3

Fiscal policy

In brief

- Economic growth has been weaker than anticipated and revenue collection below projections, leading to a budget deficit of 5.2 per cent in 2012/13. As a result, government is taking additional steps to ensure that expenditure remains firmly under control.
- Growth in spending has been curbed, with medium-term expenditure framework (MTEF) allocations to national departments adjusted downwards to reduce the deficit.
- The contingency reserve is reduced by a total of R23.5 billion over the medium term, with R4 billion, R6.5 billion and R10 billion allocated to the reserve during each year of the spending period.
- Real growth in non-interest spending will average 2.3 per cent over the medium term, down from 2.9 per cent projected at the time of the 2012 *Medium Term Budget Policy Statement*. Real growth in capital expenditure will average 3.4 per cent.
- Expenditure reviews will seek to increase the efficiency of spending and eliminate waste. A tax policy review will examine whether revenue levels are sufficient to ensure fiscal sustainability over the long term.

Overview

Government continues to provide support for the economy while ensuring sustainable public finances. Fiscal policy is anchored by the principles of countercyclicality, debt sustainability and intergenerational fairness:

Countercyclicality, debt sustainability and intergenerational equity are guiding principles of policy

- Countercyclicality means that spending supports the economy during downturns, even if revenue is insufficient, and the accumulation of debt is reversed to build fiscal space as the economy recovers.
- Sustainability ensures that debt remains under control so that government can continue to borrow at reasonable rates.
- Intergenerational fairness means that our children do not have to repay debts taken on today unless they also share in the benefits of assets created by that spending.

Expenditure will moderate, debt will stabilise and capital investment will be prioritised

Within this framework, government has three medium-term objectives:

- Moderating expenditure growth to expand public services at a sustainable pace.
- Stabilising debt as a share of national income by narrowing the budget deficit.
- Improving the impact of public spending by prioritising capital investment, and reducing waste and inefficiency.

With the onset of the global financial crisis in 2008, and in line with its countercyclical stance, government sustained expenditure levels even as revenue declined sharply. South Africa's economic cycle reached a low point during the 2009 recession. Since then structural constraints and weak global demand have dampened the pace of economic growth. Revenue has not yet fully recovered and, although spending growth has been well contained, the budget deficit has remained elevated.

Economic weakness over the past six months has resulted in a pronounced shortfall in revenue, leading to an unavoidable widening of the deficit in 2012/13. The budget deficit is now estimated at 5.2 per cent of GDP. The widening of the deficit supports the economy, but continued countercyclicality in the short term necessitates a stronger medium-term path of consolidation to ensure debt sustainability.

Reduction in core spending plans

To realise government's objectives, core spending has been reduced

The 2013 Budget adjusts the fiscal framework to ensure a stronger path of consolidation towards debt sustainability. Compared with the fiscal framework outlined in the October 2012 *Medium Term Budget Policy Statement*, government's core spending plans are reduced by R10.4 billion over the next three years. This has been achieved by moderating the growth of allocations, mainly to national departments. Government has also reduced the unallocated portion of spending by trimming the contingency reserve, which will now be R4 billion, R6.5 billion and R10 billion over the three years of the MTEF. Real non-interest expenditure is projected to grow at an average rate of 2.3 per cent per year over the medium term, down from 2.9 per cent projected in October 2012.

Government is committed to remaining within its expenditure ceiling. New policy initiatives will be financed from savings, efficiency gains and reprioritisation over the next three fiscal years.

Expenditure reviews will be conducted to find savings and improve value for money

To support this process, the Ministers' Committee on the Budget will oversee expenditure reviews in the coming year to analyse patterns of public spending, including personnel spending. The reviews will also identify opportunities to improve value for money, such as enhanced procurement controls and the phasing out of projects that are ineffective or no longer aligned with policy priorities. A complementary review will assess whether tax policy is appropriate to support government's policy objectives, including fiscal sustainability.

Over the longer term, faster and more inclusive economic growth is required to create jobs, widen the tax base and generate sufficient revenue to support government's priorities.

Fiscal framework

Table 3.1 summarises the consolidated fiscal framework. The 2012/13 budget deficit is projected at 5.2 per cent of GDP, up from 4.8 per cent of GDP projected in October 2012. The wider deficit is largely the result of a revenue shortfall, as well as downward revisions to nominal GDP by the Reserve Bank to correct previous estimates. A stronger moderation in expenditure growth offsets the wider deficit over the medium term. The budget deficit is projected to narrow as economic growth and revenue collections gather pace over the three-year period, reaching 3.1 per cent of GDP in the outer year.

Budget deficit widens to 5.2 per cent of GDP in 2012/13 as a result of revenue shortfall

Table 3.1 Consolidated fiscal framework, 2009/10 – 2015/16

R billion / percentage of GDP	2009/10	2010/11 Outcome	2011/12	2012/13 Revised estimate	2013/14	2014/15 Medium-term estimates	2015/16
Revenue	**664.5**	**757.2**	**836.9**	**887.8**	**985.7**	**1 091.1**	**1 199.8**
	27.1%	*27.7%*	*28.1%*	*27.7%*	*28.0%*	*28.1%*	*28.1%*
Expenditure	**824.1**	**877.5**	**954.2**	**1 055.9**	**1 149.4**	**1 244.3**	**1 334.1**
	33.6%	*32.1%*	*32.1%*	*32.9%*	*32.6%*	*32.1%*	*31.2%*
Non-interest expenditure	766.9	811.3	877.7	967.6	1 049.6	1 135.6	1 215.9
	31.3%	*29.7%*	*29.5%*	*30.2%*	*29.8%*	*29.3%*	*28.5%*
Debt-service cost	57.1	66.2	76.5	88.3	99.7	108.7	118.2
	2.3%	*2.4%*	*2.6%*	*2.8%*	*2.8%*	*2.8%*	*2.8%*
Budget balance	**-159.6**	**-120.4**	**-117.3**	**-168.0**	**-163.7**	**-153.2**	**-134.4**
	-6.5%	*-4.4%*	*-3.9%*	*-5.2%*	*-4.6%*	*-3.9%*	*-3.1%*
Primary balance	*-4.2%*	*-2.0%*	*-1.4%*	*-2.5%*	*-1.8%*	*-1.1%*	*-0.4%*

New format for the consolidated government account

The annexures to the 2013 Budget present the statistical tables for the consolidated government accounts in a new format. The tables in this chapter are presented in the old format.

The new format, which was announced in the 2012 Budget, clearly distinguishes between operating activities and capital budgets, and separates transactions in financial assets and liabilities, which includes loans and equity provided to public corporations and agencies. Extraordinary receipts and payments are brought into the budget framework in line with global standards, in particular the International Monetary Fund's *Government Finance Statistics Manual 2001*.

One consequence of the new format is that the budget deficit is narrower than previously reported, since it is financed partly by extraordinary receipts. Applying the new format to historical numbers results in revisions of 0.1 to 0.5 per cent of GDP. For 2012/13 the difference amounts to 0.3 per cent.

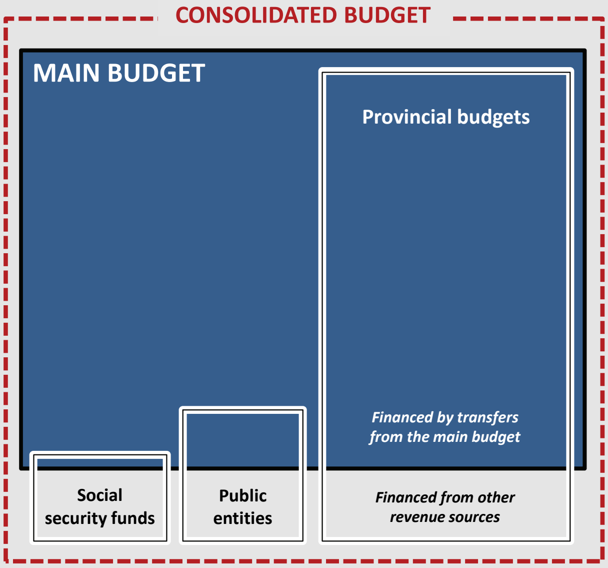
The old format is retained in this chapter to maintain comparability with the *Medium Term Budget Policy Statement* – which set out fiscal policy parameters over the current MTEF. The new format is presented in Table 8 of Annexure B. In future, all budget data will appear in the new format.

Revenue and spending trends

The consolidated fiscal framework brings national and provincial government, social security funds and a diverse set of public entities under the purview of a single budget process. The *main budget* finances the bulk of spending, and includes funds appropriated by Parliament in the form of budget votes as well as the provincial share of revenue and other direct charges mandated by the Constitution. Provincial governments, social security funds and public entities also finance their activities from own revenue, and the *consolidated budget* includes these elements. These budget categories are explained in the box below.

Main budget finances the bulk of spending, including funds appropriated by Parliament in budget votes

An overview of the consolidated budget



Government finances are presented in two ways, each highlighting key aspects of the budget.

The **main budget** determines national government's borrowing requirement. It consists of two elements. The first, appropriations by Parliament through budget votes, are mainly for national departments, and includes transfers to provinces, local government and public entities. The second, direct charges against the National Revenue Fund, includes the provincial equitable share, debt-service costs, and the salaries of judges and public representatives.

The **consolidated budget** provides a fuller picture of government's contribution to the economy. It takes account of the main budget as well as the spending of provinces, social security funds and public entities financed from their own revenue.

Provincial budgets are largely financed by the provincial equitable share and conditional grants from the main budget. But provinces supplement these funds with their own revenues, such as gambling taxes, hospital fees and sales of goods and services. Also excluded from the consolidation is expenditure by metros and other large municipalities, which is financed from own revenue, such as property rates.

The consolidated budget includes 187 **public entities**. These include large entities such as the South African National Roads Agency Limited, the Passenger Rail Agency, the South African Revenue Service and agencies that provide bulk water infrastructure. Public entities receive some transfers from the main budget, but are also financed from own revenue. State-owned companies that function as standalone operations largely on a commercial basis, such as Eskom and Transnet, are not included in the consolidated accounts.

Social security funds include the Unemployment Insurance Fund, compensation funds and the Road Accident Fund. They are financed mainly by statutory levies or contributions, but receive some transfers from the main budget.

Revenue

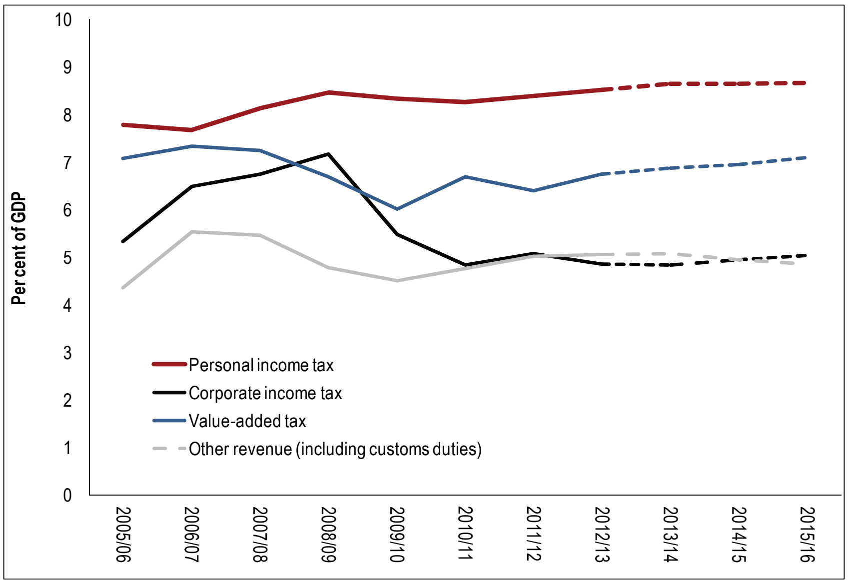
Weaker-than-expected economic growth and supply disruptions in the mining sector have resulted in a downward adjustment in revenue estimates for 2012/13. Tax revenue is expected to be R16.3 billion below the 2012 Budget estimate of R826 billion. The lower base of revenue collection carries through over the three-year spending period. Compared with the 2012 Budget, tax revenue is revised down by R13.2 billion and R27.8 billion in 2013/14 and 2014/15 respectively.

Corporate income tax is likely to stabilise at a lower share of GDP than during the mid-2000s

Corporate income tax collections are expected to yield R156.4 billion compared with the 2012 Budget estimate of R167.4 billion. Corporate income tax is likely to stabilise at a lower share of GDP than at the height of the economic upturn in the mid-2000s, with a moderate improvement over the medium term, as shown in Figure 3.1.

Personal income tax is also lower than projected for 2012/13. Against a budget estimate of R286 billion, government now expects to collect R274 billion. This underperformance began in August 2012, with the outcome in the second half of the year 5.7 per cent lower than in the first half, owing to mining sector disputes and sluggish employment growth.

Figure 3.1 Tax revenue performance and projections, 2005/06 – 2015/16



Source: National Treasury

A new SACU revenue-sharing formula would reduce regional volatility

Transfers under the Southern African Customs Union (SACU) agreement have recovered promptly to their pre-crisis levels. This has led to substantial increases in SACU transfers over the past three years. Government continues to seek agreement from its partners on a new SACU revenue-sharing formula that would reduce the volatility of transfers and contribute more effectively to regional development.

Non-tax revenue included a once-off reimbursement of R3.5 billion in 2011/12 due to the cancellation of the A400M Airbus contract by the Department of Defence. During 2012/13, turbulence in the mining sector led to reduced mineral royalties. Non-tax revenue for 2012/13 is now estimated at R14.5 billion, R616 million lower than the 2012 Budget estimate.

Table 3.2 Consolidated government budget revenue, 2009/10 – 2015/16

R billion	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
		Outcomes		Revised estimate		Medium-term estimates	
Main budget revenue							
Gross tax revenue	598.7	674.2	742.7	810.2	898.0	991.8	1 099.0
Non-tax revenue	8.9	13.5	19.2	14.5	18.3	19.1	20.2
SACU transfers	-27.9	-17.9	-21.8	-42.2	-43.4	-43.0	-48.5
National revenue fund	**579.7**	**669.7**	**740.1**	**782.5**	**873.0**	**967.9**	**1 070.7**
Percentage of GDP	*23.6%*	*24.5%*	*24.9%*	*24.4%*	*24.8%*	*24.9%*	*25.1%*
Net own revenue of:							
Net additions due to consolidation[1]	84.8	87.4	96.8	105.4	112.8	123.2	129.0
Consolidated budget revenue	**664.5**	**757.2**	**836.9**	**887.8**	**985.7**	**1 091.1**	**1 199.8**
Percentage of GDP	*27.1%*	*27.7%*	*28.1%*	*27.7%*	*28.0%*	*28.1%*	*28.1%*

1. Includes revenue earned by social security funds, public entities and provinces net of transfers and transactions between institutions

Table 3.3 Revisions to revenue outcomes and projections, 2011/12 – 2014/15

R billion	2011/12		2012/13		2013/14		2014/15	
	Budget estimate	Outcome	Budget estimate	Revised estimate	2012 Forward estimate	2013 Budget	2012 Forward estimate	2013 Budget
Revenue								
Gross tax revenue	738.7	742.7	826.4	810.2	913.6	898.0	1 019.6	991.8
Non-tax revenue	17.6	19.2	15.1	14.5	17.9	18.3	19.0	19.1
SACU transfers	-21.8	-21.8	-42.2	-42.2	-37.2	-43.4	-41.4	-43.0
Main budget revenue	**734.6**	**740.1**	**799.3**	**782.5**	**894.3**	**873.0**	**997.2**	**967.9**
Percentage of GDP	*24.5%*	*24.9%*	*24.2%*	*24.4%*	*24.7%*	*24.8%*	*24.9%*	*24.9%*
Net additions due to consolidation[1]	95.7	96.8	105.5	105.4	111.6	112.8	121.0	123.2
Consolidated budget revenue	**830.2**	**836.9**	**904.8**	**887.8**	**1 005.9**	**985.7**	**1 118.2**	**1 091.1**
Percentage of GDP	*27.7%*	*28.1%*	*27.4%*	*27.7%*	*27.8%*	*28.0%*	*28.0%*	*28.1%*

1. Includes revenue earned by social security funds, public entities and provinces net of transfers and transactions between institutions

Expenditure

Government has moderated spending over MTEF period, trimmed contingency reserve and reprioritised allocations

The 2012 *Medium Term Budget Policy Statement* reported that government would stay within the overall spending projection set out in the 2012 Budget. In light of subsequent developments, government has taken the additional step of moderating spending growth over the next three years to offset the effects of lower revenue collection on the deficit.

Since the publication of the *Medium Term Budget Policy Statement* in October 2012, government has:

- Trimmed the medium-term spending projections of national departments. Reductions focused on programmes that had forecast high spending growth, but had not met their projections.
- Reduced the contingency reserve, which is the unallocated portion of non-interest expenditure. While the adjusted levels are consistent with the historic needs of unforeseen and unavoidable expenditure, this step also means that there is a limited pool of financing for new policy initiatives over the medium term unless there are significant improvements in revenue collection.
- Reprioritised resource allocation to strengthen service delivery, paying attention to the efficiency of spending. Departments were asked to review their spending, and R52.1 billion has been shifted in support of key priorities.

Table 3.4 Main budget non-interest expenditure, 2010/11 – 2015/16

R billion	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Budget 2010	746.8	799.9	860.3			
Budget 2011	743.4	812.3	877.3	949.0		
Budget 2012		814.6	880.0	953.0	1 030.5	
MTBPS 2012			878.7	953.0	1 030.5	1 119.0
Budget 2013			878.6	955.3	1 029.3	1 107.6

In combination, these revisions bring reductions in government's main budget non-interest expenditure to R10.4 billion over the MTEF period compared with the October 2012 estimate. The main budget spending plans are the core components of expenditure over which government has direct control.

Reduction in main budget non-interest expenditure of R10.4 billion

In 2013/14, main budget non-interest expenditure is expected to be about R2.3 billion higher than set out in the 2012 Budget. This deviation is the result of government's decision to recapitalise the Development Bank of Southern Africa to improve the financing of local government infrastructure. This transaction, however, will not affect the overall borrowing requirement, as it is financed fully through a corresponding disposal of non-core assets.

Consolidated non-interest expenditure is now estimated to grow by 2.3 per cent in real terms on average over the three years, lower than the 2.9 per cent presented in the 2012 *Medium Term Budget Policy Statement* and the 2.6 per cent anticipated at the time of the 2012 Budget.

Expenditure growth over medium term will be lower than forecast in October 2012

The contingency reserve

Government allocates a contingency reserve to fund unforeseeable and unavoidable expenditure not included in the baseline. The reserve is relatively small in the first year of the MTEF, but increases in the outer years owing to a greater degree of uncertainty. In the first year, the contingency reserve is allocated in the adjustment budget six months after the start of the fiscal year (October), and is usually applied to cover the balance of revenue shortfalls or spending overruns.

Contingency reserve, 1998 – 2013 Budgets

R million	1998	2002	2006	2010	2013
Year 1	1 000	3 300	2 500	6 000	4 000
Year 2	3 000	5 000	5 000	12 000	6 500
Year 3	7 000	9 000	8 000	24 000	10 000
Total	**11 000**	**17 300**	**15 500**	**42 000**	**20 500**

Between 2008 and 2012, the three-year contingency reserve averaged R39.7 billion. Unforeseen and unavoidable expenditure adjustments have, however, averaged just R4 billion in the last five years, implying considerable space to reduce the reserve without jeopardising the financing of unexpected contingencies.

Table 3.5 Consolidated government expenditure, 2009/10 – 2015/16

R billion	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
		Outcomes		Revised estimate		Medium-term estimates	
Main budget expenditure							
Main appropriation	436.4	455.6	499.3	542.4	592.7	642.4	695.0
Direct charges	310.8	349.5	389.2	424.6	462.4	495.6	530.7
of which:							
Provincial equitable share	*236.9*	*265.1*	*291.7*	*313.0*	*337.6*	*359.9*	*383.7*
Debt-service cost	*57.1*	*66.2*	*76.5*	*88.3*	*99.7*	*108.7*	*118.2*
Main budget expenditure	**747.2**	**805.1**	**888.5**	**967.0**	**1 055.1**	**1 138.0**	**1 225.7**
Percentage of GDP	*30.5%*	*29.4%*	*29.9%*	*30.1%*	*30.0%*	*29.3%*	*28.7%*
Net additions due to consolidation[1]	76.9	72.4	65.7	88.9	94.3	106.4	108.4
Consolidated expenditure	**824.1**	**877.5**	**954.2**	**1 055.9**	**1 149.4**	**1 244.3**	**1 334.1**
Percentage of GDP	*33.6%*	*32.1%*	*32.1%*	*32.9%*	*32.6%*	*32.1%*	*31.2%*

1. Includes expenditure incurred by social security funds, public entities and provinces not financed from the main budget, net of transfers and transactions between institutions

Revisions to estimates of expenditure are relatively small, with the outcome for 2012/13 anticipated at R2 billion below the forward estimate of the 2012 Budget.

Table 3.6 Revised estimates of consolidated government expenditure, 2012/13 – 2014/15

	2012/13		2013/14		2014/15	
R billion	Budget estimate[1]	Revised estimate	2012 Forward estimate[1]	2013 Budget	2012 Forward estimate[1]	2013 Budget
Expenditure						
Current payments	640.4	637.1	690.3	688.8	736.4	740.5
of which:						
Compensation of employees	*371.1*	*376.6*	*394.4*	*406.2*	*417.9*	*431.7*
Debt-service costs	*89.4*	*88.3*	*100.8*	*99.7*	*109.0*	*108.7*
Transfers and subsidies	340.0	346.2	371.7	375.6	398.5	406.0
Payments for capital assets	70.9	71.2	77.1	78.0	83.1	88.0
Payments for financial assets	1.6	1.5	0.5	2.9	0.7	3.3
Contingency reserve	5.8	–	11.9	4.0	24.0	6.5
Total	**1 058.7**	**1 055.9**	**1 151.6**	**1 149.4**	**1 242.8**	**1 244.3**
Percentage of GDP	*32.1%*	*32.9%*	*31.8%*	*32.6%*	*31.1%*	*32.1%*

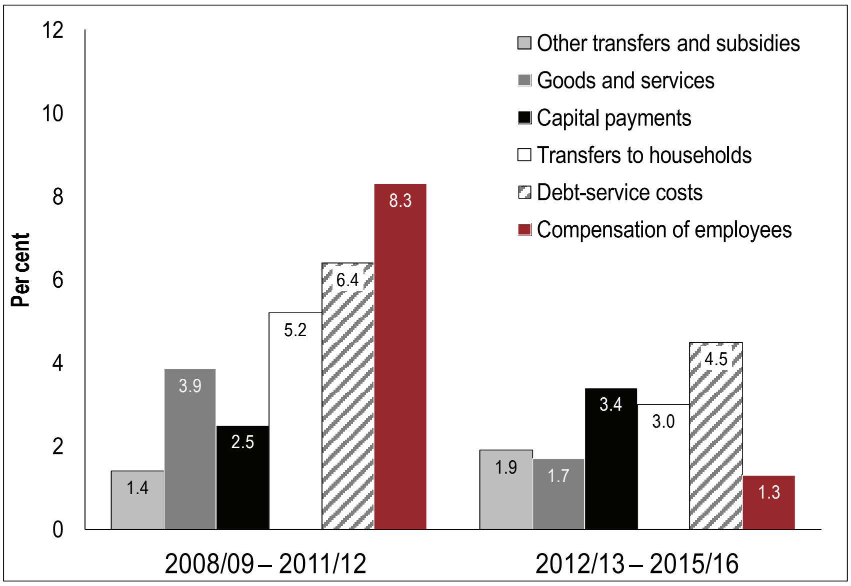
1. Adjusted for accounting policy changes and additional netting of inter-entity transactions

Expenditure by economic classification

A greater share of public funds must become available for capital investment over time

Government is committed to ensuring that a greater share of public funds becomes available for capital investment over time. Over the medium term, government will moderate growth in employee compensation, progressively reduce capital underspending, accelerate rollout of infrastructure, and eliminate waste in goods and services budgets.

Figure 3.2 Real growth in expenditure by economic classification, outcomes for 2008/09 – 2011/12 and projections for 2012/13 – 2015/16



Source: National Treasury

Interest payments are fastest-growing expenditure item over MTEF, followed by real capital expenditure

Interest payments for debt are projected to be the fastest-growing expenditure item over the next three years, followed by real capital expenditure, which is forecast to grow by an annual average of 3.4 per cent over the MTEF period.

Employee compensation as percentage of spending declines over medium term

Spending on compensation of employees is far slower than in previous years, growing at an annual average of 1.3 per cent in real terms over the MTEF period. As a result, government's wage bill declines as a share of total spending. The multi-year wage settlement reached in 2012 provides greater certainty against unanticipated wage increases that have to be financed by the fiscus. Government will continue to monitor growth in state employment, which has been a major contributor to the increasing wage bill over the past five years, to ensure that budget objectives are met.

Table 3.7 Composition of spending by economic classification, 2011/12 and 2015/16

Share of allocated spending	2011/12 Outcome	2015/16 Projection
Compensation of employees	36.2%	34.5%
Goods and services	16.1%	15.3%
Interest and rent on land	8.8%	9.5%
Transfers and subsidies	32.2%	32.8%
of which:		
Households	*15.5%*	*15.8%*
Departmental agencies, provinces and municipalities	*9.7%*	*9.8%*
Public corporations and private enterprises	*2.2%*	*2.5%*
Higher education institutions	*2.1%*	*2.0%*
Payments for capital assets	6.5%	6.9%

Fiscal sustainability

Composition of the deficit

The main budget deficit, which determines the level of state borrowing, deteriorated in 2012/13. From an estimated R170 billion at the time of the 2012 Budget, the gap between spending and revenue on the main budget is now projected as R184.5 billion. This wider borrowing requirement will carry through over the MTEF period.

Table 3.8 Consolidated deficit, 2009/10 – 2015/16

R billion	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Main budget balance	-167.5	-135.4	-148.4	-184.5	-182.1	-170.1	-155.0
Social security funds	10.6	10.8	15.1	15.6	14.2	12.4	13.2
Public entities	-2.5	-0.5	9.7	0.3	-0.8	-2.5	-2.1
Provinces	-0.2	4.7	6.3	0.6	5.0	6.9	9.5
Consolidated budget balance	**-159.6**	**-120.4**	**-117.3**	**-168.0**	**-163.7**	**-153.2**	**-134.4**

The main budget deficit is offset by surpluses expected on the accounts of provincial governments and social security funds. Provinces have been asked to budget for surpluses, in part to compensate for previous unauthorised expenditure. Spending of social security funds is projected to be lower owing to weaknesses in processing claims in the Road Accident Fund and compensation funds. Delayed rollout of decentralisation and lower actuarial projections of benefit payments by the Unemployment Insurance Fund and compensation funds over the medium term are contributing factors. Borrowing by public entities for capital investment widens the consolidated deficit.

The result of these dynamics is that the consolidated deficit is considerably lower than the main budget deficit. Risks that may affect this outcome include moderating social security fund surpluses as operational weaknesses are addressed, and rising spending pressures that reduce provincial surpluses. The National Treasury will monitor these developments closely.

Current balance shows how much government borrows to run its operations

The sustainability of the deficit and the question of intergenerational fairness are reflected in the current balance, which shows how much government borrows to run its operations. A long-term operating deficit is unsustainable, while a positive operating balance allows for investment in future productive capacity. The current deficit of 3 per cent of GDP in 2012/13 will narrow over the MTEF period. Lower borrowing for current spending, alongside sustained spending on capital investment, will improve the composition of the deficit.

Table 3.9 Current and capital balances, 2010/11 – 2015/16

R billion	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
	Outcome		Estimate	Medium-term estimates		
Current receipts	755.0	831.1	886.5	984.5	1 089.9	1 198.5
Current payments	800.3	890.4	983.2	1 064.4	1 146.6	1 228.7
Current balance	**-45.3**	**-59.3**	**-96.8**	**-79.9**	**-56.7**	**-30.2**
Percentage of GDP	*-1.7%*	*-2.0%*	*-3.0%*	*-2.3%*	*-1.5%*	*-0.7%*
Capital financing requirement	**-55.4**	**-62.2**	**-71.0**	**-77.9**	**-87.9**	**-92.3**
Percentage of GDP	*-2.0%*	*-2.1%*	*-2.2%*	*-2.2%*	*-2.3%*	*-2.2%*

Public-sector borrowing requirement

The public-sector borrowing requirement covers consolidated government, local government and non-financial public institutions, but excludes the development finance institutions.

This category of borrowing represents the funds needed by the entire non-financial public sector to cover any deficit in financing its activities. The borrowing requirement is forecast to widen to 7.4 per cent of GDP in 2012/13, up from the 7.1 per cent of GDP projected a year ago, largely as a result of the wider budget deficit.

Table 3.10 Public-sector borrowing requirement,[1] 2009/10 – 2015/16

R billion / percentage of GDP	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
		Outcome		Revised estimate	Medium-term estimates		
Consolidated government[2]	**153.8**	**118.2**	**113.5**	**159.8**	**159.6**	**150.3**	**131.3**
	6.3%	*4.3%*	*3.8%*	*5.0%*	*4.5%*	*3.9%*	*3.1%*
Local authorities	**10.5**	**8.9**	**6.2**	**9.6**	**8.3**	**9.3**	**9.8**
	0.4%	*0.3%*	*0.2%*	*0.3%*	*0.2%*	*0.2%*	*0.2%*
State-owned companies[3]	**76.3**	**44.4**	**42.5**	**68.5**	**57.9**	**43.6**	**46.0**
	3.1%	*1.6%*	*1.4%*	*2.1%*	*1.6%*	*1.1%*	*1.1%*
Borrowing requirement	**240.7**	**171.5**	**162.2**	**238.0**	**225.8**	**203.3**	**187.0**
	9.8%	*6.3%*	*5.5%*	*7.4%*	*6.4%*	*5.2%*	*4.4%*

1. A negative number reflects a surplus and a positive number a deficit
2. Net borrowing requirement including extraordinary receipts and payments
3. South African National Roads Agency Limited and Trans-Caledon Tunnel Authority are included in consolidated government net borrowing

Borrowing by state-owned companies is projected to decline from 2.1 per cent of GDP in 2012/13 to 1.1 per cent of GDP by 2015/16. Eskom and Transnet remain the largest contributors to the borrowing requirement. The financing of their capital infrastructure programmes will be supported by higher cash flows, limiting the need for increased debt-issuance.

Borrowing requirement of state-owned companies declines to 1.1 per cent of GDP in outer year

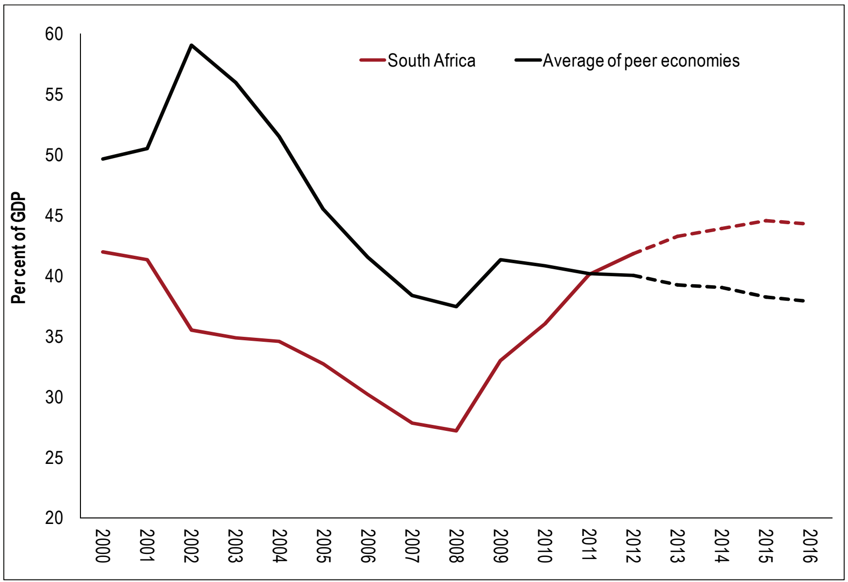
Compared to the 2012 Budget, municipal debt issuance has been revised upwards. Local government borrowing is projected to stabilise as a percentage of GDP over the three-year framework. Several metropolitan municipalities are nearing their prudential debt limits, reducing their ability to increase borrowing at low rates on the open market. Municipalities are increasingly substituting borrowing for grant financing from the main budget to fund capital expenditure, as weaknesses in revenue collection persist. Government is providing R7.9 billion to recapitalise the Development Bank of Southern Africa over the MTEF period to support the financing of municipal infrastructure.

Debt sustainability

During the mid-2000s, South Africa built up ample fiscal space that enabled a robust countercyclical response to the 2009 recession. Since then, substantial deficits and the slow economic recovery have eroded South Africa's debt position relative to its peers, as shown in Figure 3.3.

Fiscal framework is adjusted to stabilise debt over medium term

Figure 3.3 South Africa's gross debt-to-GDP ratio compared with peer economies,[1] 2000 – 2016



1. Average of Argentina, Brazil, Bulgaria, Chile, Colombia, India, Indonesia, Kenya, Latvia, Lithuania, Malaysia, Mexico, Morocco, Peru, Poland, Russia, Thailand, Turkey and Uruguay
Source: International Monetary Fund, National Treasury; South African data is for fiscal years

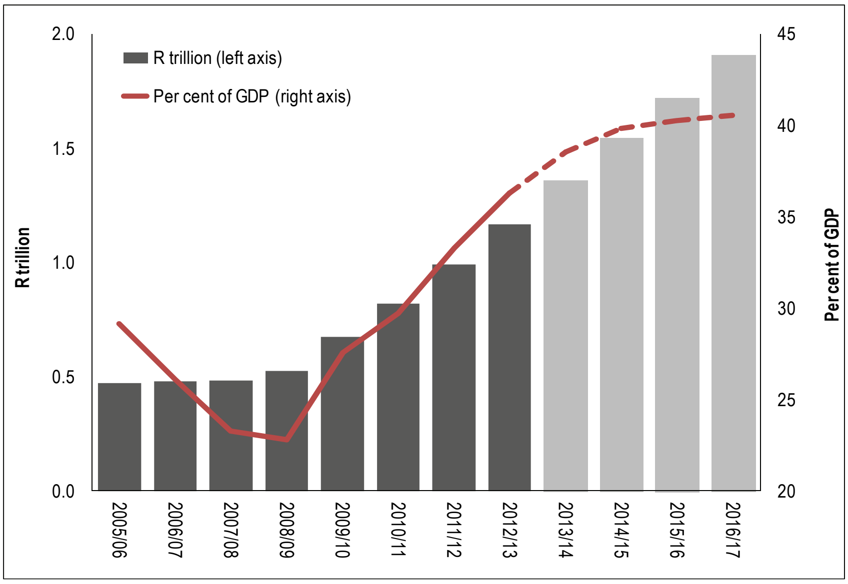
The fiscal framework accommodates the wider deficit position this year but is adjusted to stabilise the debt over the medium term.

The principal factor influencing the debt trajectory is the primary balance on the main budget – the gap between revenue and non-interest expenditure that government must finance. The 2013 fiscal framework narrows the primary deficit on the main budget from 3 per cent of GDP in

Primary balance narrows to 0.9 per cent of GDP in outer year

2012/13 to 0.9 per cent of GDP in 2015/16, ensuring that debt stabilises as a share of GDP in the outer year. The level at which debt stabilises, however, is marginally above the October 2012 estimate of 40 per cent, owing to downward revisions to nominal GDP, a weaker growth outlook and the higher deficit in the current year.

Figure 3.4 Net government debt, 2005/06 – 2016/17



Source: National Treasury

Beyond the medium term, debt sustainability requires government to close the gap between long-term trend revenue and structural non-interest spending. The 2013 fiscal framework also achieves this objective, as discussed in the box below.

Long-term fiscal sustainability

Long-term fiscal report projects expenditure trends over 15-25 years based on demographic trends and economic scenarios

Beyond the medium term, as the economy strengthens, government will consolidate the fiscal position by maintaining a rate of expenditure growth commensurate with increasing economic potential, and reducing the ratio of debt to GDP.

The National Treasury has prepared a long-term fiscal report. The report projects expenditure trends over the next 15-25 years based on demographic trends and economic scenarios that model the main components of social spending, including social grants, health and education expenditure. The report contrasts a “no policy change” trajectory with the likely impact of new policies on expenditure, and draws on proposals contained in the National Development Plan.

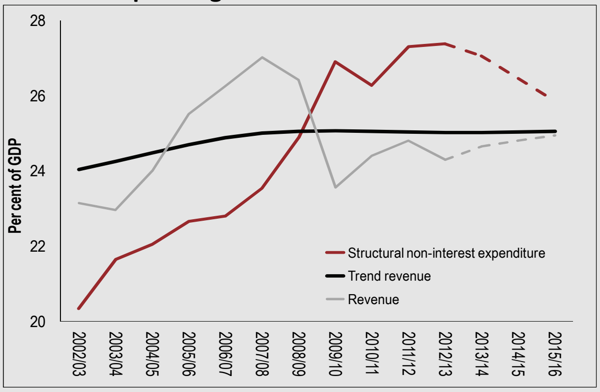
Long-term projections are inherently uncertain and depend heavily on the underlying assumptions. Noting this caveat, the study concludes that the current fiscal policy and spending mix is sustainable, but would remain vulnerable unless government builds fiscal space beyond the medium term. It also shows that structural increases in spending require concomitant revenue increases if they are to be financed sustainably.

Structural revenue and expenditure

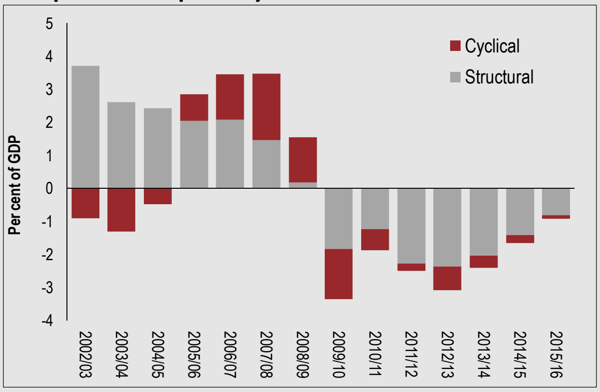
The business cycle has a significant short-term impact on the fiscus. During a boom, tax revenue overperforms. The resulting improvement in the budget balance is temporary, and an economy seems "richer" than it really is. In poor economic conditions, part of the deficit is explained by a temporary shortfall from ordinary levels of revenue. Distinguishing between temporary, cyclical effects and enduring structural factors helps provide a truer picture of government's fiscal position. This is reflected in the structural budget balance.

During the 2000s, non-interest expenditure grew sharply as a percentage of GDP. The figure at the left shows that since 2008, spending has been sustained well above long-term trend revenue. However, the deficit is also explained by revenue shortfalls that result from economic weakness. The widening of the deficit in 2012/13 is largely the result of such a temporary weakening. As revenue recovers, however, a structural deficit will remain, pointing to the need to slow expenditure growth over the medium term.

Structural spending and revenue as share of GDP



Composition of primary balance



Source: National Treasury

Government spending does not vary automatically with the business cycle, but revenue fluctuates strongly with economic conditions. The figure at the right shows the primary balance on the main budget, broken down into its cyclical and structural components. The cyclical component is the gap between actual revenue and its long-term trend, which can be seen in the figure at the left. The structural deficit is the gap between non-interest spending and trend revenue.

Trend revenue is calculated by applying a statistical filter to main budget revenue as a share of GDP. Structural non-interest expenditure is also calculated on the main budget and excludes once-off payments and transactions in financial assets and liabilities, such as large loans to Eskom between 2008/09 and 2010/11.

In the baseline scenario, in which the economy grows at 3.5 per cent per year, and policy is unchanged, projections suggest that:

- The pressure that social grants place on the fiscus will begin to decline over the next decade.
- Government spending on health will continue to rise as a share of GDP in coming decades, even without reforms. Implementing national health insurance will increase public health expenditure.
- As the school-age population begins to decline, resource pressures on the basic education sector will ease. This highlights the need to improve the quality of inputs and ensure better learning outcomes.

Without faster economic growth, South Africa's finances will remain vulnerable to external shocks for years to come

As the National Development Plan points out, if the economy grows by more than 5 per cent a year, government revenue will double in the next 20 years. This will make major new policy initiatives such as national health insurance or expanded vocational education affordable with relatively limited adjustments to tax policy. If growth continues on the existing trajectory, however, significant adjustments in revenue and/or reductions in other areas of spending would be required to sustainably meet those commitments.

Conclusion

Budget reduces real growth in expenditure, while maintaining strong growth in capital investment

With economic growth weaker than anticipated and revenue collections below projection, the fiscal environment is more constrained than before. In response, the 2013 Budget reduces real growth in medium-term expenditure, while maintaining strong growth in capital investment.

Given limited fiscal space, new policy initiatives will have to be financed through savings and improved spending quality. Expenditure reviews over the year ahead will help to improve value for money in public spending, complementing a comprehensive review of tax policy.