the value of assets and liabilities. As a result, the spending ceiling will differ slightly from non-interest expenditure. Details are provided in the technical annexure.

Steps to make fiscal reporting more transparent

The National Treasury is also taking several steps to make fiscal reporting more transparent in the years ahead. In this MTBPS, several assumptions underlying economic and revenue projections are disclosed for the first time. A stronger reporting framework on government guarantees and other contingent liabilities will be included in the 2016 Budget. During 2016 the National Treasury will publish a fiscal risks report.

Capital project appraisal

By entrenching the principle of intergenerational equity, government ensures that current social programmes can be sustained over several decades without a large build-up of debt and the higher tax burden this would impose on future generations.

Government will improve its capacity to appraise, select, plan and build capital projects

In principle, borrowing to fund investments that generate high returns for national development should not be unduly constrained by the fiscal framework. However, government’s capacity to appraise, select, plan and build capital projects can be strengthened. While coordination and oversight has improved, further work is required to develop institutions that can deliver technically sound cost-benefit analyses, enabling government to choose projects and assess their returns.

A capital budgeting framework that addresses the planning, skills and capacity shortfalls across the public sector is being developed. Over the medium term, the emphasis will be on improving spending efficiency within existing budgets, with a greater share of funds directed to improving asset management and maintenance. The development of a strong capital project planning and appraisal system will also enable government to adjust expenditure plans where financially viable projects with clear social or economic benefits have been identified.

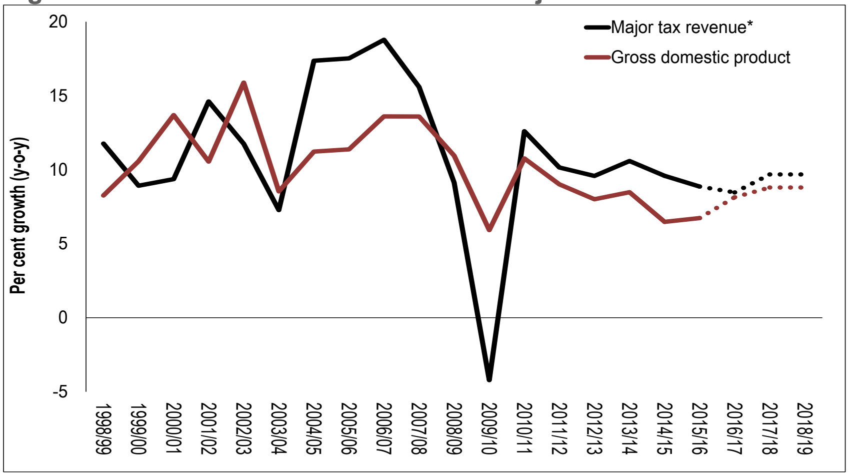
Medium-term fiscal considerations

Revenue performance and outlook

Gross tax revenue revised down by R35 billion between 2015/16 and 2017/18

In 2015/16, gross tax revenue has been revised downwards by R7.6 billion. This is attributable to weak performance of corporate income tax collection in the year to date due to the steep decline in commodity prices and the slowdown in economic activity. In total, lower growth has resulted in a downward revision of R35 billion to gross tax revenue between 2015/16 and 2017/18.

Figure 3.1 Growth in nominal GDP and major tax revenues



**Personal income tax, corporate income tax and value-added tax*

Source: National Treasury

Gross tax revenue for 2014/15 came in R7.3 billion above projections in the 2015 Budget, led by strong growth in personal income tax. Factors contributing to the increase included moderate relief for the effects of inflation, high growth in public-sector compensation and fairly high private-sector wage settlements.

Tax issues under consideration

Since 2014, the Davis Tax Committee has published reports on small business taxation, value-added tax (VAT), base erosion and profit shifting, estate duty and mining taxation. The committee also published a report on the role of the tax system in supporting inclusive growth, employment, equity and fiscal sustainability. The reports are intended to stimulate debate on tax issues, which can sometimes be contentious. Two topics of current interest are:

- Corporate income tax – Concerns about base erosion and profit shifting, in particular the misuse of transfer pricing, remain topical globally and in South Africa. Initiatives are underway to comprehensively deal with leakages in corporate income tax.
- VAT – While VAT might be perceived as regressive, comparative studies show that South Africa's overall fiscal system (tax and public expenditure) is strongly redistributive. Receipts generated from VAT – the second-largest source of tax revenue – are an important part of the resources that fund progressive public expenditure programmes in education, health and social protection. The committee's analysis of the efficacy of the VAT system, and the scenarios it presented on the likely impact of an increase in the VAT rate, have generated welcome debate. To date, no decisions have been made. But an increase in the VAT rate remains one of the options available over the medium term to finance key elements of the National Development Plan.

Carbon tax

The need to take action to address the causes and consequences of climate change is increasingly important. The National Treasury will soon publish a draft carbon-tax bill for public comment. It will provide further opportunity for debate on the detailed design and impact of the proposed tax.

Despite weak economic growth over the past five years, revenue collection has consistently outpaced economic expansion. While nominal GDP growth has averaged 8.6 per cent over the past five years, tax revenue has averaged 10.5 per cent growth during this period. It is not clear whether this is due to temporary or permanent factors. Over the medium term, gross tax revenue collection is projected to continue growing faster than nominal GDP, but by a narrower margin than in the recent past.

Increases in tax rates and fuel levy announced earlier this year help sustain revenue collection

The increases in income tax rates and the fuel levy announced in the 2015 Budget will help sustain revenue collection over the medium term. Growth in corporate income tax receipts, however, is expected to remain subdued through 2016/17. The technical annexure includes key assumptions underpinning the medium-term revenue forecast.

Public-sector wage bill

The 2015 Budget assumed that the public-sector wage agreement would not depart significantly from inflation. The final settlement increases the salaries and benefits of public servants by 10.1 per cent in the current year, followed by improvements that will be at least two percentage points higher than consumer inflation in the next two years. Without corresponding improvements in the quality of public services, increases of this kind are not sustainable over the long term.

Shortfall in compensation budgets has significant consequences for fiscus

The shortfall in compensation budgets has significant consequences for the public finances, absorbing resources that had been set aside for other priorities. A moderating factor is that the number of personnel employed on government's payroll has declined since 2012. Nonetheless, departments will need to reallocate spending away from existing priorities. Budgets that would have been available to fund vacant positions will now be required to compensate existing employees. It is expected that national and provincial employment will remain stable in the years ahead.

The National Treasury will work with national and provincial departments to avoid any compromises on service delivery, or the diversion of resources from capital budgets to pay for compensation. Nevertheless, it is likely that the agreement will have adverse consequences for the quality and composition of the public finances.

The fiscal framework

Medium-term revenue estimates underperform 2015 Budget projections

Table 3.1 summarises the consolidated fiscal framework. Medium-term revenue estimates are below 2015 Budget projections. The lower receipts will be partially offset by higher-than-anticipated income from financial transactions, reflecting premiums on inflation-linked bonds and the bond-switch programme, as well as higher revaluation profits on foreign-currency transactions.

Southern African Customs Union (SACU) transfer projections have increased over the medium term, largely due to upward revisions in customs and excise duties, and a lower-than-expected reconciliation payment in 2016/17. Adjustments to estimates of GDP, population and intra-SACU trade also contribute to an overall increase in SACU payments. The volatility of transfers remains a concern for Botswana, Lesotho, Namibia and Swaziland. South Africa continues to work with its fellow SACU member states on a new revenue-sharing agreement that would reduce the volatility of transfers and encourage regional development.

Spending growth will slow during 2016/17 as government implements the reduced ceilings announced in the last budget. From 2017/18, the fiscal framework allows for moderate real growth in spending aligned with the longer-term trend of economic growth.

Table 3.1 Consolidated fiscal framework,[1] 2012/13 – 2018/19

	2012/13	2013/14	2014/15	2015/16		2016/17	2017/18	2018/19
R billion/Percentage of GDP		Outcome		Budget	Revised		Medium-term estimates	
Main budget								
Revenue	**800.1**	**887.3**	**963.6**	**1 049.3**	**1 070.7**	**1 147.7**	**1 249.1**	**1 365.0**
of which: Asset disposals	–	–	–	–	*25.4*	–	–	–
Expenditure	**965.5**	**1 047.8**	**1 132.0**	**1 222.3**	**1 246.9**	**1 313.1**	**1 426.9**	**1 551.1**
of which								
Non-interest allocations[2]	*877.4*	*946.6*	*1 017.2*	*1 095.9*	*1 093.8*	*1 168.0*	*1 260.8*	*1 361.5*
Special appropriations[3]	–	–	–	–	*25.2*	–	–	–
Debt-service costs	*88.1*	*101.2*	*114.8*	*126.4*	*127.9*	*142.6*	*157.2*	*174.6*
Contingency reserve	–	–	–	–	–	*2.5*	*9.0*	*15.0*
Main budget balance	**-165.4**	**-160.5**	**-168.4**	**-173.1**	**-176.3**	**-165.4**	**-177.8**	**-186.1**
	-5.0%	*-4.4%*	*-4.4%*	*-4.1%*	*-4.3%*	*-3.7%*	*-3.7%*	*-3.5%*
Primary balance	**-77.2**	**-59.3**	**-53.6**	**-46.6**	**-48.4**	**-22.8**	**-20.7**	**-11.5**
	-2.3%	*-1.6%*	*-1.4%*	*-1.1%*	*-1.2%*	*-0.5%*	*-0.4%*	*-0.2%*
Budget balances of social security funds, public entities and provinces	29.5	24.3	31.5	10.9	18.4	20.1	25.1	28.0
Consolidated budget balance	**-135.8**	**-136.2**	**-136.9**	**-162.2**	**-157.9**	**-145.3**	**-152.8**	**-158.2**
	-4.1%	*-3.8%*	*-3.6%*	*-3.9%*	*-3.8%*	*-3.3%*	*-3.2%*	*-3.0%*

1. Further details of the fiscal framework can be found in the technical annexure

2. Excluding special appropriations

3. Special appropriations for Eskom and New Development Bank

Source: National Treasury

Contingency reserves sharply reduced to accommodate increase in compensation budgets

The contingency reserves have been sharply reduced to accommodate the increase in compensation budgets and to fund critical social priorities. The R5 billion contingency reserve for 2015/16 was fully absorbed by the wage bill shortfall. Projected reserves of R15 billion and R45 billion in the two outer years have been cut to R2.5 billion and R9 billion respectively.

The main budget deficit, which defines government's borrowing requirement, stabilises at 3.5 per cent of GDP over the medium term. The deficit excluding interest payments – known as the primary balance – continues to narrow in nominal terms, stabilising the growth of debt and ensuring that government can meet its spending commitments without additional borrowing.

Consolidated deficit declines towards 3 per cent over medium term

The consolidated deficit, which takes into account the budget balances of social security funds, public entities and provinces, declines to 3 per cent over the medium term. Compared with the 2015 Budget forecast, the consolidated deficit is roughly unchanged in the current year, and wider by about 0.7 per cent of GDP in 2016/17 and 2017/18.

Following consultation on the 2015 Budget's proposed once-off relief for contributors to the Unemployment Insurance Fund, the proposal was withdrawn, resulting in an improvement in consolidated revenue this year. However, this is offset by substantial reductions in revenue projections at the Compensation Fund, reflecting lower debt collection estimates. In the outer years, the wider deficit reflects a combination of lower Compensation Fund revenues and a wider main budget deficit.

Figure 3.2 Real main budget non-interest spending

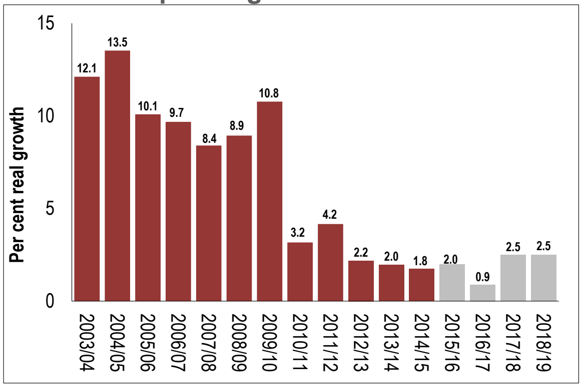
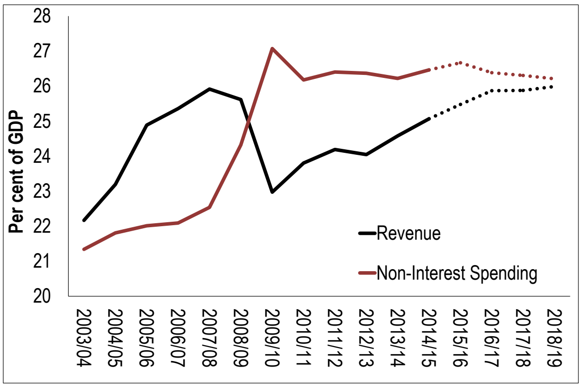


Figure 3.3 Main budget primary balance



Source: National Treasury

Despite higher wage bill projections, government's current balance – the difference between current revenue and spending on compensation, goods and services, interest, and current transfers and subsidies – will move into surplus over the medium term. Over the same period the capital financing requirement will remain broadly unchanged at about 3.8 per cent of GDP, financed in part by the current surplus.

Table 3.2 Consolidated current and capital balances, 2014/15 – 2018/19

	2014/15	2015/16	2016/17	2017/18	2018/19
R billion/Percentage of GDP	**Outcome**	**Estimate**	**Medium-term estimates**		
Current balance	**-1.0**	**-3.1**	**17.7**	**31.2**	**45.4**
	-0.0%	*-0.1%*	*0.4%*	*0.6%*	*0.9%*
Capital borrowing requirement	**-145.3**	**-158.3**	**-168.4**	**-179.3**	**-193.0**
	-3.8%	*-3.9%*	*-3.8%*	*-3.7%*	*-3.7%*
Financial transactions	**9.4**	**3.4**	**7.9**	**4.3**	**4.4**
Contingency reserve	**–**	**–**	**2.5**	**9.0**	**15.0**
Budget balance	**-136.9**	**-157.9**	**-145.3**	**-152.8**	**-158.2**

Source: National Treasury

The expenditure ceiling set in the 2015 Budget remains in place. Indicative allocations in the third year of the budget framework have been restrained, growing at 2.5 per cent above inflation. Spending pressures, including the higher wage bill, have been accommodated within the contingency reserve and departmental baselines.

R23 billion special appropriation for Eskom funded from sale of Vodacom shares

The special appropriation of R23 billion announced in the 2015 Budget is not regarded as part of the spending ceiling because it is funded directly from the sale of government's shareholding in Vodacom, and has no effect on the budget balance. Future payments from sales of non-strategic state assets to finance capital payments will also be excluded from the expenditure ceiling.

Table 3.3 Main budget expenditure ceiling, 2012/13 – 2018/19

R million	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
2013 Budget Review	864 658	942 000	1 015 718	1 092 747			
2014 Budget Review		935 071	1 014 222	1 091 253	1 168 284		
2014 MTBPS			1 008 344	1 081 242	1 152 800	1 250 078	
2015 Budget Review			1 006 905	1 081 214	1 152 833	1 250 086	
2015 MTBPS[1]			1 001 789	1 077 527	1 152 833	1 250 086	1 354 422

1. Excludes skills development levy and special appropriations for Eskom and the New Development Bank. See technical annexure for further details

Source: National Treasury

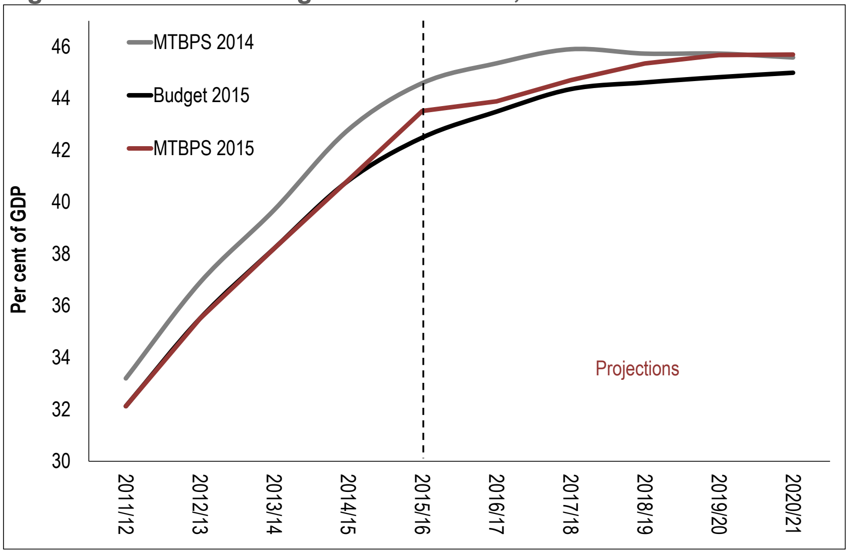
Stabilising the growth of debt

Debt ratio stabilises over medium term as result of restrained spending growth and improved budget balance

The downward revision to GDP, shortfalls in revenue and the weaker exchange rate have led to an upward revision of the debt-to-GDP ratio. However, as Figure 3.4 shows, the debt-ratio trend stabilises in the years ahead as a result of continued restraint in expenditure growth and improvements in the budget balance. Gross debt stabilises at 49.4 per cent of GDP in 2018/19. Net debt stabilises at 45.7 per cent of GDP in 2019/20.

Government’s gross debt stock is projected to increase by about R600 billion over the next three years, reaching R2.4 trillion in 2018/19. The domestic capital market remains the main source of financing. Debt management is focused on mitigating the risks presented by the sharp increase in loan payments over the medium term and beyond. To meet these repayments, government will continue its bond-switch programme, through which short-dated bonds are exchanged for longer-dated paper. More details on the financing of national government borrowing appear in Tables A7 and A8 of the technical annexure.

Figure 3.4 Net national government debt, 2011/12 – 2020/21



Source: National Treasury

Risks to the fiscal outlook

Main risks are lower GDP growth, inflation and financial weakness of some state-owned companies

The main risks to the medium-term fiscal outlook are a further deterioration in economic growth, inflationary pressures and the weak financial positions of several major public entities.

The economic outlook

Weaker economic growth remains the main risk to government achieving its fiscal objectives. Any decline in growth typically results in falling revenue growth, increasing the deficit and debt as a share of GDP. As discussed in Chapter 2, the primary risks to the economic outlook are the binding electricity constraint, slowing global growth and declining commodity prices.

Decline in growth would typically result in a rising deficit and debt as a share of GDP

Continued global uncertainty, particularly concerning the path of US monetary policy, could put upward pressure on domestic interest rates, increasing the cost of issuing debt. Further rand depreciation and higher inflation would push up the level of debt and debt-service costs on bonds denominated in foreign currency and those linked to inflation.

Expenditure pressures

Rising inflation would increase the likelihood of unplanned expenditure. Inflation is expected to peak at about 6 per cent next year and then decline, but risks to this outlook include further rand depreciation, faster food inflation due to drought, and a strong rebound in the oil price. In addition, higher-than-expected increases in electricity and water tariffs would increase the cost of providing free basic services.

Risks to inflation outlook include exchange rate, oil price, and water and electricity tariff escalations

A deterioration in the outlook would also result in faster compensation expenditure growth, because the wage agreement is linked to inflation. Maintaining expenditure priorities under these circumstances would require further reductions in headcount or spending reallocations. Higher inflation would also require government to revise social protection budgets to ensure that the real value of the social wage is protected.

State-owned companies and public entities

Reform of state-owned companies

The 2014 MTBPS announced changes to the financial management framework for state-owned companies. Government expressed its intention to cost the developmental mandates undertaken by companies separately from their commercial activities, with the financial implications being more clearly set out in shareholder compacts. This process is being piloted at a number of entities. Work has also begun to develop a uniform legislative framework to regulate state-owned companies.

Work on a uniform legislative framework to regulate state-owned companies is under way

While these reforms gather pace, government has acted to stabilise several state-owned enterprises.

Financial stabilisation of public entities

In June 2015, approved government guarantees to state-owned companies amounted to R470 billion, with Eskom, the South African National Roads Agency Limited (Sanral) and South African Airways (SAA) constituting some of the largest exposures. Of this total, R245 billion has been utilised. Government's focus has been on stabilising these entities with the aim of ensuring that potential risks do not materialise, which would lead to calls on government guarantees and requests for additional funding. Government remains committed to deficit-neutral capital financing of state-owned companies in the years ahead.

Government has focused on stabilising entities to ensure that potential risks do not materialise

Minister of Finance has attached strict conditions to Eskom's R23 billion capitalisation

Eskom constitutes the largest share of government's guarantee portfolio. The utility benefits from a R350 billion guarantee facility, of which R162 billion has been utilised. During 2015/16, R23 billion of equity will be injected into the company. The Minister of Finance has attached stringent conditions to the R23 billion recapitalisation to drive delivery of planned maintenance, capital expenditure and cost savings. In addition, government's R60 billion subordinated loan has been fully converted to equity, adding to Eskom's equity and reducing the company's debt burden.

The National Treasury, Department of Public Enterprises, Department of Cooperative Governance and Traditional Affairs, and South African Local Government Association have provided support to Eskom by ensuring that 59 defaulting municipalities enter into agreements to repay the utility R4.9 billion in outstanding debt over time. These efforts are beginning to yield results, with an immediate reduction in the debt observed. Eskom recorded a profit of R3.5 billion in 2014/15.

Sanral maintains its investment-grade rating and remains well funded over medium term

Sanral, which holds the second-largest share of guaranteed debt, has maintained its investment-grade rating and remains well-funded over the MTEF period. Total guarantee support to the agency stands at R39 billion, including R32 billion in committed guarantees. In addition, national government provided a one-time allocation of R5.75 billion for the Gauteng Freeway Improvement Project in 2011/12.

The new tolling dispensation has created greater certainty about Sanral's finances and restored confidence in its investment programme. Sanral's most recent bond issuance was oversubscribed. The reduction in toll fees has created a long-term revenue shortfall that will be shared between national government and the provincial government. In the first year of the new dispensation, an allocation of R301 million will be made to Sanral.

Even with diligent efforts, SAA is only expected to generate sustainable profits in five years' time.

Government guarantees to SAA amount to R14.4 billion, of which R11.4 billion has been used. With support from the National Treasury, SAA executed a 90-day action plan, which included closing unprofitable routes, reducing the cost of its fleet, and reviewing onerous agreements and procurement contracts.

However, a successful turnaround will require continued diligent implementation of a long-term strategy to boost revenues, contain costs, strengthen governance, improve accountability and manage performance. Even if these measures are well executed, the airline is only expected to generate sustainable profits in five years' time. Continued government support will be required over this period to allow SAA to operate.

Conclusion

Government's central fiscal objective over the medium term is to stabilise the growth of debt as a share of GDP. The fiscal framework sets a path to achieve this objective. A new fiscal guideline links spending in the outer year with the long-term path of economic growth. Government will continue efforts to improve the governance and financial sustainability of state-owned enterprises.

4

Expenditure priorities and the division of revenue

In brief

- Medium-term spending priorities include education and skills development, health, social protection and infrastructure.
- Strong growth in proposed allocations to provincial and local government reflects the prioritisation of health and education, and the rising cost of these personnel-intensive services associated with the wage bill. It also reflects higher bulk electricity and water costs.
- The 2015 public-sector wage settlement has created a funding shortfall in the current year and the two subsequent years. That portion of the shortfall that cannot be absorbed by existing budgets will be funded through savings, reallocation and drawdowns on the contingency reserve.
- Government is strengthening cost-containment measures and reforming procurement to improve efficiency on non-wage spending, and departments are encouraged to use personnel more productively.
- To improve the planning and execution of infrastructure projects, a new capital budgeting framework will be introduced and the incentive system for provincial infrastructure will be expanded.

Overview

Government remains committed to spending growth within ceiling announced in 2015 Budget

Spending proposals for the next three years are shaped by the economic outlook outlined in Chapter 2 and the fiscal policy considerations set out in Chapter 3. Government remains committed to moderate expenditure growth within the ceiling announced in the 2015 Budget, while supporting National Development Plan (NDP) priorities as expressed through the medium-term strategic framework.

Spending priorities over the medium term focus on education and skills development, health, social protection, social and economic infrastructure, and support for job creation. Government is stepping up cost-containment measures to ensure that spending plans deliver greater value for money. Departments have shifted funds to support core social and economic programmes. In addition, procurement reforms are being rolled out to improve efficiency, reduce red tape and stamp out corruption.

Public-sector wage agreement exceeded budgeted amounts

The 2015 public-sector wage agreement exceeded the funding available for cost-of-living adjustments. As a result, spending plans have been adjusted, and funding set aside in the contingency reserve was diverted to cover the higher costs of the wage settlement. Consequently, new policy proposals requiring additional funding in the first two years of the medium-term expenditure framework (MTEF) period are to be delayed, or funded through reprioritisation or improved efficiencies.

MTEF shifts about R9 billion within existing baselines to priority programmes

The revised MTEF shifts about R9 billion from within existing baselines to priority programmes. About R4.8 billion is reprioritised for upgrades and maintenance of the national and provincial road networks, R1.4 billion has been identified to support provincial public transport, and about R1 billion will be shifted for the rollout of broadband infrastructure and broadcast digital migration. The National Treasury will continue to work with line departments to encourage better alignment of budgets with medium-term strategic framework priorities.

Public expenditure challenges

Absorbing the impact of the public-sector wage agreement

Portion of shortfall resulting from wage agreement can be absorbed within existing department budgets

The public-sector wage agreement led to a compensation budget shortfall of R12.2 billion in the current fiscal year, R20.6 billion in 2016/17 and R31.1 billion in 2017/18. Some of these costs do not need to be funded. Moderate declines in employment levels have created space to absorb costs in some departments' budgets. In other cases, compensation budgets are overestimated due to weaknesses in budget management.

Most of the costs of the agreement, however, will need to be funded through savings, reallocation and drawdowns on contingency reserves:

- The contingency reserves will be drawn down by R5 billion in 2015/16, R10 billion in 2016/17 and R26 billion in 2017/18.
- The revised MTEF provides no funds to expand public-sector employment over the next three years. Departments that had planned to expand headcount or fill vacancies need to postpone their plans. Some institutions may need to reduce the number of people they employ.
- Several provinces have budgeted for surpluses. These resources will now be used to support compensation budgets.
- Departments will shift funds from other budget lines to meet their compensation commitments. Most of these resources will be drawn from goods and services and capital budgets.

Employment trends in national and provincial government

In March 2015, national government departments employed 402 748 staff, down from 404 496 in March 2012. Most national government employees are in justice, crime prevention and security cluster departments such as police, defence and correctional services, where employment levels have declined over the past three years.

This trend has been offset by the expansion of managerial personnel in administrative and policy departments in central government. A recent National Treasury review showed that, across the 13 departments analysed, 1 158 posts were added in the last five years. Aggregate compensation spending across these departments more than doubled between 2008 and 2014. This was the result of higher compensation flowing from cost-of-living and occupation-specific dispensation adjustments, and the creation of new posts at higher salary levels.

Provincial staff headcount declined from 923 553 in 2012 to 913 033 in March 2015, with a decrease of more than 10 000 since the start of the current financial year. The changes have not necessarily resulted in smaller compensation budgets, largely due to above-inflation wage increases and occupation-specific adjustments.

Table 4.1 shows estimates of additional allocations towards compensation resulting from contingency-reserve drawdowns and national baseline reprioritisation. These figures will be revised in the 2016 budget, once provincial reallocations are firm and national adjustments are refined.

Table 4.1 Preliminary reallocation to compensation of employees

	2015/16	2016/17	2017/18
R million	Estimate	Medium-term estimates	
National departments			
Allocations from contingency reserve	1 173	2 866	7 126
Reprioritisation within baseline	–	907	1 040
Provincial departments			
Allocations from contingency reserve	3 827	7 134	18 938
Total	**5 000**	**10 907**	**27 104**

Source: National Treasury

Doing more with less

Government is considering reforms to strengthen link between public-sector pay and performance

To build a capable, effective developmental state supported by sustainable public finances, government and labour need to address the structure of the wage bill. The balance between remuneration levels, employee numbers and productivity needs further consideration. Government will seek reforms that strengthen the link between pay and performance, improve payroll systems, simplify remuneration policies, streamline bonuses and allowances, and ensure that institutional arrangements for collective bargaining are effective and mindful of resource constraints.

Human resource management strategies are being refined to ensure a suitable mix of frontline, technical and support staff. The number of employees on government's payroll peaked at about 1.328 million in 2012 and has declined by about 12 000 since then. The moderate decline in employee headcount has been strongest among professionals in the front line of service delivery, while employment of managerial and policy staff appears to be growing.

Human resource strategies are adjusting to ensure public servants are working where they are needed

There is also a need to ensure that public servants are working where they are most needed. For example, population shifts have increased demand for teachers in some provinces and reduced demand in others. Over the medium term, graduates of the Funza Lushaka bursary programme will be allowed to take jobs where vacancies exist, even if these are outside of their home provinces, which is where they are normally employed to fulfil the bursary's repayment terms.

Cost-containment measures and budgetary controls on non-essential items to be strengthened

Government is also acting to make non-wage spending more efficient. Budgetary controls on non-essential items, innovative procurement reforms and strengthened cost-containment measures will encourage more effective use of resources in the years ahead.

The health sector has taken several steps to improve efficiency. The integrated primary health care information system is being expanded. Manual recordkeeping will be replaced by an electronic system to ensure patient records are easily accessible, reducing administrative burdens and waiting times.

Health-sector innovations yield greater efficiencies

The electronic medicines stock management and national data warehousing system, in pilot phase, will ensure that inventory can be monitored at national level and that hospitals do not run out of medicines. Real-time data on the availability of medicine for over 1 200 healthcare facilities is presently available online. Another pilot programme aims to centralise chronic medicine distribution, allowing patients to collect medication from designated pick-up points, such as private pharmacies. By September 2015, 267 980 persons had been enrolled in this programme, reducing queues and waiting times at public health facilities.

Over the period ahead, government will conduct several expenditure reviews and evaluations to ensure greater value for money.

Public procurement reforms

Public procurement is big business. This year, government has budgeted about R190 billion for goods and services and R162 billion for infrastructure. Initiatives led by the Office of the Chief Procurement Officer aim to deliver lower-cost goods and services more efficiently and transparently through streamlined processes, strategic sourcing, transversal tenders and improved use of technology. The goal is to reduce bureaucratic inertia and red tape, and stamp out corrupt procurement practices.

The **central supplier database** has been in operation since 1 September 2015. More than 20 000 suppliers have already registered on the site, with 9 500 verified. About 1 200 profiles are created each day on the database, which is to become mandatory on 1 April 2016 for national and provincial departments and 1 July 2016 for municipalities. This will reduce the administrative and cost burden of procurement, as the requisite documents will only need to be submitted once for a predetermined period.

The **eTender portal** provides a single point of entry to identify business opportunities with government. Between 1 April and 15 October 2015, more than 2 000 tenders worth about R28 billion were posted onto the portal. Launched on 1 October 2015, www.gCommerce.gov.za gives government departments an opportunity to purchase routine supplies through transversal contracts, reducing administrative processes.

A **single procurement bill** is being developed to replace the more than 80 different legal instruments, guidelines and instruction notes that govern public procurement. The Office of the Chief Procurement Officer will present a draft bill for comment in January 2016.

Tender documents will be made more user-friendly. The number of documents needed for a tender will be reduced, and the language used will be clear and unambiguous. Standard procurement operating procedures will be developed. The changes are set to take effect from 1 April 2016.

Improving capital budgeting and implementation

Local government spending on infrastructure has improved, with 91 per cent of allocated budgets spent

Central coordination and other recent incentives have led to improved planning and execution of infrastructure projects. 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. These efforts are being reinforced by programmes to build municipal financial capacity.

The National Treasury is instituting reforms to strengthen infrastructure planning, implementation and procurement. Over the medium term, a new capital budgeting framework will be introduced. It will set out a systematic, consistent methodology for evaluating proposals for large projects to improve resource allocation, value for money and service delivery. The framework will include clear institutional roles and responsibilities for national, provincial and local government, and outline steps to build skills and capacity for project appraisal, monitoring and evaluation.

Grants adjusted to encourage asset management over full life cycle of infrastructure

In 2013, government introduced a new incentive system for provincial health and education infrastructure grants, leading to an improvement in asset management. Incentives will be expanded to reward performance in project implementation and in the appointment of suitably qualified personnel to key infrastructure posts. Infrastructure grants to local government have been reviewed and will be adjusted to encourage asset management over the full design life of facilities. Similarly, greater emphasis will be placed on managing municipal infrastructure over its entire life cycle, with grant funds made available for refurbishment.

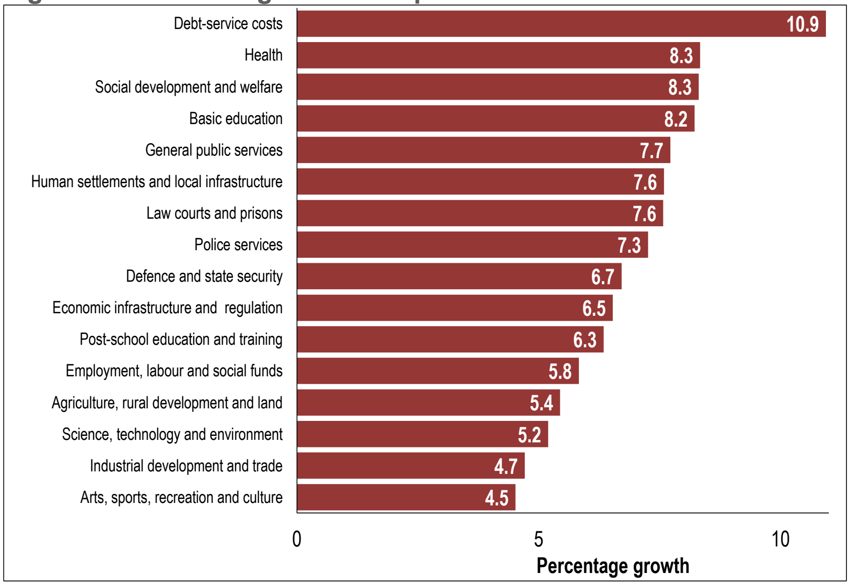
New Treasury Regulations that come into effect in April 2016 include a compulsory standard for infrastructure procurement and delivery management.

Medium-term spending trends and priorities

Government spending to grow above inflation, led by compensation budgets

Government spending is set to grow at 7.2 per cent over the medium term, remaining above inflation. On average, compensation budgets outpace inflation by 2 per cent each year, leading to strong growth in health, education, security and other personnel-intensive sectors. Capital spending declines in real terms but capital transfers grow, partly reflecting shifts towards local government grants that fund water infrastructure. Debt-service costs remain the fastest-growing expenditure item.

Figure 4.1 Nominal growth in expenditure



Source: National Treasury

Funding for basic education, health and social protection grows faster than inflation over medium term

Within available resources, proposed allocations are guided by the 2014-2019 medium-term strategic framework and its 14 outcomes. Basic education, health and social protection receive over 43 per cent of allocations, reflecting government's continued prioritisation of funding for the social sector. Proposed funding for each of these functions continues to grow above inflation over the medium term. About R165 billion is allocated for community infrastructure over the MTEF period and budgets for integrated human settlements continue to grow strongly. Government proposes to allocate R313 billion to capital spending, and transfer another R228.9 billion to municipalities for infrastructure projects. These figures do not include investment funded from the balance sheets of state-owned companies.

Consolidated government expenditure results for 2014/15, revised projections for the current year and medium-term estimates by function are set out in Table 4.2. The same information is provided by economic classification in Table 4.3.

Table 4.2 Consolidated expenditure by function,[1] 2014/15 – 2018/19

R billion	2014/15 Outcome	2015/16 Revised	2016/17 Medium-term estimates	2017/18	2018/19	Average annual growth 2015/16 – 2018/19
Basic education	**197.4**	**213.9**	**228.6**	**249.8**	**270.0**	**8.1%**
Basic education	189.2	204.5	219.2	239.6	259.3	8.2%
Arts, sport, recreation and culture	8.2	9.4	9.5	10.2	10.7	4.5%
Health	**144.6**	**157.7**	**169.7**	**184.7**	**200.6**	**8.3%**
Defence, public order and safety	**162.6**	**172.0**	**183.7**	**198.9**	**211.8**	**7.2%**
Defence and state security	47.5	50.0	53.0	57.2	60.8	6.7%
Police services	78.3	83.1	88.7	96.0	102.5	7.3%
Law courts and prisons	36.9	38.9	42.0	45.7	48.5	7.6%
Post-school education and training	**54.4**	**63.7**	**66.2**	**71.0**	**76.6**	**6.3%**
Economic affairs	**168.8**	**187.6**	**202.3**	**208.5**	**222.5**	**5.9%**
Industrial development and trade	26.4	30.4	32.2	32.6	34.9	4.7%
Employment, labour affairs and social security funds	52.3	65.7	73.1	75.4	77.8	5.8%
Economic infrastructure and network regulation	71.9	71.1	76.0	78.8	86.0	6.5%
Science, technology, innovation and the environment	18.1	20.5	20.9	21.7	23.8	5.2%
Human settlements and municipal infrastructure	**156.4**	**178.7**	**189.9**	**204.2**	**222.6**	**7.6%**
Agriculture, rural development and land reform	**24.2**	**25.6**	**26.5**	**28.3**	**30.0**	**5.4%**
General public services	**62.2**	**72.5**	**71.8**	**75.8**	**79.8**	**3.3%**
Executive and legislative organs	10.2	12.6	13.1	14.0	14.9	**5.7%**
General public administration and fiscal affairs	37.5	44.9	44.0	46.5	47.1	**1.6%**
Home affairs	7.0	7.2	7.2	7.4	9.3	**8.8%**
External affairs and foreign aid	7.4	7.7	7.5	7.9	8.5	**3.5%**
Social protection	**143.4**	**154.0**	**168.0**	**181.3**	**195.7**	**8.3%**
Allocated by function	**1 114.0**	**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	114.8	127.9	142.6	157.2	174.6	10.9%
Contingency reserve	–	–	2.5	9.0	15.0	–
Consolidated expenditure	**1 228.8**	**1 378.7**	**1 451.7**	**1 568.8**	**1 699.1**	**7.2%**

1. Consisting of national, provincial, social security funds and public entities
Source: National Treasury

Table 4.3 Consolidated expenditure by economic classification,[1] 2014/15 – 2018/19

R billion	2014/15 Outcome	2015/16 Revised	2016/17	2017/18	2018/19	Average annual growth 2015/16 – 2018/19
			Medium-term estimates			
Current payments	**735.8**	**806.3**	**870.4**	**944.0**	**1 021.6**	**8.2%**
Compensation of employees	441.1	486.2	524.0	569.4	615.6	8.2%
Goods and services	173.9	186.1	198.1	212.6	226.1	6.7%
Interest and rent on land	120.8	133.9	148.4	162.0	179.9	10.3%
of which: Debt-service costs	*114.8*	*127.9*	*142.6*	*157.2*	*174.6*	*10.9%*
Transfers and subsidies	**400.0**	**445.5**	**479.9**	**511.0**	**551.6**	**7.4%**
of which: Capital transfers	*58.1*	*62.6*	*70.6*	*75.3*	*83.0*	*9.8%*
Provinces and municipalities	96.0	107.2	114.4	123.5	137.3	8.6%
Departmental agencies and accounts	24.8	30.6	31.1	33.9	36.7	6.2%
Higher education institutions	25.7	27.5	29.0	30.8	32.8	6.0%
Foreign governments and international organisations	2.3	2.1	2.2	2.3	2.5	6.1%
Public corporations and private enterprises	27.8	30.7	34.3	35.1	39.2	8.4%
Non-profit institutions	26.9	28.0	29.0	30.2	32.0	4.6%
Households	196.6	219.5	239.9	255.3	271.2	7.3%
Payments for capital assets	**87.6**	**97.2**	**98.4**	**104.2**	**110.4**	**4.3%**
Buildings and other capital assets	66.8	76.3	80.4	84.8	90.4	5.8%
Machinery and equipment	20.8	20.9	18.0	19.4	20.0	-1.5%
Payments for financial assets	**5.4**	**29.6**	**0.5**	**0.5**	**0.5**	**–**
Total	**1 228.8**	**1 378.7**	**1 449.2**	**1 559.8**	**1 684.1**	**6.9%**
Contingency reserve	–	–	2.5	9.0	15.0	–
Consolidated expenditure	**1 228.8**	**1 378.7**	**1 451.7**	**1 568.8**	**1 699.1**	**7.2%**

1. Consisting of national, provincial, social security funds and public entities
Source: National Treasury

Social sector

Social grants and free basic services

Social assistance to reach 18.1 million South Africans by 2018/19

Social assistance and welfare services have grown rapidly in recent years. About 16.7 million South Africans receive social grants, up from 2.5 million in 1998. This figure is projected to reach 18.1 million in 2018/19, growing at 2.2 per cent a year over the MTEF period, mainly due to higher life expectancy and efforts to ensure all eligible children younger than two years of age benefit from the grant.

Several grants grow by R10 per month to bring annual increase in line with long-term inflation

The old-age, war veterans', disability and care dependency grants have each increased by R10 per month from 1 October 2015 to bring the annual increase in line with long-term inflation. Over the spending period ahead, nearly R13 billion will be added to social assistance budgets to accommodate the increase in beneficiaries and ensure that the value of grants keeps pace with inflation. Social assistance expenditure will remain stable as a percentage of GDP.

Rising electricity prices and population growth have put pressure on the ability of municipalities to fund free basic services for low-income households. Government proposes to add R6 billion to the local government equitable share to offset these trends.

Health

Growth in health spending to fund scaling up of response to HIV/AIDS and tuberculosis

Additions to health expenditure are focused on the HIV/AIDS pandemic, particularly the national antiretroviral treatment programme, which now reaches more than 3 million people. Government's review of the effectiveness, coverage, costing and outcomes of its HIV/AIDS and tuberculosis strategies has highlighted the need to scale up specific prevention interventions, such as social and behavioural change communication. Replacement funding is proposed to offset an expected reduction in the United States President's Emergency Plan for AIDS Relief in 2018. New resources will also be allocated to improve primary health care and medicine stock surveillance information systems.

Integrated white paper on NHI to be published in near future

Developing a system of national health insurance (NHI) will enable South Africa to achieve universal health coverage. NHI, which aims to ensure equitable access to health services for all South Africans, is being phased in over a 14-year period, reaching full implementation in 2025/26. A white paper outlining key features and proposed financing arrangements for NHI will be published before the end of the financial year. Lessons learnt from the current NHI pilots will be used in designing an appropriate model for the system.

Education

Spending on education supported improvements in outcomes, but quality is below acceptable levels

The NDP stresses the importance of quality education to reduce poverty and inequality. While government spends about 15 per cent of its budget on basic education, the quality of outputs does not match the extent of the investment. Learner performance improved in the 2014 annual national assessments and international benchmark assessments, for example, but is still below acceptable levels. Government is committed to improving and expanding the annual national assessments, which serve as a monitoring mechanism.

Over the medium term, government will expand provision of learner and teacher support materials, including workbooks to over 10 million learners each year. Targeted support programmes will help teachers improve instruction in maths, science and technology through an intensive in-service training programme.

Government to provide subsidy to all poor children in registered early childhood development centres

Universal access to grade R is expected to be achieved within the next three years. In line with recommendations of the Department of Planning, Monitoring and Evaluation, the qualifications of grade R practitioners will be upgraded to ensure that quality improves.

A well-developed early childhood development (ECD) system enhances educational outcomes. Of the 1.35 million children enrolled in this system, half are subsidised. Government aims to provide all qualifying children in registered centres with an ECD subsidy. Over the medium term, government will increase the number of children subsidised by 127 000. Funding is also being considered for minor facilities upgrades to about 4 000 ECD sites.

Jobs and skills development

R37 billion allocated to public employment over next three years

Over the MTEF period, R37 billion is allocated to public employment programmes. These resources will allow the Expanded Public Works Programme to create about 6 million short-term jobs. By 2017, the

Community Work Programme is expected to be present in every municipality.

After experiencing strong growth in the last five years, expenditure on post-school education and training will keep pace with inflation in the years ahead. An interdepartmental team is working out the financial implications of the white paper on post-school education, and how the expected expansion of enrolments can be funded. Proposals will be available for consideration by Cabinet in 2016.

Spending on post-school education to keep pace with inflation

Subsidising targeted economic sectors

Aggregate medium-term funding of R16.2 billion supports industrialisation through incentives, promotion of various industries, and assistance to small enterprises and cooperatives. Government also forgoes revenue of about R24 billion each year to provide tax incentives to businesses.

Support for business includes R24 billion in tax incentives and R16.2 billion in direct funding

The Manufacturing Competitiveness Enhancement Programme will support enhanced production capacity, while the Automotive Production and Development Programme will continue to subsidise capital investments in the car industry. Special economic zones will receive continued funding to support the sustainability of current and proposed designated zones. New zones will begin operating in the Free State and Gauteng.

Government to review effectiveness of business incentives

This year, more than R7 billion will be transferred directly from the fiscus to support the operations of South African companies, which also receive about R24 billion in tax incentives annually. A number of additional proposals that would increase incentives to the private sector have also been raised for consideration.

The first phase of the Economic Competitiveness Support Programme, which was introduced in 2011/12, concludes in 2017/18. Over the six-year period, total allocations to this programme amount to R22.7 billion. The programme supports training, equipment and technological upgrades to improve competitiveness, and research and development. Government intends to renew the programme following a review of all business incentives.

The review, which will be conducted during 2016, will assess the impact of incentives on economic growth, productivity, competitiveness, the balance of trade and employment. Particular focus will be given to job creation and the need to incentivise labour-intensive economic activities. The outcomes of the review will inform the allocation of resources for business incentives in 2018/19 and beyond.

Safety, security and justice

Over the next three years, the South African Police Service will strengthen its public-order policing capabilities and address training gaps, including those identified by the Marikana Commission of Enquiry. In line with the commission's recommendations, the police have established a transformation task force. It will investigate global best practice in combating syndicated and other crime, develop proposals for organisational reform and integrate recommendations from an independent panel of experts.

Public-order policing to be strengthened in line with Marikana Commission recommendations

Proposed allocations will allow for key positions in the Public Protector of South Africa to be filled and advocacy field capacity in the South African Human Rights Commission to be enhanced. The judge president offices in all divisions of the High Court of South Africa will employ additional staff to coordinate judicial functions, and ensure that judicial norms and standards are implemented, monitored and reported on.

Following parliamentary approval, funding of defence review to be considered

Parliament approved the 2014 defence review this year, and the Department of Defence is developing an implementation plan. The National Treasury is working with the department on the plan's funding components.

Infrastructure development

In line with the NDP, government has invested to expand South Africa's infrastructure network. In addition to the economic infrastructure projects conducted by large state-owned companies, government has invested about R650.5 billion in infrastructure since 2009/10.

Focus on improving value for money in infrastructure and maintaining existing facilities

Over the period ahead, there will be a strong focus on building partnerships with the private sector to boost inclusive growth and job creation in South Africa's cities. Government's infrastructure investments will continue to grow, but not as rapidly as in the past, with the focus shifting to improving value for money in infrastructure delivery. Government will also invest more in the refurbishment and renewal of ageing infrastructure, while continuing to expand social infrastructure to underserved areas.

Supporting urban development and spatial transformation

South Africa needs higher-density settlements, integrated land-use patterns and better public transport

The United Nations (UN) estimates that by 2030, 68 per cent of South Africa's population will live in the 11 largest urban areas, up from 59 per cent in 1995. The UN Sustainable Development Goals reinforce the need to build cities that are productive, inclusive, resilient, safe and sustainable. In South Africa's case, urban development must also overcome apartheid spatial planning. With 60 per cent of GDP already being generated in the eight metropolitan cities, urban development and growth will become increasingly important. Capturing the economic dividends of urbanisation and reducing inequality requires higher-density settlements, more integrated land-use patterns and better public transportation.

Government will continue to help municipalities plan and implement urban development projects that catalyse spatial change. Projects currently receiving support include Cornubia and Warwick Junction in eThekwini, the Sleeper Site development in Buffalo City and Athlone power station redevelopment in Cape Town. More projects are due to enter the preparation pipeline shortly.

Development Bank of Southern Africa to facilitate new, long-term lending instruments

While cities borrow regularly to fund infrastructure investment, there has been a mismatch between borrowing periods and project lifespans. The Development Bank of Southern Africa will facilitate new, long-term lending instruments that encourage the participation of institutional investors and pension funds.

Transfers from national government will continue to support urban development by subsidising the provision of infrastructure and free basic services to low-income households. Increased emphasis will be placed on coordinating the investments made in bulk services and housing.

Roads

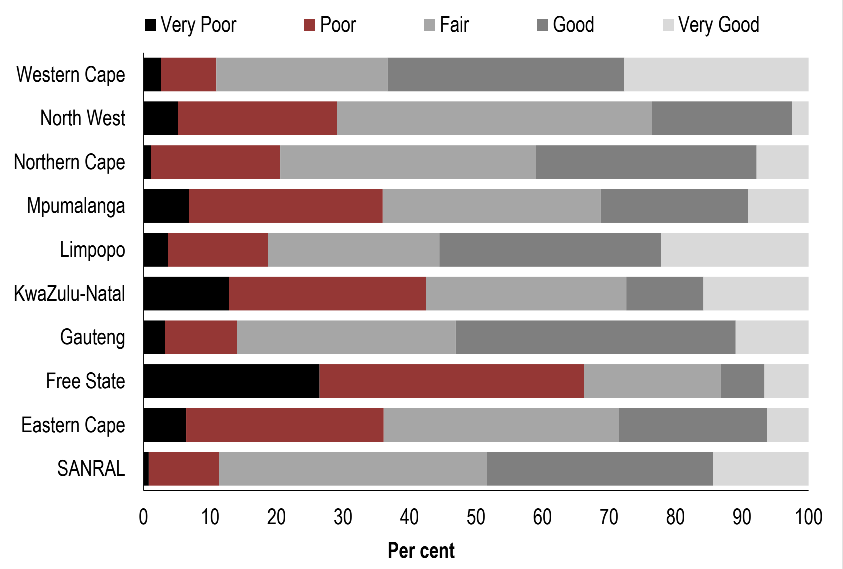
The South African National Roads Agency (Sanral) manages a 21 500 km national road network, only 15 per cent of which is tolled. About 74 per cent of this network is beyond its design life and significant sections of the non-toll network require urgent rehabilitation.

Sanral to receive baseline increases to maintain national road network

Government proposes baseline increases to Sanral over the MTEF period to arrest deterioration of the national road network. Funding is also proposed for the new dispensation on the Gauteng Freeway Improvement Project, which includes reduced caps and a single tariff for all users.

To improve the efficiency of investments in the secondary road network, a new performance component incorporating efficiency indicators for managing road networks will be introduced in the *provincial roads maintenance grant*.

Figure 4.2 Road conditions



Source: Committee of Transport Officials, 2014

Rural infrastructure and development

Government is committed to investing in rural infrastructure to eradicate backlogs in access to services, increase mobility and create opportunities to grow local economies. The majority of municipal infrastructure grants for services such as water, sanitation, electricity and roads are allocated to the 27 priority rural district municipalities. The bulk of provincial grants for school upgrading and building clinics are also allocated to rural areas.

27 identified rural district municipalities to receive capacity support

While all municipalities require capacity support, the need is most pressing in rural municipalities. To provide support to these areas, the *municipal systems improvement grant* will be refocused as an indirect grant, helping to build well-governed, capable municipal institutions as set out in the Back to Basics strategy.

Government's land reform programme can also stimulate rural development. The Office of the Valuer-General in the Department of Rural Development and Land Reform is now operating and is expected to facilitate more efficient acquisition of land at equitable values.

Land reform programme to source land more efficiently at equitable values

The National Treasury is working with the Department of Agriculture, Forestry and Fisheries and the Department of Rural Development and Land Reform to identify overlapping programmes and budget allocations where resource use can be improved and savings achieved.

Division of revenue

Growth in provincial and local government allocations reflects priority on front-line service delivery

Over the three-year spending period ahead, national departments are allocated 47.4 per cent of available non-interest expenditure, provinces are allocated 43.4 per cent, and local governments are allocated 9.2 per cent. These allocations equate to spending growth of 5.6 per cent for national government (excluding indirect grants), 7.8 per cent for provinces and 8.2 per cent for local government.

Table 4.4 Division of revenue, 2015/16 – 2018/19

R billion	2015/16	2016/17	2017/18	2018/19	Average annual growth 2015/16 – 2018/19
National allocations	550.2	557.6	596.7	642.0	5.3%
Provincial allocations	471.8	503.4	548.8	591.1	7.8%
Local government allocations	101.3	106.9	115.3	128.4	8.2%
Total allocations	**1 123.2**	**1 168.0**	**1 260.8**	**1 361.5**	**6.6%**
Percentage shares					
National departments	49.0%	47.7%	47.3%	47.2%	
Provincial	42.0%	43.1%	43.5%	43.4%	
Local government allocations	9.0%	9.2%	9.1%	9.4%	

Source: National Treasury

Strong growth in allocations to provincial and local government reflects the priority placed on front-line services such as health, education and basic services, as well as the rising cost of these services due to higher wages, and bulk electricity and water costs.

Compensation costs pose most pressing funding challenges over the MTEF period

The most pressing funding challenge provinces face over the MTEF period is covering higher compensation costs stemming from the public-sector wage settlement. An amount of R29.9 billion will be added to the provincial equitable share in the current year and over the next two years to fund the shortfall. The balance will be covered through savings and the reallocation of surpluses. The additional funds will be allocated using the equitable share formula, the largest components of which measure demand for services in education and health. The National Treasury and the provinces will review this formula over the medium term to ensure it takes spending pressures across provinces into account fairly.

Several reforms will improve the administration of conditional grants. Details of changes to transfers to provinces and local government over the MTEF period are contained in the technical annexure.

Reforms to conditional grants

Government has completed the second phase of its local government infrastructure grant review. Several changes will be introduced over the MTEF period to streamline these grants and improve the value and sustainability of associated investments. Proposed reforms to be introduced from next year include:

- Enabling the use of funds for the renewal, refurbishment and rehabilitation of existing infrastructure, alongside asset management systems to plan and prioritise maintenance.
- Reforming the *public transport network grant* to support financially sustainable transit networks in large cities.
- Consolidating urban grants over the MTEF period to tackle challenges in the built environment.
- Rationalising grants to reduce complexity and administrative burdens. Several water and sanitation grants are being merged, for example.
- Introducing grants that differentiate between metros, secondary cities and rural areas. Secondary cities in particular will see changes to their planning requirements.

Conclusion

Medium-term spending priorities include education and skills development, health, social protection and infrastructure. Government plans to strengthen cost-containment measures and implement procurement reforms to improve efficiency on non-wage spending, and departments are encouraged to use personnel more efficiently and productively.

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Technical annexure

Introduction

This annexure presents the budget framework, expenditure outcomes for 2014/15, mid-year estimates of expenditure for 2015/16 and the division of revenue.

The budget framework consists of the fiscal framework, government spending priorities, the division of resources between national, provincial and local government, and a tabulation of the major conditional grants. The budget framework allows national departments, provinces and municipalities to prepare their detailed budgets for the following year. South Africa has a multi-year budgeting process, so the framework covers the present fiscal year and the three subsequent years.

Assumptions for the macroeconomic forecast

The assumptions shown in Table A.1 underpin the macroeconomic forecast contained in this *Medium Term Budget Policy Statement.* The National Treasury's forecasts for global growth are consistent with those of the International Monetary Fund. Assumptions about commodity prices are informed by futures curves and analysis of commodity-market fundamentals. The projections are consistent with market expectations of weak demand from emerging markets, in particular China, as well as the abundant supply of commodities.

Table A.1 Assumptions underpinning the macroeconomic forecast

Percentage change (unless otherwise indicated)	2013	2014	2015	2016	2017	2018
	Outcomes		Projections			
Global growth						
Global demand	1.2	1.7	1.9	2.2	1.9	1.7
Commodity prices						
Brent crude (US$ per barrel)	109	100	55	55	57	57
Gold (US$ per ounce)	1 411	1 266	1 165	1 127	1 132	1 132
Platinum (US$ per ounce)	1 488	1 385	1 082	1 002	1 003	1 003
Iron ore (US$ per ton)	135	97	56	48	47	47
Coal (US$ per ton)	80	72	58	54	54	54

Source: National Treasury

The fiscal framework

The fiscal framework sets out government's revenue projections, spending estimates, borrowing requirements and assumptions concerning debt-service costs. The consolidated fiscal framework comprises the main budget, as well as spending by provinces, social security funds and public entities financed from own revenue.

Difference between the main and consolidated budgets

Government's finances are presented in two ways that highlight different aspects of the budget: the main and consolidated budgets. The main budget shows all expenditure financed from the National Revenue Fund. With the exception of direct charges mandated by specific legislation, all expenditure incurred against the National Revenue Fund needs parliamentary approval. The consolidated budget is a wider category of the public finances. It includes the main budget, as well as spending financed from the revenues raised directly by provinces, social security funds and public entities. These revenues are not deposited into the National Revenue Fund. Different aspects of the budget can be presented at either the main or consolidated level. For instance, the main budget indicates how much money central government has to borrow to finance its operations, while the consolidated budget provides a fuller picture of government's impact on the economy.

Revenue outcomes and revised estimates

The revenue outcome for 2014/15, revised estimates for 2015/16 and the estimates for 2016/17 are presented in Table A.2. Projected revenues from corporate income tax and value-added tax (VAT) have underperformed for the first half of the current fiscal year, and have been revised downwards. Personal income tax (PIT) collection has been stronger, supported by above-inflation wage settlements and higher marginal tax rates.

The tax revenue outcome for 2014/15 was R986 billion, a 9.6 per cent increase on collections in 2013/14 and R7.3 billion higher than the 2015 Budget target. Revenue was higher than projected largely due to strong growth in PIT as a result of less-than-full fiscal drag relief and fairly high wage growth, particularly for high-income earners. Large once-off payments arising from the disposal of share options also had a material effect on PIT collection in the year.

Overall, gross tax revenue has been revised downwards by R7.6 billion in 2015/16, R14.6 billion in 2016/17 and R12.4 billion in 2017/18 compared with the projections tabled in the 2015 Budget.

Table A.2 Total tax and consolidated budget revenue, 2014/15 – 2016/17

	2014/15		2015/16		2016/17
R billion	**Outcome**	**Budget**	**Revised**	**Deviations**	**Estimates**
Persons and individuals	353.0	393.9	396.0	2.1	442.4
Companies	184.9	202.0	189.0	-13.0	197.2
Value-added tax	261.3	283.8	280.5	-3.3	305.0
Dividend withholding tax	21.2	22.5	25.0	2.5	26.6
Specific excise duties	32.3	34.5	35.0	0.5	35.7
Fuel levy	48.5	55.7	56.3	0.6	58.0
Customs duties	40.7	41.7	42.8	1.1	46.7
Other	44.4	47.3	49.1	1.8	53.1
Gross tax revenue	**986.3**	**1 081.3**	**1 073.7**	**-7.6**	**1 164.6**
Non-tax revenue	29.0	19.0	48.0	28.9	22.6
of which:					
Mineral royalties	*5.4*	*6.2*	*3.2*	*-3.0*	*4.2*
Asset disposals	–	–	*25.4*	–	–
Receipts from financial transactions [1]	*12.6*	*2.0*	*8.2*	*6.2*	*6.5*
Estimate of SACU payments[2]	-51.7	-51.0	-51.0	–	-39.5
Provinces, social security funds and selected public entities	128.4	139.6	150.1	10.5	158.7
Consolidated budget revenue	**1 091.9**	**1 188.9**	**1 220.8**	**31.9**	**1 306.4**

1. Consists mainly of premiums and revaluation profits on debt transactions

2. Actual payments will be determined by outcomes of customs and excise revenue collections in line with the Southern African Customs Union agreement

Source: National Treasury

Non-tax revenue in 2015/16 is expected to be R28.9 billion higher than the 2015 Budget estimate. This is attributed to the R25.4 billion sale of Vodacom shares and higher receipts from other financial transactions. The higher-than-expected estimate is partially offset by a downward revision to mineral royalties, which are R3 billion lower than the estimate in the 2015 Budget.

Table A.3 presents outcomes and estimates of receipts and payments from financial transactions. The receipts arise from financial transactions in assets and liabilities, and are presented in the 2015 *Adjusted Estimates of National Expenditure* as part of departmental revenue.

In 2015/16, total receipts from financial transactions are expected to be R8.2 billion, R6.2 billion higher than the 2015 Budget estimate of R2 billion. The revised estimate includes revaluation profits of R2.6 billion on foreign-currency transactions and premiums of R5.6 billion on loan transactions, in particular on inflation-linked bonds and the bond-exchange programme. Over the medium term, provision is made for receipts from financial transactions of R11.2 billion relating to revaluation profits on foreign-currency transactions. Given current forecasts of bond yields, no premiums on loan transactions are projected over the medium-term expenditure framework (MTEF) period.

In 2015/16, payments from financial transactions will amount to R681 million, made up of losses on the Gold and Foreign Exchange Contingency Reserve Account (R153 million) and premiums on loan transactions (R528 million). Payments for financial transactions are not projected over the MTEF period.

Table A.3 Financial transactions receipts and payments, 2014/15 – 2018/19

R million	2014/15 Outcome	2015/16 Budget	2015/16 Revised	2016/17	2017/18	2018/19
				Medium-term estimates		
Receipts	**12 647**	**2 000**	**8 167**	**6 500**	**2 800**	**1 900**
Premiums on loan transactions[1]	8 197	–	5 565	–	–	–
Revaluation profits on foreign currency transactions[2]	4 407	2 000	2 600	6 500	2 800	1 900
Liquidation of SASRIA investment[3]	40	–	–	–	–	–
Other[4]	3	–	2	–	–	–
Payments	**-1 526**	**-121**	**-681**	**–**	**–**	**–**
Premiums on loan transactions[1]	-1 458	–	-528	–	–	–
Defrayal of GFECRA losses[5]	-68	-121	-153	–	–	–
Total	**11 121**	**1 879**	**7 486**	**6 500**	**2 800**	**1 900**

1. Premiums received or incurred on new loan issues, bond switch and buy-back transactions
2. Revaluation profits or losses on government's foreign exchange deposits at the Reserve Bank when used to meet foreign currency commitments
3. Liquidation of government's investments in the South African Special Risk Insurance Association
4. Mainly penalties on early withdrawal of retail bonds
5. Realised profits/losses on the Gold and Foreign Exchange Contingency Reserve Account
Source: National Treasury

Assumptions for revenue projections

Table A.4 presents the assumptions underlying the revised revenue projections for 2015/16 to 2018/19. Revenue projections assume that personal income tax brackets are adjusted for inflation and that tax rates are held constant.

Tax buoyancy is the ratio of the growth of a revenue stream to the growth of its underlying tax base. At the most aggregate level, tax revenue growth is based on increases in nominal GDP. A tax buoyancy of 1.04 in 2016/17 means for each per cent increase in nominal GDP, tax revenues will grow by 1.04 per cent. It is assumed that overall tax buoyancy will increase to 1.10 by 2018/19.

Above-inflation wage settlements have supported high buoyancy in PIT collection in recent years. Measured against the growth of remuneration in the formal non-agricultural sector, PIT buoyancy has exceeded 1.20 for the last three years. In the current year, PIT buoyancy is supported by higher tax rates announced in the 2015 Budget. The budget framework assumes that PIT buoyancy declines over the medium term.

The under-collection of corporate income tax in the current year is mainly due to contractions in the mining and manufacturing sectors on the back of poor global demand, lower commodity prices and domestic electricity constraints. Mining and manufacturing production showed only moderate gains for the first half of 2015 and indicators suggest that underlying activity will remain weak for the remainder of the year. As a result, the buoyancy of corporate income tax against gross operating surplus (a proxy for corporate income) is assumed at only 0.34 in 2015/16, gradually increasing to a historic average of 1 in the outer years of the forecast period.

VAT includes revenues collected on imports, but performance is mainly influenced by collections of domestic VAT. Final household consumption, which is the proxy tax base for VAT, indicates that households remain under pressure, weighed down by lower real disposable income, weak credit growth and higher food inflation. VAT buoyancy against final household consumption remains flat, at 1.10 per cent between 2015/16 and 2018/19. This is somewhat lower than the performance of recent years.

Table A.4 Tax revenue projections and assumptions, 2012/13 – 2018/19

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
R billion		Outcome		Estimate		Projections	
Personal Income tax	**276**	**310**	**353**	**396**	**442**	**494**	**550**
Wage bill [1]	1 503	1 639	1 762	1 927	2 093	2 288	2 514
Buoyancy	*1.21*	*1.37*	*1.85*	*1.30*	*1.36*	*1.25*	*1.14*
Corporate income tax	**159**	**177**	**185**	**189**	**197**	**215**	**234**
Gross operating surplus	1 442	1 540	1 611	1 716	1 840	2 002	2 180
Buoyancy	*0.74*	*1.67*	*0.94*	*0.34*	*0.60*	*1.00*	*1.00*
Value-added tax	**215**	**238**	**261**	**281**	**305**	**334**	**366**
Final household expenditure	2 022	2 184	2 328	2 484	2 681	2 913	3 167
Buoyancy	*1.25*	*1.31*	*1.51*	*1.10*	*1.10*	*1.10*	*1.10*
Gross tax revenue	**814**	**900**	**986**	**1 074**	**1 165**	**1 277**	**1 401**
Nominal GDP	3 328	3 610	3 844	4 103	4 437	4 827	5 252
Buoyancy	1.20	1.25	1.48	1.32	1.04	1.10	1.10

1. Remuneration in the formal non-agriculture sector, private and public
Source: National Treasury

Technical modification of the expenditure ceiling

The National Treasury introduced the expenditure ceiling in the 2012 Budget as a refinement of the MTEF introduced in 1998. The allocations made through the MTEF provide an agreed-upon baseline from which departments prepare budgets. The expenditure ceiling is a measure that monitors and manages departmental spending levels in the context of a constrained fiscal framework.

The expenditure ceiling has helped government manage expenditure. But, to minimise any unintended negative effects on service delivery, the measure needs to be refined. The ceiling was originally linked directly to main budget non-interest expenditure. However, this is a rudimentary measure of spending limits as it includes some payments that are directly financed by dedicated revenue flows and others that are not subject to policy oversight, such as payments from realised valuation adjustments on foreign debt and financial assets.

In future budgets, the expenditure ceiling will differ slightly from total non-interest expenditure. The following items will be excluded, as indicated in Table A.5:

- ***Payments for financial assets financed by the sale of financial assets:*** Funds allocated to equity investments financed from the sale of assets, for example, the Eskom equity purchase, are deficit neutral. The increases in spending levels caused by them are generally not financed through adjustments to departmental allocations.

- ***Payment transactions that are linked to the management of debt*:** This includes premiums paid on new loan issues, bond switches and buy-back transactions, revaluation profits or losses on government's foreign exchange deposits at the Reserve Bank when used to meet government's foreign-currency commitments, and realised profits and losses on the Gold and Foreign Exchange Contingency Reserve Account. These spending items relate to debt and currency transactions that are not financed through adjustments in departmental appropriations.
- ***Direct charges that relate to specific payments made in terms of legislation that provides for the collection and transfer of such receipts outside of the main budget:*** This applies to the skills development levy contributions, which are paid to the National Skills Fund and the sector education and training authorities. In general the payment schedule to the National Skills Fund is revised to align it directly with anticipated receipts from the levy.

Changing appropriations to accommodate increases or decreases in such spending is not sensible, as these items are financed from dedicated resources and are largely the result of fluctuations outside the direct control of policy makers.

Table A.5 Technical adjustments to calculate expenditure ceiling, 2012/13 – 2018/19

R million	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Non-interest expenditure	**877 374**	**946 574**	**1 017 153**	**1 119 028**	**1 170 473**	**1 269 774**	**1 376 479**
Technical adjustments:							
Eskom equity contribution				*-23 000*			
New Development Bank				*-2 019*			
Skills development levy			*-13 839*	*-15 800*	*-17 640*	*-19 687*	*-22 057*
Debt management and GFECRA[1] transactions			*-1 526*	*-682*			
Expenditure ceiling			**1 001 789**	**1 077 527**	**1 152 833**	**1 250 086**	**1 354 422**
Comparable data for expenditure ceiling[2]:							
2013 Budget Review	864 658	942 000	1 015 718	1 092 747			
2014 Budget Review		935 071	1 014 222	1 091 253	1 168 284		
2014 MTBPS			1 008 344	1 081 242	1 152 800	1 250 078	
2015 Budget Review			1 006 905	1 081 214	1 152 833	1 250 086	
2015 MTBPS			1 001 789	1 077 527	1 152 833	1 250 086	1 354 422

1. Gold and Foreign Exchange Contingency Reserve Account (GFECRA)
2. Adjusted non-interest expenditure for purposes of comparison
Source: National Treasury

The adjustments include R23 billion appropriated for Eskom Holdings through the Eskom Special Appropriation Act (2015) and R2 billion for the payment of South Africa's first capital contribution of US$150 million to the New Development Bank. These allocations are conditional on the total amount being covered by receipts from the sale of assets, including government's shareholding in Vodacom. The Vodacom share sale is set to increase the 2015/16 estimate of revenue by R25.4 billion. An amount of R12.6 billion from the sale has already been paid into the National Revenue Fund and the balance will be paid during the second half of the year.

Consolidated framework

Table A.6 summarises the consolidated fiscal framework outlined in Chapter 3.

Following revised nominal GDP estimates, lower tax revenue projections and projected underspending by national departments in 2015/16, the consolidated budget deficit is forecast at 3.8 per cent of GDP, a 0.1 percentage point improvement against the 2015 Budget target.

The proposal made in the 2015 Budget for a break in contributions to the Unemployment Insurance Fund (UIF) was not implemented as it did not find support in the National Economic Development and Labour Council. This alteration is reflected in a further R13.5 billion surplus build-up in the books of the UIF in

2015/16. This is offset by substantial reductions in revenue projections at the Compensation Fund, reflecting lower debt-collection estimates.

Compared to the 2015 Budget, the consolidated budget deficit decreases at a slower pace over the MTEF period, reaching 3 per cent of GDP in 2018/19. The fiscal framework allows for moderate growth in consolidated non-interest spending over the next two years, averaging 6.3 per cent nominal growth, with growth increasing to 8 per cent in 2018/19. The fastest-growing expenditure item in the consolidated framework continues to be interest payments. Nominal growth in interest and rent on land is expected to average 10.3 per cent over the MTEF period, slower than the 12.8 per cent recorded over the past three fiscal years.

Compensation accounts for the largest share of current spending. In 2015/16, compensation is expected to make up 40.9 per cent of total current spending, unchanged from 2014/15. The consolidated wage bill increases at a nominal annual average of 8.2 per cent over the MTEF period, while goods and services budgets are expected to grow at a nominal rate of 6.7 per cent over the three-year spending period.

Current transfers and subsidies, which account for 32.2 per cent of consolidated current spending, are expected to grow by 7 per cent over the three-year period. The nominal growth rate is slower than the 9.9 per cent recorded over the past three years.

Table A.6 Consolidated fiscal framework, 2012/13 – 2018/19

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
R billion		**Outcome**		**Estimate**		**Medium-term estimates**	
Operating account							
Revenue	**893.4**	**993.0**	**1 076.7**	**1 186.1**	**1 297.4**	**1 410.9**	**1 535.6**
Current payments	**921.1**	**1 009.7**	**1 077.7**	**1 189.2**	**1 279.7**	**1 379.7**	**1 490.2**
Compensation	376.6	409.6	441.1	486.2	524.0	569.4	615.6
Goods and services	162.7	174.7	173.9	186.1	198.1	212.6	226.1
Interest and rent on land	93.3	109.3	120.8	133.9	148.4	162.0	179.9
Transfers and subsidies	288.5	316.1	341.9	382.9	409.3	435.7	468.6
Current balance	**-27.7**	**-16.8**	**-1.0**	**-3.1**	**17.7**	**31.2**	**45.4**
Percentage of GDP	*-0.8%*	*-0.5%*	*0.0%*	*-0.1%*	*0.4%*	*0.6%*	*0.9%*
Capital account							
Capital receipts	0.3	0.3	0.4	1.6	0.6	0.2	0.4
Capital payments and transfers	118.6	130.3	145.7	159.9	169.0	179.5	193.4
Capital financing requirement[1]	**-118.2**	**-130.1**	**-145.3**	**-158.3**	**-168.4**	**-179.3**	**-193.0**
Percentage of GDP	*-3.6%*	*-3.6%*	*-3.8%*	*-3.9%*	*-3.8%*	*-3.7%*	*-3.7%*
Financial transactions[2]	10.1	10.6	9.4	3.4	7.9	4.3	4.4
Contingency reserve	–	–	–	–	2.5	9.0	15.0
Budget balance	**-135.8**	**-136.2**	**-136.9**	**-157.9**	**-145.3**	**-152.8**	**-158.2**
Percentage of GDP	*-4.1%*	*-3.8%*	*-3.6%*	*-3.8%*	*-3.3%*	*-3.2%*	*-3.0%*
Revenue	**908.7**	**1 007.9**	**1 091.9**	**1 220.8**	**1 306.4**	**1 416.0**	**1 540.9**
Expenditure	**1 044.6**	**1 144.2**	**1 228.8**	**1 378.7**	**1 451.7**	**1 568.8**	**1 699.1**
Non-interest expenditure[3]	*951.3*	*1 034.9*	*1 108.0*	*1 244.7*	*1 303.3*	*1 406.7*	*1 519.3*
Interest payments[4]	*93.3*	*109.3*	*120.8*	*133.9*	*148.4*	*162.0*	*179.9*
Primary balance[5]	***-42.5***	***-27.0***	***-16.1***	***-24.0***	***3.1***	***9.3***	***21.7***
Percentage of GDP	*-1.3%*	*-0.7%*	*-0.4%*	*-0.6%*	*0.1%*	*0.2%*	*0.4%*

1. Includes payments for capital assets, receipts from the sale of capital assets and capital transfers
2. Transactions in financial assets and liabilities including net receipts from financial transactions
3. All spending except for consolidated interest payments
4. Includes main budget debt-service costs and interest payments of other levels of government
5. Revenue less non-interest expenditure
Source: National Treasury

The current balance shows the gap between revenue and operational spending. In 2015/16, a consolidated current deficit of R3.1 billion is expected, before it gradually improves to a surplus in 2018/19 of

R45.4 billion, or 0.9 per cent of GDP. Capital payments and transfers are expected to grow by a nominal annual average of 6.6 per cent over the MTEF period. As the deficit narrows in line with fiscal objectives, the capital financing requirement will decline to 3.7 per cent of GDP in 2018/19 compared to 3.9 per cent in the current year.

Financing the borrowing requirement and national debt outlook

Government's medium-term borrowing strategy will continue to take into account debt levels, the main budget balance, funding instruments, cash-flow requirements, investor needs, developments in the domestic and global markets, and the risks and costs of alternative strategies.

Table A.7 shows the financing of the national government borrowing requirement for 2014/15, revised estimates for 2015/16 and projections over the medium term. The main budget borrowing requirement is projected to decline from R176.3 billion in the current fiscal year to R165.4 billion in 2016/17, before increasing to R186.1 billion in 2018/19.

Short-term loans will increase from R13 billion in 2015/16 to an average of R30 billion over the medium term. New bond issuance in 2015/16 will be marginally higher than the 2015 Budget estimate level at R175 billion, increasing to R191 billion in 2018/19.

Over the medium term, US$4.5 billion will be borrowed in international markets.

Table A.8 shows total national government debt over the period 2014/15 to 2018/19. National government's net debt as a percentage of GDP is estimated to increase from 43.5 per cent in 2015/16 to 45.4 per cent in 2018/19, while gross debt is projected to stabilise below 50 per cent of GDP over the MTEF period.

As a result of higher-than-expected revenue and underspending, excess cash balances amounting to R12 billion were realised in 2014/15. Of these balances, R10 billion is carried forward into 2016/17 and offsets debt issuance. In addition, the main budget deficit, which is equivalent to the borrowing requirement, declines in nominal terms by R12.5 billion. These factors contribute to a fall in gross loan debt as a share of GDP in 2016/17.

Table A.7 Financing of national government borrowing requirement, 2014/15 – 2018/19

	2014/15	2015/16		2016/17	2017/18	2018/19
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Main budget balance[1]	**-168 391**	**-173 054**	**-176 266**	**-165 352**	**-177 846**	**-186 137**
Financing						
Domestic short-term loans (net)	**9 569**	**13 000**	**13 000**	**26 000**	**35 000**	**29 000**
Treasury bills	10 011	13 000	12 325	26 000	35 000	29 000
Corporation for Public Deposits	-442	–	675	–	–	–
Domestic long-term loans (net)	**157 014**	**144 809**	**144 944**	**122 725**	**126 636**	**138 447**
Market loans (gross)	192 414	172 500	174 979	180 500	185 000	191 000
Loans issued for switches[2]	-1 160	–	-2 479	–	–	–
Redemptions	-34 240	-27 691	-27 556	-57 775	-58 364	-52 553
Foreign loans (net)	**8 357**	**7 797**	**9 464**	**6 382**	**15 037**	**17 023**
Market loans (gross)	22 952	11 530	13 110	18 900	18 990	19 035
Redemptions (including revaluation of loans)	-14 595	-3 733	-3 646	-12 518	-3 953	-2 012
Change in cash and other balances[3]	**-6 549**	**7 448**	**8 858**	**10 245**	**1 173**	**1 667**
Total	**168 391**	**173 054**	**176 266**	**165 352**	**177 846**	**186 137**

1. A negative number reflects a deficit
2. Net of loans issued and redeemed in switch transactions
3. A negative change indicates an increase in cash balances
Source: National Treasury

Table A.8 Total national government debt, 2014/15 – 2018/19

As at 31 March	2014/15	2015/16		2016/17	2017/18	2018/19
R billion	Outcome	Budget	Revised	Medium-term estimates		
Domestic debt						
Gross loan debt[1]	1 632.1	1 814.5	1 820.9	1 968.5	2 163.6	2 370.4
Cash balances	-120.3	-112.1	-121.1	-112.1	-112.1	-112.1
Net loan debt[2]	1 511.8	1 702.4	1 699.8	1 856.4	2 051.5	2 258.3
Foreign debt						
Gross loan debt[1]	166.8	168.6	188.1	187.2	203.7	221.6
Cash balances[3]	-94.4	-89.7	-102.2	-96.2	-97.2	-97.9
Net loan debt[2]	72.4	78.9	85.9	91.0	106.5	123.7
Total gross loan debt	**1 798.9**	**1 983.1**	**2 009.0**	**2 155.7**	**2 367.3**	**2 592.0**
Total net loan debt	**1 584.2**	**1 781.3**	**1 785.7**	**1 947.4**	**2 158.0**	**2 382.0**
As percentage of GDP:						
Total gross loan debt	*46.8%*	*47.3%*	*49.0%*	*48.6%*	*49.0%*	*49.4%*
Total net loan debt	*41.2%*	*42.5%*	*43.5%*	*43.9%*	*44.7%*	*45.4%*
Foreign debt as percentage of gross loan debt	*9.3%*	*8.5%*	*9.4%*	*8.7%*	*8.6%*	*8.5%*

1. Forward estimates are based on projections of exchange and inflation rates

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

3. Foreign currency deposits revalued at forward estimates of exchange rates

Source: National Treasury

2014/15 outcomes and 2015/16 mid-year estimates

Table A.9 presents a summary of the national and provincial appropriated expenditure outcomes for 2014/15 and estimates for the first half of 2015/16. Details are presented in Tables A.13 and A.14.

Main budget expenditure was R1.13 trillion in 2014/15, R4.4 billion lower than the adjusted budget estimate and R3.1 billion lower than the 2015 Budget estimate. Excluding special appropriations for Eskom and the New Development Bank, main budget spending for 2015/16 was revised down from the 2015 Budget estimate by R434 million to R1.22 trillion. This represents an increase in expenditure of 7.9 per cent over the previous year. An amount of R628.7 billion, or 99.2 per cent of the February 2015 revised estimate of R633.5 billion in appropriations to national departments, was spent in 2014/15. Spending in the first six months of 2015/16 was R339.8 billion, or 48.1 per cent of the October 2015 revised estimate of R706.4 billion for the year. Transfers and subsidies form the largest economic category of main budget expenditure. This category includes transfers to provincial and local government through the equitable share and conditional grants, as well as payments for social grants, housing subsidies, and transfers to universities, science councils and public entities.

Provincial expenditure in 2014/15 was R454.3 billion, or 98.7 per cent of the 2015 Budget estimate. Expenditure by provinces was R235.3 billion in the first six months of 2015/16, representing 48.7 per cent of the original budget for the year. Provinces are primarily responsible for the delivery of social services, including basic education and health. Compensation of employees is the largest economic category of expenditure in provincial budgets, accounting for 60.8 per cent of expenditure in the first half of 2015/16.

Table A.9 National and provincial expenditure: 2014/15 outcomes and 2015/16 mid-year estimates

R billion	2014/15 Original budget	2014/15 Adjusted estimate	2014/15 Preliminary outcome	2014/15 Over(-)/ under(+)	2015/16 Original budget	2015/16 Adjusted estimate[1]	2015/16 Actual spending April to September
National Revenue Fund Expenditure	**1 142.6**	**1 136.3**	**1 132.0**	4.4	**1 217.3**	**1 251.1**	**606.8**
Debt-service costs	114.9	114.5	114.8	-0.3	126.4	127.9	62.6
Provincial equitable share	359.9	359.9	359.9	–	382.7	386.5	191.3
Other direct charges	26.8	26.9	28.5	-1.6	28.7	30.4	13.0
National votes	**640.9**	**635.0**	**628.7**	**6.3**	**679.5**	**706.4**	**339.8**
of which:							
Compensation of employees	*129.9*	*130.6*	*127.5*	*3.1*	*137.6*	*138.0*	*66.5*
Transfers and subsidies	*812.5*	*813.5*	*810.1*	*3.4*	*873.0*	*876.9*	*434.4*
Payments for capital assets	*17.5*	*16.5*	*16.0*	*0.5*	*16.7*	*17.1*	*4.8*
Contingency reserve	*3.0*	–	–	–	*5.0*	–	–
National government projected underspending	–	*-3.7*	–	*-3.7*	–	*-3.0*	–
Local government repayment to the National Revenue Fund	–	*-0.5*	–	*-0.5*	–	*-1.2*	–
Provincial expenditure	**454.5**	**460.4**	**454.3**	**6.1**	**483.6**	**n/a**	***235.3***
of which:							
Compensation of employees	*275.2*	*275.2*	*271.1*	*4.0*	*291.7*	*n/a*	*143.0*
Transfers and subsidies	*62.4*	*65.2*	*67.1*	*-1.8*	*66.0*	*n/a*	*34.2*
Payments for capital assets	*31.0*	*33.0*	*31.3*	*1.6*	*35.4*	*n/a*	*15.0*

1. Provinces will table adjusted estimates during November 2015
Source: National Treasury

Adjusted Estimates of National Expenditure

Details of the revised national spending allocations are set out in the 2015 *Adjusted Estimates of National Expenditure*, including rollovers of unspent funds from 2014/15, approved allocations for unforeseeable and unavoidable expenditure, the appropriation of expenditure earmarked in the 2015 Budget Speech for future allocation, other shifts and adjustments, and declared unspent funds. Revised provincial appropriations will be tabled in provincial legislatures before the end of the financial year.

Key highlights of the adjusted estimates for 2015/16

- R1.2 billion for the national government public-sector salary adjustment.
- R118 million in funds rolled over arising from commitments related to unspent balances in 2014/15.
- R301 million for the Gauteng Freeway Improvement Project, half of which will be funded by Gauteng province.
- R720 million to cover the impact of the depreciation of the rand on foreign-currency denominated expenditure.
- R33.1 million for contractual penalties incurred by Denel Aerostructures related to the A400M military aircraft contracts.
- R1.2 billion refunded to departments for monies paid directly into the National Revenue Fund from department-specific activities.
- R2.7 billion that will not be spent in 2015/16 and has been declared as unspent funds by departments.
- R1.1 billion for the projected increase in the skills development levies, and expenditure by the sector education and training authorities.

Key revisions to provincial allocations

- R3.8 billion for the provincial government public-sector salary adjustment.
- R518 million reduction in conditional grants due to historical spending performance by some provinces.
- R7.7 million is shifted from the national health insurance component of the indirect *national health grant* to the *national health insurance grant*.
- R193 million is shifted from the health facility revitalisation component of the indirect *national health grant* in the national sphere to the *health facility revitalisation grant*.
- R100 million is shifted from the *restructuring capital grant* for the Social Housing Regulatory Authority in the national sphere to the *human settlements development grant*.

Revisions to local government allocations

- R1.5 billion is rolled over from unspent balances in 2014/15.

Special appropriations

- R23 billion through the Eskom Special Appropriation Act (2015).
- R2 billion through the New Development Bank Special Appropriation Bill.

Division of revenue

The largest share of the consolidated fiscal framework is the main budget, made up of all spending from the National Revenue Fund. The main budget is shared between national, provincial and local government. This section outlines the proposed substantial adjustments to provincial and local government allocations not already discussed in Chapter 4.

Table A.10 Main budget framework,[1] 2012/13 – 2018/19

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
R billion		Outcome		Revised		Medium-term estimates	
Division of available funds							
National departments	**420.0**	**453.2**	**489.6**	**550.2**	**557.6**	**596.7**	**642.0**
Provinces	**380.9**	**410.6**	**439.8**	**471.8**	**503.4**	**548.8**	**591.1**
Equitable share[2]	310.7	336.5	359.9	386.5	412.2	447.6	482.5
Conditional grants	70.2	74.1	79.8	85.3	91.2	101.2	108.6
Local government	**76.4**	**82.8**	**87.8**	**101.3**	**106.9**	**115.3**	**128.4**
Equitable share	37.1	39.0	41.6	51.7	52.9	57.5	62.7
General fuel levy sharing with metropolitan municipalities	9.0	9.6	10.2	10.7	11.2	11.8	12.5
Conditional grants	30.3	34.3	36.0	38.9	42.9	46.0	53.2
Total	**877.4**	**946.6**	**1 017.2**	**1 123.2**	**1 168.0**	**1 260.8**	**1 361.5**
Percentage shares							
National departments	47.9%	47.9%	48.1%	49.0%	47.7%	47.3%	47.2%
Provinces	43.4%	43.4%	43.2%	42.0%	43.1%	43.5%	43.4%
Local government	8.7%	8.8%	8.6%	9.0%	9.2%	9.1%	9.4%

1. Includes function shifts between spheres
2. Includes unallocated amounts
Source: National Treasury

Over the MTEF period, national departments are allocated 47.4 per cent of available non-interest expenditure, provinces 43.4 per cent and local government 9.2 per cent. Medium-term allocations to national departments increase by an average annual rate of 5.6 per cent (excluding all indirect grants), provincial resources grow by 7.8 per cent and local government allocations grow by 8.2 per cent. The faster growth in allocations to provincial and local government reflects the priority placed on front-line services such as health, education and basic services, as well as the rising cost of these services due to higher wages, and bulk electricity and water costs. The proposed changes to the division of revenue are outlined in Table A.11.

Table A.11 Changes to the division of revenue, 2015/16 – 2017/18

R billion	2015/16 Revised	2016/17 Medium-term	2017/18
Changes to baseline			
National allocations[1]	**27.2**	**3.9**	**10.6**
of which:			
Indirect grants to provinces [2]	*-0.3*	*0.2*	*-2.4*
Indirect grants to local government [2]	*-0.3*	*-2.7*	*-3.6*
Provincial allocations	**3.6**	**7.1**	**22.4**
Equitable share	3.8	6.9	18.7
Conditional grants	-0.2	0.2	3.7
Local government allocations	**1.5**	**3.0**	**5.3**
Total	**32.3**	**14.0**	**38.3**

1. The 2015/16 amount includes the allocation for Eskom and the New Development Bank
2. Amounts may be shifted between direct and indirect grants to provinces and local government before the 2016 Budget is tabled
Source: National Treasury

In line with Section 214 of the Constitution and Section 9 of the Intergovernmental Fiscal Relations Act (1997), the Financial and Fiscal Commission tabled its submission on the national budget in Parliament in May 2015. Government will formally respond to matters raised by the Commission when it tables the 2016 Budget.

Changes to provincial allocations

The most pressing funding challenge provinces face over the MTEF period is dealing with the impact of the public-sector wage settlement agreed earlier this year. An amount of R29.9 billion will be added to the provincial equitable share in the current year and over the next two years to fund the shortfall. The balance will be covered through savings and the reallocation of surpluses. The additional funds will be allocated between provinces through the provincial equitable share formula. The formula allocates funds based on six components, the largest of which measures demand for services in the education and health sectors. The National Treasury and the provinces will review this formula over the MTEF period to ensure it takes the spending pressures across all provinces into account fairly.

Table A.12 shows the preliminary equitable share allocations to each province in 2015/16 and over the MTEF period.

Table A.12 Provincial equitable share, 2015/16 – 2018/19

R million	2015/16	2016/17	2017/18	2018/19
Eastern Cape	54 867	58 272	62 785	66 911
Free State	21 996	23 079	24 915	26 558
Gauteng	74 100	79 892	87 548	93 693
KwaZulu-Natal	83 132	88 217	95 283	101 061
Limpopo	45 866	48 885	52 770	56 070
Mpumalanga	31 337	33 573	36 684	39 130
Northern Cape	10 226	10 902	11 887	12 623
North West	26 397	28 166	30 761	32 835
Western Cape	38 580	41 213	44 999	47 769
Total	**386 500**	**412 199**	**447 631**	**476 651**

Source: National Treasury

Changes to provincial conditional grants over the period ahead include merging the *school infrastructure backlog grant* with the *education infrastructure grant* from 2017/18. Funds will be added to the *provincial roads maintenance grant* to allow for the collection of data to measure performance in maintaining roads and to create an incentive component to reward good performance in managing provincial roads infrastructure. Funds will also be added to the *public transport operations grant* over the MTEF period to compensate for the rising costs of subsidised bus services. Provinces are also expected to contribute from their own budgets towards the costs of providing public transport.

The scope of the *comprehensive HIV and AIDS grant* will be expanded to also cover the treatment of tuberculosis (TB). The name of the grant will change to the *comprehensive HIV, AIDS and TB grant* to reflect this, and funds will be added to it in 2017/18 and 2018/19 to support expanded treatment of these diseases. The human papillomavirus component of the *indirect national health grant* was scheduled to end in 2015/16 but will now be extended over the MTEF period. It will remain an indirect grant for the first two years of the period before becoming a direct grant from 2018/19.

Funds are added to provincial allocations in the two outer years of the MTEF period for the expansion of early childhood development services, including for the maintenance of facilities. Funds will be added to the *substance abuse treatment grant* to complete the building of new treatment centres in four provinces. Funds will also be allocated in 2017/18 and in 2018/19 to fund the operations of these centres.

To assist the Department of Agriculture, Forestry and Fisheries with capacitation to improve the monitoring of grants and the performance of the sector, a small amount will be reprioritised out of the Comprehensive Agriculture Support Programme. Funds are also reprioritised out of the *human settlements development grant* in 2016/17, mainly to fund the extension of the bucket eradication programme.

Changes to local government allocations

Transfers to local government will increase over the MTEF period to support the continued delivery of basic services. However, the number of grants to municipalities will be reduced, helping to decrease the reporting burden on municipalities and make the grants system more efficient to administer.

Infrastructure funding

Changes to local government infrastructure grants emanate from a review process that the National Treasury is leading in collaboration with the Department of Cooperative Governance, the Department of Planning, Monitoring and Evaluation, the South African Local Government Association, and the Financial and Fiscal Commission. The review focuses on making changes in three areas: changing the structure of grants to increase differentiation between types of municipality, while also reducing grant proliferation; improving asset management over the lifespan of municipal infrastructure; and improving national support and oversight of grants. Initial changes emerging from the review are being implemented in 2015/16, with further reforms being phased in over the MTEF period.

Ensuring reliable service delivery depends on maintaining and renewing existing infrastructure, and building new infrastructure to reach unserved households. The 2011 Census found, for example, that although 85 per cent of households had access to water services infrastructure, only 65 per cent had a reliable water supply. For this reason, the grants review has proposed a number of changes to incentivise asset management practices that improve functionality and reliability over the full lifecycle of municipal infrastructure. Changes include allowing grant funds to be used to refurbish infrastructure whereas previously funds had largely targeted the construction of new infrastructure. Grants will also fund the establishment of asset maintenance plans, and stronger conditions will be placed on municipalities to use these asset management systems to prioritise the maintenance and investment needed on their infrastructure.

Three overlapping water and sanitation grants will be merged in 2016/17. The *municipal water infrastructure grant*, the *water services operating subsidy grant* and the *rural households infrastructure grant* will be merged into a single grant that will be targeted at reticulation and on-site-solutions in low-capacity municipalities. Over the MTEF period, some regional bulk infrastructure grant allocations will also be converted to direct transfers to municipalities to allow them to implement their own bulk water and sanitation projects. More emphasis will also be placed on ensuring that, where possible, municipalities raise financing to co-fund bulk projects that serve paying customers.

New planning requirements will be introduced in 2016/17 for secondary cities. This is the first step towards introducing greater differentiation in the grant system to better respond to the urban development challenges in these cities. The cities that meet specified performance criteria will be eligible for a separate grant from 2017/18 onwards. The consolidation of infrastructure grants for metropolitan municipalities is intended to be phased in over the medium term and extended in the long-term to secondary cities.

The *public transport network grant* will have a new formula-based allocation method phased in from 2016/17. This should increase certainty about the extent of national funding that municipalities can expect when planning their public transport networks, and encourage cities to plan and develop systems that they can afford to operate in the long run. Qualification criteria and conditions in the grant will also emphasise the need for cities to ensure that the public transport networks developed will be affordable and sustainable over the long term while extending high quality public transport to more people.

Data on the extent and condition of roads has been collected over several years using the *rural roads asset management systems grant*. The data will begin to guide the selection of municipal roads projects. Conditions in the *municipal infrastructure grant* will require this and will also be changed to allow funds to be used for road maintenance and refurbishment if project selection is based on this data. Generalised ring-fencing in the *municipal infrastructure grant* will be changed to conditions that require that municipalities respond to identified gaps in sports infrastructure. Municipalities will also be encouraged to increase their investment in other community infrastructure, including cemeteries, community centres, taxi ranks and market places.

The indirect *bucket eradication programme grant* was due to end in 2015/16 but will be extended to 2016/17 to complete the eradication of bucket sanitation systems in formal residential areas. Sanitation upgrading and bucket system eradication in informal areas will continue to be funded through the *urban settlements development grant*, *human settlements development grant* and *municipal infrastructure grant* as part of the rollout of basic services and informal settlement upgrading.

Operational and capacity funding

To help subsidise the rising costs of providing free basic services, R6 billion over the MTEF period will be added to the local government equitable share.

The Municipal Demarcation Board has approved a number of significant boundary changes in an attempt to improve the viability of municipalities. These changes involve merging or splitting existing municipalities, and will result in substantial administrative costs during the transition. To support the implementation of the changes, the *municipal demarcation transition grant* will receive increased allocations in 2016/17 and 2017/18.

Government is committed to making changes to achieve the NDP goal of building a capable state at all three levels of government. To support more strategic capacity building interventions in municipalities, the *municipal systems improvement grant* will become an indirect grant. The initiatives funded from this grant will be aligned to the Back-to-Basics Strategy. The Department of Cooperative Governance and the National Treasury will agree to the details of how the programme will work.

The *municipal human settlements capacity grant* was introduced in 2014/15 to facilitate the development of capacity to manage human settlements programmes in anticipation of the assignment of the housing function to cities. However, there is no longer a need for this standalone grant as the assignment process was subsequently suspended indefinitely. The grant will be terminated in 2016/17. In place of a separate grant, cities will be allowed to use up to 3 per cent of the *urban settlements development grant* to improve their capacity with regard to built-environment functions.

To finance government priorities, including those described above, funds will be reprioritised out of the *municipal infrastructure grant* and the *municipal systems improvement grant.*

Table A.13 Expenditure by vote, 2014/15 and 2015/16

R million	2014/15[1] Main budget	Adjusted budget	Preliminary outcome	Over(-)/ Under(+)	2015/16 Main budget	Adjusted budget	Actual spending April to September
1 The Presidency	1 010	484	453	32	510	476	209
2 Parliament[2]	1 508	1 508	1 668	-160	1 567	1 594	826
3 Communication	1 283	1 295	1 287	8	1 281	1 291	622
4 Cooperative Governance and Traditional Affairs	63 213	63 454	59 478	3 976	69 314	70 815	29 517
5 Home Affairs	6 545	7 145	7 144	0	6 451	7 349	3 416
6 International Relations and Cooperation	5 754	6 104	5 992	113	5 699	6 511	2 758
7 National Treasury	27 265	26 704	26 183	521	26 957	28 726	11 353
8 Planning, Monitoring and Evaluation	–	734	709	25	718	754	353
9 Public Enterprises	256	320	296	23	267	23 303	10 100
10 Public Service and Administration	875	875	814	61	931	941	427
11 Public Works	6 121	6 121	6 022	99	6 411	6 312	2 499
12 Statistics South Africa	2 243	2 243	2 156	86	2 245	2 323	1 033
13 Women	–	181	178	3	187	189	94
14 Basic Education	19 680	19 690	19 529	161	21 511	21 286	12 294
15 Higher Education and Training	38 988	38 988	38 987	1	41 844	41 880	29 491
16 Health	34 380	34 325	33 579	746	36 468	36 254	18 132
17 Social Development	128 799	128 598	127 860	737	138 169	137 894	67 654
18 Correctional Services	19 721	19 722	19 529	193	20 618	20 589	9 876
19 Defence and Military Veterans	42 831	42 857	42 842	14	44 579	45 088	20 748
20 Independent Police Investigative Directorate	235	235	232	2	235	235	113
21 Justice and Constitutional Development	14 594	14 489	14 228	261	14 984	15 011	6 915
22 Office of the Chief Justice and Judicial Administration	565	670	670	–	742	783	307
23 Police	72 507	72 507	72 507	0	76 377	76 721	36 004
24 Agriculture, Forestry and Fisheries	6 692	6 692	6 629	64	6 383	6 409	3 467
25 Economic Development	697	697	695	2	886	886	424
26 Energy	7 416	7 438	6 220	1 218	7 482	7 268	4 550
27 Environmental Affairs	5 668	5 680	5 675	5	5 948	5 943	2 862
28 Labour	2 527	2 546	2 420	126	2 687	2 704	1 218
29 Mineral Resources	1 471	1 476	1 475	0	1 619	1 639	925
30 Science and Technology	6 470	6 480	6 389	91	7 482	7 466	4 850
31 Small Business Development	1 148	1 101	1 101	–	1 103	1 128	548
32 Telecommunications and Postal Services	973	1 616	1 568	48	1 413	1 405	792
33 Tourism	1 662	1 583	1 558	26	1 800	1 794	932
34 Trade and Industry	8 687	8 818	8 685	133	9 594	9 498	3 623
35 Transport	48 727	48 771	49 147	-376	53 357	53 615	27 195
36 Water and Sanitation	–	13 647	11 617	2 031	16 447	15 747	4 808
37 Arts and Culture	3 528	3 528	3 454	74	3 920	3 826	1 728
38 Human Settlements	30 521	29 418	29 358	59	30 943	30 543	13 127
39 Rural Development and Land Reform	9 455	9 455	9 396	60	9 380	9 197	3 611
40 Sport and Recreation South Africa	970	970	967	3	989	981	423
Discontinued departments[3]	12 907	–	–	–	–	–	–
Total appropriation by vote	**637 896**	**639 165**	**628 698**	**10 467**	**679 498**	**706 374**	**339 824**
Plus:							
Direct charges against the National Revenue Fund							
President and Deputy President salary (The Presidency)	3	5	5	1	6	6	3
Members' remuneration (Parliament)[2]	481	481	480	1	503	503	208
Debt-service costs (National Treasury)	114 901	114 485	114 798	-313	126 440	127 902	62 645
Provincial equitable share (National Treasury)	359 922	359 922	359 922	–	382 673	386 500	191 337
General fuel levy sharing with metropolitan municipalities (National Treasury)	10 190	10 190	10 190	–	10 659	10 659	3 553
National Revenue Fund payments (National Treasury)[4]	–	311	1 526	-1 215	121	682	512
Skills levy and sector education and training authorities (Higher Education and Training)	13 440	13 200	13 839	-639	14 690	15 800	7 502
Magistrates' salaries (Justice and Constitutional Development)	1 901	1 858	1 622	236	1 881	1 831	818
Judges' salaries (Office of the Chief Justice and Judicial Administration)	829	872	872	–	874	874	419
Total direct charges against the National Revenue Fund	**501 667**	**501 325**	**503 254**	**-1 929**	**537 847**	**544 756**	**266 997**
Contingency reserve	3 000	–	–	–	5 000	–	–
National government projected underspending	–	-3 650	–	-3 650	–	-3 000	–
Local government repayment to the National Revenue Fund	–	-500	–	-500	–	-1 200	–
Total	**1 142 562**	**1 136 340**	**1 131 952**	**4 388**	**1 222 345**	**1 246 930**	**606 821**

1. The 2014/15 financial year numbers were adjusted to include function shifts
2. The audited outcome for Parliament is converted from accrual to cash
3. Funds originally appropriated to discontinued departments, now absorbed in relevant newly created departments with historical numbers adjusted accordingly
4. National Revenue Fund payments previously classified as extraordinary payments
Source: National Treasury

Table A.14 Expenditure by province, 2014/15 and 2015/16

R million	2014/15 Main budget	2014/15 Adjusted budget	2014/15 Preliminary outcome	2014/15 Over(-)/ Under(+)	2014/15 Deviation from adjusted budget	2015/16 Main budget	2015/16 Actual spending April to September[1]
Eastern Cape	**62 141**	**62 842**	**61 558**	**1 284**	**2.0%**	**64 995**	**31 299**
Education	27 935	28 283	27 681	602	2.1%	29 438	13 534
Health	17 509	17 679	17 550	129	0.7%	18 496	9 719
Social Development	2 159	2 157	2 134	22	1.0%	2 231	1 189
Other functions	14 538	14 723	14 193	530	3.6%	14 830	6 857
Free State	**27 925**	**28 532**	**28 833**	**-301**	**-1.1%**	**29 375**	**15 084**
Education	11 259	11 266	11 709	-443	-3.9%	10 633	5 751
Health	8 155	8 324	8 290	33	0.4%	10 968	4 939
Social Development	973	968	956	11	1.2%	736	377
Other functions	7 538	7 974	7 877	97	1.2%	7 037	4 017
Gauteng	**86 969**	**87 284**	**85 753**	**1 531**	**1.8%**	**95 391**	**46 174**
Education	32 845	33 213	32 778	434	1.3%	35 495	17 653
Health	31 524	31 491	31 005	486	1.5%	43 528	21 643
Social Development	3 525	3 434	3 409	26	0.7%	2 333	1 148
Other functions	19 074	19 146	18 560	585	3.1%	14 034	5 730
KwaZulu-Natal	**96 718**	**97 558**	**97 385**	**173**	**0.2%**	**101 961**	**50 646**
Education	39 447	39 950	39 663	286	0.7%	43 726	21 199
Health	30 914	31 119	31 246	-126	-0.4%	41 976	21 619
Social Development	2 498	2 490	2 485	4	0.2%	2 235	1 076
Other functions	23 859	23 999	23 991	8	0.0%	14 024	6 752
Limpopo	**51 460**	**52 224**	**50 943**	**1 281**	**2.5%**	**52 728**	**25 268**
Education	24 966	25 338	24 980	358	1.4%	26 097	11 964
Health	14 371	14 616	14 557	59	0.4%	17 089	8 844
Social Development	1 469	1 476	1 472	5	0.3%	1 244	661
Other functions	10 654	10 793	9 934	859	8.0%	8 298	3 800
Mpumalanga	**36 470**	**37 098**	**36 372**	**727**	**2.0%**	**38 702**	**18 899**
Education	16 103	16 263	15 910	353	2.2%	17 213	8 111
Health	8 992	9 033	8 879	153	1.7%	12 674	5 591
Social Development	1 232	1 220	1 220	0	0.0%	1 004	507
Other functions	10 143	10 582	10 362	220	2.1%	7 811	4 689
Northern Cape	**13 123**	**13 530**	**13 400**	**130**	**1.0%**	**14 161**	**7 005**
Education	4 744	4 792	4 786	6	0.1%	5 083	2 482
Health	3 696	3 758	3 714	44	1.2%	4 074	2 153
Social Development	651	661	654	6	0.9%	710	333
Other functions	4 031	4 319	4 245	74	1.7%	4 294	2 038
North West	**31 770**	**32 414**	**31 840**	**574**	**1.8%**	**34 224**	**16 693**
Education	12 498	12 563	12 350	213	1.7%	13 432	6 466
Health	8 174	8 185	8 373	-188	-2.3%	8 904	4 564
Social Development	1 241	1 254	1 218	36	2.9%	1 334	576
Other functions	9 856	10 412	9 899	513	4.9%	10 554	5 087
Western Cape	**47 935**	**48 939**	**48 228**	**711**	**1.5%**	**52 059**	**24 223**
Education	16 425	17 026	17 001	25	0.1%	17 745	8 692
Health	17 338	17 430	17 306	125	0.7%	18 813	8 954
Social Development	1 756	1 758	1 734	24	1.4%	1 898	997
Other functions	12 416	12 725	12 187	538	4.2%	13 604	5 580
Total	**454 510**	**460 422**	**454 312**	**6 110**	**1.3%**	**483 597**	**235 290**
Education	186 222	188 695	186 860	1 836	1.0%	198 863	95 852
Health	140 674	141 635	140 920	715	0.5%	176 523	88 024
Social Development	15 504	15 418	15 283	134	0.9%	13 725	6 864
Other functions	112 110	114 674	111 249	3 425	3.0%	94 486	44 550

1. September expenditure numbers obtained from Vulindlela
Source: National Treasury

Glossary

Above-the-line	Expenses or revenue that are regular and expected, having a direct effect on an income statement.
Adjustments estimate	Presentation to Parliament of the amendments to be made to the appropriations voted in the main budget for the year.
Appropriation	The approval by Parliament of spending from the National Revenue Fund, or by a provincial legislature from the Provincial Revenue Fund.
Balance of payments	A summary statement of all the transactions of the residents of a country with the rest of the world over a particular time period.
Baseline	The initial allocations used during the budget process, derived from the previous year's forward estimates.
Budget balance	The difference between expenditure and revenue. If expenditure exceeds revenue, the budget is in deficit. If the reverse is true, it is in surplus.
Capital flow	A flow of investments in and out of a country.
Conditional grants	Allocations of money from one sphere of government to another, conditional on certain services being delivered or on compliance with specified requirements.
Consolidated government expenditure	Total expenditure by national and provincial government, social security funds and selected public entities, including transfers to municipalities, businesses or other entities. See also *main budget*.
Consumer price index (CPI)	The main measure of inflation, charting the price movements of a basket of consumer goods and services.
Consumption expenditure	Expenditure on goods and services, including salaries, which are consumed within a short period of time – usually a year.
Contingency reserve	An amount set aside, but not allocated in advance, to accommodate changes to the economic environment and to meet unforeseen spending pressures.
Core inflation	A measure of the change in price level that excludes temporary shocks and represents the long-run trend of the price level.
Countercyclical fiscal policy	Policy that has the opposite effect on economic activity to that caused by the business cycle, such as slowing spending growth in a boom period and accelerating spending in a recession.
Credit rating	An indicator of the risk of default by a borrower or the riskiness of a financial instrument. Grades such as AAA, Baa2 and D are given, signifying the extent of the borrower's capacity to meet its financial obligations or the probability that the value of the financial instrument will be realised.

Crowding-in	Increase of private investment as a result of government spending.
Crowding-out	A fall in private investment or consumption as a result of increased government expenditure.
Current account (of the balance of payments)	The difference between total exports and imports, including service payments and receipts, interest, dividends and transfers. This account can be in deficit or surplus. See also *trade balance.*
Current balance	The difference between revenue and current expenditure, which consists of compensation of employees, goods and services, and interest and rent on land.
Debt-service cost	The cost of interest on government debt.
Debt redemption	Repayment of the principal and any outstanding interest on a bond.
Depreciation (capital)	A reduction in the value of fixed capital as a result of wear and tear or redundancy.
Depreciation (exchange rate)	A reduction in the external value of a currency.
Division of revenue	The allocation of funds between national, provincial and local government as required by the Constitution.
Economic cost	The cost of an alternative forgone to pursue a certain action.
Employment tax incentive	An incentive meant to encourage the creation of jobs for youths by allowing employers to claim a reduction in employees' tax.
Equitable share	The allocation of revenue to national, provincial and local government as required by the Constitution.
External imbalance	An excessively positive or negative current account balance, reflecting an excess or deficit of domestic investment over domestic savings.
Financial account (of the balance of payments)	A statement of all financial transactions between a country and the rest of the world, including portfolio and fixed investment flows, and movements in foreign reserves.
Financial and Fiscal Commission	An independent body established in terms of the Constitution to make recommendations to Parliament and provincial legislatures about financial issues affecting the three spheres of government.
Financial year	The 12 months according to which companies and organisations budget and account. Government's financial year runs from 1 April to 31 March.
Fiscal drag	The tendency of inflation and earnings growth to push taxpayers into higher tax brackets.
Fiscal policy	Policy on taxation, spending and borrowing by government.
Fiscal space	The ability of a government's budget to provide additional resources without jeopardising fiscal sustainability.
Flexible exchange rate	Determination of currency exchange rates by market forces.

Foreign direct investment	The acquisition of long-term business interests in another country, usually involving management, technology and financial participation.
GDP inflation	A measure of the total increase in prices in the whole economy. Unlike CPI inflation, GDP inflation includes price increases in goods that are exported and intermediate goods such as machines, but excludes imported goods.
Gold and foreign exchange account	A Reserve Bank account that reflects its losses and profits on holdings of foreign currency and gold reserves, driven by changes in the rand/$ exchange rate and the gold price.
Gross domestic product (GDP)	A measure of total national output, income and expenditure in the economy.
Gross fixed capital formation	The addition to a country's fixed capital stock over a specific period, before provision for depreciation.
Headline inflation	A measure of the increase in price level that includes temporary price shocks to the economy, such as one-time price changes.
Independent power producer	A private-sector producer of power for the national grid.
Indirect grant	A grant allowing a national department to perform a function on behalf of a province or municipality. No funds are transferred, but the end-product of the grant, such as infrastructure built, is generally transferred to provincial or municipal ownership.
Inflation	An increase in the general level of prices.
Inflation targeting	A monetary policy framework intended to achieve price stability over a certain period of time. The Reserve Bank and government agree on a target rate or range of inflation to be maintained.
Labour force participation	The ratio of employed and unemployed workers (the labour force) relative to the working age population.
Main budget expenditure	National government expenditure and transfers to provincial and local government financed from the National Revenue Fund, excluding revenues and spending related to social security funds, extra-budgetary institutions and provincial own revenue. See also *consolidated government expenditure*.
Medium-term Expenditure Committee	The committee responsible for evaluating the budget submissions of national departments and recommending allocations.
Medium-term expenditure framework (MTEF)	The three-year spending plans of national and provincial governments published at the time of the Budget.
Medium-term strategic framework	The five-year strategy of government coinciding with the electoral term.
Monetary policy	The actions taken by a country's monetary authority (e.g. the Reserve Bank), normally focused around money supply and interest rates.
Money supply	The total stock of money in an economy.
National budget	The projected revenue and expenditure flowing through the National Revenue Fund. It does not include spending by provinces or local government from their own revenues.

National Development Plan (NDP)	A national strategy to eliminate poverty and reduce inequality.
National Revenue Fund	The consolidated account of national government into which all taxes, fees and charges collected by the South African Revenue Service and departmental revenue must be paid.
Nominal exchange rate	The current rate of exchange between the rand and foreign currencies.
Non-interest expenditure	Total expenditure by government less debt-service costs.
Primary deficit/surplus	The difference between total revenue and non-interest expenditure. When revenue exceeds non-interest expenditure there is a surplus.
Primary expenditure	Non-interest expenditure by government.
Primary sector	The agricultural and mining sectors of the economy.
Private-sector credit extension	Credit provided to the private sector by banks. This includes all loans, credit card balances and leases.
Productivity	A measure of the amount of output generated from every unit of input over a period of time. Typically used to measure changes in labour efficiency.
Public entities	Companies, agencies, funds and accounts that are fully or partly owned by government or public authorities and regulated by law.
Public-private partnership (PPP)	A contractual arrangement in which a private party performs part of a government function and assumes the associated risks. In return, the private party receives a fee based on predefined performance criteria.
Public-sector borrowing requirement	The consolidated cash borrowing requirement of general government and non-financial public enterprises.
Purchasing managers' index (PMI)	A composite index measuring the change in manufacturing activity compared with the previous month.
Rating agency	A company that evaluates the ability of countries or other borrowers to honour their debt obligations. Credit ratings are used by international investors as indications of sovereign risk. See also *credit rating*.
Real effective exchange rate	A measure of the rate of exchange of the rand relative to a trade-weighted average of South Africa's trading partners' currencies, adjusted for price trends.
Real expenditure	Expenditure measured in constant prices, i.e. after taking account of inflation.
Real interest rate	The level of interest after taking account of inflation.
Repurchase (repo) rate	The rate at which the Reserve Bank lends to commercial banks.
Reserves (foreign exchange)	Holdings of foreign exchange, either by the Reserve Bank only, or by the Reserve Bank and domestic banking institutions.
Rollover	Funds not spent during a given financial year that flow into the following year's budget.

Seasonally adjusted and annualised	The process of removing the seasonal volatility (monthly or quarterly) from a time series. This provides a measure of the underlying trend in the data. Annualised: to express a rate as if it were applied over one year.
Social wage	Social benefits available to all individuals, funded wholly or partly by the state.
Southern African Customs Union (SACU) agreement	An agreement that allows for the unrestricted flow of goods and services, and a sharing of customs and excise revenue, between South Africa, Botswana, Lesotho, Namibia and Swaziland.
Southern African Development Community (SADC)	A regional intergovernmental organisation that promotes collaboration, economic integration and technical cooperation throughout Southern Africa.
Sovereign debt	Debt issued by a government.
Special economic zone	A designated area where infrastructure and incentives are provided to clusters of businesses to encourage private investment and employment growth.
Switch (auction)	Auctions to exchange bonds to manage refinancing risk or improve tradability.
Terms of trade	An index measuring the ratio of export prices to import prices.
Trade balance	The monetary record of a country's net imports and exports of physical merchandise. See also *current account.*
Transversal term contract	A fixed-term contract for the procurement of goods or services needed by more than one government department.
Twin deficit	A budget deficit in combination with a deficit on the current account.
Twin peaks	An approach to organising financial sector regulation and supervision involving two regulators. One is responsible for ensuring financial services firms sell their products in an appropriate way. The other is responsible for ensuring financial firms remain financially sound and are generally prudent.
Undercapitalisation	Lack of sufficient funds (capital) to conduct day-to-day operations.
Unit labour costs	The cost of labour per unit of output, calculated by dividing average wages by productivity (output per worker per hour).
Unsecured lending	A loan that is not backed or secured by any type of collateral to reduce the lender's risk.
Yield	A financial return or interest paid to buyers of government bonds.