3

Fiscal policy

In brief

- Fiscal policy ensures the health of the public finances by applying the principles of countercyclicality, debt sustainability and intergenerational fairness.
- Over the next three years, government will continue to finance real increases in spending that enhance the social wage, within an explicit expenditure ceiling.
- The consolidated budget deficit is expected to narrow from 4.0 per cent of GDP in 2013/14 to 2.8 per cent in the outer year, supporting a stabilisation of debt at 44.3 per cent of GDP.
- The composition of expenditure improves moderately over the medium term, with capital spending emerging as the fastest-growing area of non-interest spending.

Overview

Spending will remain well contained over the medium term

South Africa's fiscal framework is grounded in a sustainable, countercyclical approach to managing revenue and expenditure. Over the medium term, government will balance continued support for economic recovery with fiscal consolidation. Key social and economic programmes will be maintained, complemented by efforts to improve value for money. Spending will be well contained over the medium-term expenditure framework (MTEF) period.

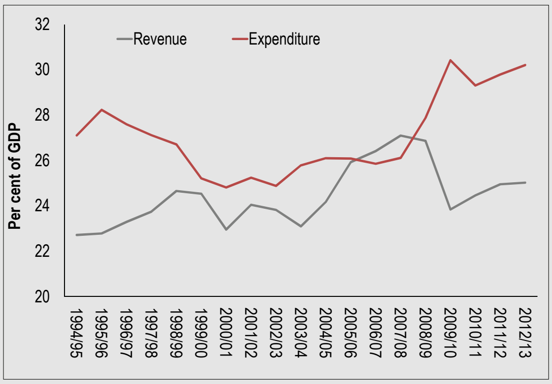
Despite slower-than-expected GDP growth, the budget deficit is expected to narrow to 4.0 per cent in 2013/14 from 4.3 per cent in 2012/13. The reduction of the deficit is the combined result of government's expenditure ceiling, strong revenue collection and underspending by national departments, provinces and public entities. As economic growth improves and spending limits stay in place, the budget deficit is projected to narrow to 2.8 per cent of GDP by 2016/17.

Improving the health of public finances over 20 years of democracy

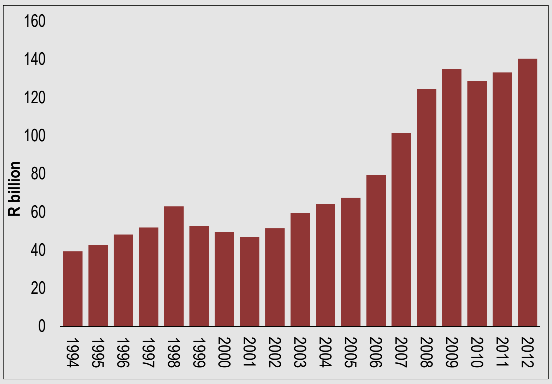
Since 1994, fiscal policy has helped stabilise and grow the economy.

The first democratic government was faced with strained fiscal accounts and a weak domestic economy. Gross national debt approached 50 per cent of GDP in 1995, while the deficit remained elevated at about 5 per cent of GDP. Real public investment had fallen to its lowest level in 30 years. To address these issues, government reduced expenditure growth and began to expand the tax base. The period from 1994 to 2000 represented a consolidation phase, as shown in the figure on the left. The resulting fall in debt and debt-service costs created the fiscal room for government to support growth and focus on its social mandate.

Main budget revenue and expenditure, 1994/95 – 2012/13



Real public-sector capital investment, 1994 – 2012



Source: National Treasury and Reserve Bank

During the 2000s, fiscal policy was adjusted to increase public spending. As shown in the figure on the right, real public-sector capital investment grew sharply, helping to increase the economy's long-term capacity. Robust economic growth and efforts to expand the tax base produced consistent revenue overruns. This improved the fiscal position, resulting in two successive years of budget surpluses in 2006/07 and 2007/08. Since the recession, government has used the fiscal space grown during the 2000s to support the economy, balancing the needs of growth and debt stabilisation.

A three-year budget framework was introduced in 1997/98. It allows government to express its medium-term policy objectives, and links budgeting choices more closely to the economic outlook. Through the MTEF, government releases extensive budget information to Parliament and the public. As a result of this commitment to budget transparency, South Africa has consistently ranked at or near the top of the Open Budget Index Survey since its inception in 2006.

Main budget fiscal indicators, 1994/95 – 2013/14

Percentage of GDP	1994/95	2000/01	2009/10	2013/14
National revenue	22.7	23.0	23.9	25.6
National non-interest expenditure	22.4	20.0	28.1	27.4
Debt-service costs	4.7	4.9	2.3	2.9
Budget balance	-4.4	-1.9	-6.6	-4.7
National debt	47.0	41.7	27.4	39.7

Source: Reserve Bank and National Treasury

Fiscal outlook

Rising global interest rates, rand depreciation and weaker commodity prices have significant fiscal implications

South Africa faces a challenging fiscal outlook in the years ahead. When the recession began in 2009, government was able to use the fiscal space built in preceding years to support the economy. Low international interest rates made it relatively cheap for government to finance its borrowing requirement. Moderate domestic inflation limited cost pressures on public-sector budgets and rising commodity prices supported government revenues.

Over the period ahead, South Africa confronts a new set of circumstances. While economic growth remains below potential, fiscal space has been eroded by rising debt. The changed environment has significant implications for the fiscus:

Projected debt-service costs for 2014/15 are R5 billion higher than estimated in October 2013

- Rising global interest rates have pushed up the cost of servicing government debt. Projected debt-service costs for 2014/15 are R5 billion higher than estimated in October 2013.
- The terms of trade deteriorated and are unlikely to improve over the medium term. A weaker outlook for commodity prices has contributed to a downward revision of estimated tax revenue in 2015/16.
- Rand depreciation has led to rising cost pressures. Compensation budgets, which are linked to inflation in the public-sector wage agreement, have been revised upwards.

In managing these pressures, the fiscal stance takes into consideration the principles of countercyclicality, debt sustainability and intergenerational fairness. In line with the October 2013 *Medium Term Budget Policy Statement*, government is committed to:

Fiscal policy based on countercyclicality, debt sustainability and intergenerational fairness

- Maintaining an explicit nominal expenditure ceiling, while preserving the value of the social wage.
- Reducing the budget deficit to stabilise debt.
- Improving the quality of spending and reducing waste.

Table 3.1 Consolidated fiscal framework, 2010/11 – 2016/17

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
R billion/percentage of GDP		**Outcome**		**Estimate**		**Medium-term estimates**	
Revenue	**762.9**	**842.3**	**909.3**	**1 010.5**	**1 099.2**	**1 201.3**	**1 324.7**
	27.7%	*28.2%*	*28.4%*	*29.2%*	*29.0%*	*28.9%*	*29.1%*
Non-interest expenditure	804.6	871.3	951.7	1 041.6	1 131.1	1 218.1	1 306.5
	29.6%	*29.4%*	*29.9%*	*30.2%*	*30.0%*	*29.5%*	*28.8%*
Interest payments	75.3	81.7	93.5	107.7	121.2	133.5	145.1
	2.7%	*2.7%*	*2.9%*	*3.1%*	*3.2%*	*3.2%*	*3.2%*
Expenditure	**879.9**	**953.1**	**1 045.2**	**1 149.3**	**1 252.3**	**1 351.6**	**1 451.6**
	32.0%	*32.0%*	*32.7%*	*33.2%*	*33.0%*	*32.6%*	*31.9%*
Budget balance	**-117.1**	**-110.8**	**-135.9**	**-138.8**	**-153.1**	**-150.3**	**-126.9**
	-4.3%	*-3.7%*	*-4.3%*	*-4.0%*	*-4.0%*	*-3.6%*	*-2.8%*

Maintaining the expenditure ceiling

Over the past decade, government spending has doubled in real terms, funding a large expansion of the social wage and capital investment. Government is committed to maintaining the value of core social expenditure programmes while increasing public investment in infrastructure within a sustainable framework.

Maintaining the social wage and increasing capital investment in a sustainable manner

The expenditure ceiling introduced in 2012 targets a nominal limit on main budget non-interest expenditure – the core spending over which government has direct legislative authority. The ceiling commits government to spending limits of R1.03 trillion in 2014/15, R1.11 trillion in 2015/16 and R1.18 trillion in 2016/17. Excluding interest payments, real spending grows at an annual average of 1.8 per cent over the MTEF period.

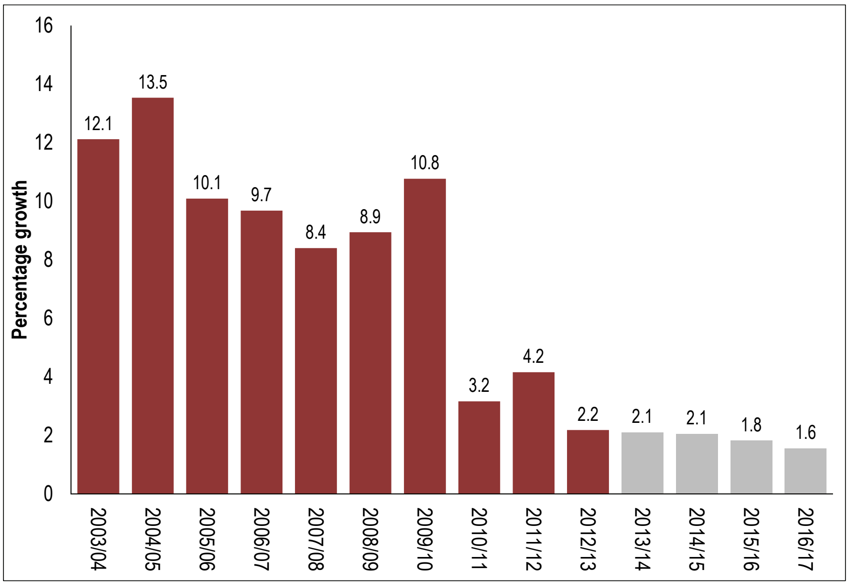
Table 3.2 Main budget non-interest expenditure, 2010/11 – 2016/17

R million	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
2012 Budget Review	738 914	814 554	879 977	953 024	1 030 539	–	–
2012 MTBPS	–	811 586	878 669	953 024	1 030 539	1 118 991	–
2013 Budget Review	–	–	878 642	955 333	1 029 262	1 107 564	–
2013 MTBPS	–	–	–	949 109	1 027 762	1 106 064	1 185 110
2014 Budget Review	–	–	–	947 853	1 027 662	1 105 943	1 184 424

Results of adopting spending limits are already evident in budget outcomes

The results of adopting spending limits are already evident in budget outcomes. Expenditure growth has been substantially reduced. Higher-than-expected growth in some areas of spending – mainly compensation – has been funded through reprioritisation. During the mid-2000s, government added to previously announced expenditure baselines in each MTEF period. Typically, expenditure in the outer year of each period was 15 per cent higher than initial estimates. Since the introduction of the ceiling, expenditure outcomes have been at or below initial estimates.

Figure 3.1 Real main budget non-interest expenditure growth, 2003/04 – 2016/17



Source: National Treasury

Nominal expenditure ceiling implies difficult trade-offs in an inflationary environment

The nominal expenditure ceiling implies difficult trade-offs in an inflationary environment. If inflation exceeds current forecasts, the purchasing power of budgeted allocations will decline, while compensation budgets will automatically increase in terms of the current public-sector wage agreement. A faster economic recovery, however, would ease fiscal pressures and allow government to direct a greater share of resources towards service delivery.

Reducing the budget deficit

Countercyclical response to downturn resulted in large budget deficit

Between 2007 and 2009, the budget balance declined from a surplus of 1.7 per cent of GDP to a deficit of 6.3 per cent of GDP. As a result, South Africa's debt-to-GDP ratio rose sharply.

In subsequent years, the deficit has remained persistently elevated, as revenue and growth forecasts were repeatedly revised downwards. Government has responded by limiting expenditure growth, trimming departmental budgets and reducing the contingency reserve.

Budget deficit to narrow from 4.0 per cent of GDP in current year to 2.8 per cent of GDP by 2016/17

As the economy begins to grow more rapidly and expenditure restraint is maintained, the deficit is projected to narrow from 4.0 per cent in the current year to 2.8 per cent of GDP by 2016/17. As a result, net debt is projected to stabilise at 44.3 per cent of GDP in 2016/17.

Improving the composition and efficiency of spending

Composition of expenditure improves moderately over medium term

Slower wage bill growth and robust expansion of capital budgets will result in a moderate improvement in the composition of spending by 2016/17. The 2014 Budget also maintains tight control of goods and services budgets, which decline in real terms over the three-year spending period. Budget allocations have been revised to ensure that goods and services required for core areas of service delivery, such as educational materials and medical supplies, are protected. Expenditure on travel, catering, consultants and other administrative payments declines as a share of spending.

Table 3.3 Selected items of goods and services: national and provinces, 2010/11 – 2016/17

	2010/11	2013/14 Estimate	2016/17	Average annual real growth	
Share of total goods and services				**2010/11 – 2013/14**	**2013/14 – 2016/17**
Travel and subsistence	7.3%	6.3%	6.0%	-0.9%	-2.9%
Catering, entertainment and venue rental	1.4%	1.5%	1.3%	6.1%	-5.7%
Consultants	10.4%	9.6%	8.5%	1.2%	-5.5%
Stationery and printing	2.4%	2.2%	2.0%	1.5%	-4.8%
Administrative and operational payments	14.3%	14.4%	14.0%	4.2%	-2.4%
Medicine and medical supplies	11.9%	11.3%	12.9%	2.2%	3.1%
Learner and teacher support material	2.5%	2.7%	3.3%	7.6%	5.2%
Fuel, oil and gas (police vehicles)	2.7%	2.3%	2.8%	-0.7%	4.2%
Total goods and services				**4.0%**	**-1.5%**

The National Treasury has taken several complementary steps to support spending efficiency.

- Cost-containment measures announced by the Minister of Finance in October 2013 limit expenditure on conferences, travel, entertainment and other non-essential items. The measures were issued through a National Treasury instruction in January 2014. Departments will be audited on these measures in the preparation of annual financial statements.
- The National Treasury, in partnership with the Department of Performance Monitoring and Evaluation, has launched a series of expenditure reviews. The reviews aim to provide greater understanding of performance and identify ways to improve value for money in housing, education and industrial policy. Initial findings will be released during 2014/15.

- The National Treasury and its provincial counterparts are working together to identify inefficiencies and improve targeting of provincial expenditure. Initial findings are summarised in Chapter 7.
- The Chief Procurement Officer is building a national system for the purchase of high-value goods and services commonly used across government. Reforms will simplify procurement procedures, strengthen accountability and improve government's ability to detect corruption and maladministration.
- Forthcoming regulations will strengthen the National Treasury's oversight of public entities by requiring them to comply with stringent reporting requirements for expenditure, revenue and performance.

Fiscal framework

2013/14 budget deficit is estimated at 4.0 per cent of GDP, compared with 4.2 per cent projected in October 2013

The consolidated fiscal framework is summarised in Table 3.4. The 2013/14 budget deficit is estimated at 4.0 per cent of GDP, lower than the 4.2 per cent of GDP projected in the October 2013 *Medium Term Budget Policy Statement.* The narrower deficit is the result of stronger revenue growth and underspending by national departments, provinces and public entities. As economic growth and revenue collections gather pace over the three-year period, the deficit is projected to narrow to 2.8 per cent of GDP.

Table 3.4 Consolidated operating and capital accounts, 2010/11 – 2016/17

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
R billion		**Outcome**		**Estimate**		**Medium-term estimates**	
Operating account							
Current revenue	**762.5**	**842.0**	**908.9**	**1 010.3**	**1 099.1**	**1 201.1**	**1 324.5**
Current payments	**756.4**	**838.7**	**920.7**	**1 011.1**	**1 093.8**	**1 176.5**	**1 254.2**
Compensation	309.9	346.0	375.0	411.3	439.4	468.7	498.9
Goods and services	137.7	153.5	167.9	180.0	189.7	199.6	211.4
Interest payments	75.3	81.7	93.5	107.7	121.2	133.5	145.1
Current transfers and subsidies	233.5	257.5	284.4	312.2	343.5	374.7	398.7
Current balance	**6.1**	**3.3**	**-11.8**	**-0.9**	**5.3**	**24.7**	**70.4**
Percentage of GDP	*0.2%*	*0.1%*	*-0.4%*	*-0.0%*	*0.1%*	*0.6%*	*1.5%*
Capital account							
Capital receipts	0.4	0.2	0.3	0.2	0.2	0.2	0.2
Capital payments	56.0	62.8	67.1	78.4	91.3	98.9	105.9
Capital transfers	45.2	48.5	52.4	55.9	60.6	66.9	73.2
Capital financing requirement[1]	**-100.8**	**-111.1**	**-119.2**	**-134.0**	**-151.7**	**-165.6**	**-179.0**
Percentage of GDP	*-3.7%*	*-3.7%*	*-3.7%*	*-3.9%*	*-4.0%*	*-4.0%*	*-3.9%*
Financial transactions[2]	22.4	3.0	4.9	3.9	3.6	3.3	0.3
Contingency reserve	–	–	–	–	3.0	6.0	18.0
Budget balance	**-117.1**	**-110.8**	**-135.9**	**-138.8**	**-153.1**	**-150.3**	**-126.9**
Percentage of GDP	*-4.3%*	*-3.7%*	*-4.3%*	*-4.0%*	*-4.0%*	*-3.6%*	*-2.8%*

1. Includes payments for capital assets, receipts from the sale of capital assets and capital transfers
2. Transactions in financial assets and liabilities

Consolidated current revenue for 2013/14 has been revised upwards by R11.4 billion since October 2013. While the economy has grown more slowly than projected in the 2013 Budget, tax revenue has performed well. The depreciation of the rand has boosted profits in some sectors, leading to buoyant corporate income tax receipts. Above-inflation wage settlements have sustained personal income tax and strong imports have boosted customs revenue. National Revenue Fund receipts (previously classified as extraordinary receipts) have also been revised upwards due to the effect of rand depreciation on dollar-denominated cash reserves.

Factors driving revenue buoyancy are not expected to persist

The factors driving revenue buoyancy in 2013/14 are not expected to persist, with revenue growth tracking GDP more closely over the medium term. Tax revenue estimates for 2015/16 have been revised downwards since the last budget and consolidated revenue remains flat at 29 per cent of GDP.

Compensation accounts for 39.5 per cent of consolidated non-interest spending in 2013/14, down marginally from a high of 39.7 per cent in 2011/12. At national and provincial level, compensation budgets have increased by about R2 billion in each year of the framework to accommodate higher inflation forecasts. The wage bill grows by an average of 6.4 per cent over the next three years.

Transfers and subsidies, which account for 29.9 per cent of consolidated non-interest spending, are forecast to grow at an annual average of 8.3 per cent over the MTEF period. Transfers to households – primarily social grants – account for most of this spending, averaging 9.8 per cent annual growth. The re-registration of social grant recipients has resulted in substantial savings on this item in 2013/14. Goods and services average 5.5 per cent growth.

Current balance improves over MTEF period, meaning government can finance capital expenditure from its own resources

The current balance shows the gap between revenue and operational spending. A long-term current deficit is inadvisable, while a positive current balance enables government to finance capital expenditure from its own resources without drawing on private savings. Government is budgeting for a rising current surplus over the MTEF period. In the outer year of the fiscal framework, it grows to 1.5 per cent of GDP, financing about 40 per cent of government's capital borrowing needs.

Capital spending is the fastest-growing component of non-interest expenditure over the three-year period, followed closely by capital transfers. Capital payments grow by a real annual average of 4.5 per cent over the medium term, driven by expenditure on education, transport and water infrastructure. Capital transfers increase by 3.4 per cent per year, mainly to finance urban settlements and public transport through grants to provincial and local government. The capital borrowing requirement will remain at about 4 per cent of GDP over the next three years.

Elements of the consolidated budget

The consolidated fiscal framework comprises the main budget, as well as spending by provinces, social security funds and public entities financed from their own revenue. (For more information, see the inside front cover of the *Budget Review* and Annexure B.)

Main budget framework

The main budget framework summarises spending financed from the National Revenue Fund. Gross tax revenue paid into the fund is projected to increase from R899 billion in the current year to R1.21 trillion in 2016/17.

Transfers to South Africa's SACU partners expected to be R43.4 billion in 2013/14

In terms of the Southern African Customs Union (SACU) agreement, customs and excise duties are shared between South Africa, Botswana, Lesotho, Namibia and Swaziland. Transfers out of the National Revenue Fund to South Africa's SACU partners increase from R43.4 billion in 2013/14 to R59.7 billion in 2016/17, reflecting higher customs revenue during the economic recovery. The decline in main budget revenue as a share of GDP in 2014/15 relative to 2013/14 is partly attributable to SACU transfers.

Table 3.5 Main budget framework, 2010/11 – 2016/17

R billion/percentage of GDP	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
		Outcome		Revised estimate		Medium-term estimates	
Revenue							
Gross tax revenue after proposals	674.2	742.7	813.8	899.0	993.7	1 095.1	1 208.7
Non-tax revenue	13.5	19.2	16.2	18.8	18.0	18.7	20.2
SACU[1]	-17.9	-21.8	-42.2	-43.4	-51.7	-57.3	-59.7
National Revenue Fund receipts[2]	3.0	5.2	11.9	11.8	2.9	1.6	3.4
Main budget revenue	**672.8**	**745.3**	**799.8**	**886.2**	**962.8**	**1 058.1**	**1 172.6**
	24.5%	*25.0%*	*25.0%*	*25.6%*	*25.4%*	*25.5%*	*25.8%*
Expenditure							
National departments	356.0	382.7	412.7	449.3	489.4	522.3	553.0
Provinces	322.8	362.5	388.2	414.9	444.4	477.6	508.3
Local government	60.9	68.3	76.4	83.7	90.8	100.0	105.2
Non-interest allocations	**739.8**	**813.5**	**877.4**	**947.9**	**1 024.7**	**1 099.9**	**1 166.4**
Debt-service costs	66.2	76.5	88.1	101.3	114.9	126.6	139.2
Contingency reserve	–	–	–	–	3.0	6.0	18.0
Main budget expenditure	**806.0**	**889.9**	**965.5**	**1 049.1**	**1 142.6**	**1 232.6**	**1 323.6**
	29.3%	*29.8%*	*30.2%*	*30.3%*	*30.1%*	*29.7%*	*29.1%*
Main budget balance	**-133.2**	**-144.6**	**-165.7**	**-162.9**	**-179.8**	**-174.5**	**-151.0**
	-4.8%	*-4.9%*	*-5.2%*	*-4.7%*	*-4.7%*	*-4.2%*	*-3.3%*
Primary balance	*-2.4%*	*-2.3%*	*-2.4%*	*-1.8%*	*-1.7%*	*-1.2%*	*-0.3%*

1. SACU payments and other adjustments
2. Previously classified as extraordinary payments

The Constitution requires that nationally raised resources be shared between national, provincial and local government. Local government's share of the division of revenue continues to grow more quickly than the provincial and national shares. This reflects increases in the local equitable share, largely to finance free basic water and electricity at municipal level. Conditional grants to provincial and local government have been revised downwards because spending capacity has not kept pace with budget allocations, leading to underspending, particularly on capital grants. The division of revenue is discussed in more detail in Chapter 7.

The fastest-growing item of main budget expenditure is debt-service costs. Projected debt-service costs for 2014/15 have increased by R5 billion since the October 2013 *Medium Term Budget Policy Statement*. This reflects exchange rate depreciation, higher inflation and the increase in the Reserve Bank's repurchase rate from 5.0 per cent to 5.5 per cent in January 2013. By 2016/17, R139.2 billion will be required for debt-service costs, accounting for more than 3 per cent of GDP.

Fastest-growing item of main budget expenditure is debt-service costs

Main budget spending will decline as a share of GDP from 30.3 per cent in 2013/14 to 29.1 per cent in 2016/17, leading to a projected main budget deficit of 3.3 per cent of GDP. The primary balance, which measures the difference between revenue and non-interest spending, is in deficit. The primary deficit narrows over the next three years, resulting in a stabilisation of the debt-to-GDP ratio. The borrowing requirement and financing strategy are discussed in detail in Chapter 5.

Primary deficit narrows over next three years, stabilising debt-to-GDP ratio

Table 3.6 Revisions to main budget revenue and expenditure estimates, 2013/14 – 2015/16

	2013/14		2014/15		2015/16	
R billion/percentage of GDP	**2013 Budget**	**2014 Budget**	**2013 Budget**	**2014 Budget**	**2013 Budget**	**2014 Budget**
Revenue						
Gross tax revenue	898.0	899.0	991.8	993.7	1 099.0	1 095.1
Non-tax revenue	18.3	18.8	19.1	18.0	20.2	18.7
SACU[1]	-43.4	-43.4	-43.0	-51.7	-48.5	-57.3
National Revenue Fund receipts	5.0	11.8	2.9	2.9	3.1	1.6
Main budget revenue	**878.0**	**886.2**	**970.8**	**962.8**	**1 073.8**	**1 058.1**
Percentage of GDP	*24.9%*	*25.6%*	*25.0%*	*25.4%*	*25.1%*	*25.5%*
Expenditure						
Current payments	271.6	277.0	291.2	299.0	309.9	320.1
of which:						
Compensation of employees	*114.8*	*116.1*	*121.4*	*123.5*	*128.6*	*130.6*
Debt-service costs	*99.7*	*101.3*	*108.7*	*114.9*	*118.2*	*126.6*
Transfers and subsidies	762.2	755.8	819.5	819.3	885.3	884.5
Payments for capital assets	14.3	12.4	17.6	17.7	17.5	18.6
Payments for financial assets	2.9	3.9	3.3	3.6	3.0	3.3
Contingency reserve	4.0	–	6.5	3.0	10.0	6.0
Total expenditure	**1 055.1**	**1 049.1**	**1 138.0**	**1 142.6**	**1 225.7**	**1 232.6**
Percentage of GDP	*30.0%*	*30.3%*	*29.3%*	*30.1%*	*28.7%*	*29.7%*

1. SACU payments and other adjustments

Social security funds, public entities and provincial balances

The main budget deficit is partly offset by the cash surpluses of social security funds, public entities and provincial governments. While government is borrowing to finance revenue shortfalls, these institutions are accumulating reserves.

As detailed in Chapter 6, expenditure by the Unemployment Insurance Fund (UIF), the Road Accident Fund and the compensation funds are expected to grow strongly over the next three years as a result of policy changes, new hiring and additional offices. However, revenue performance has also improved significantly due to greater efficiency in revenue collection. Consequently, since the 2013 Budget, the estimated cash surpluses of social security funds in 2013/14 and 2014/15 have been revised up by about R3 billion.

Public entities are projected to run a combined surplus over next three years

The projected cash balances of public entities have been revised upwards. While the 2013 Budget projected deficits, these entities are now expected to run a combined surplus over the MTEF period.

The revenue of the water-sector entities has been revised up to reflect improved collection and increased water sales. Capital spending plans have been revised down. Lower capital spending typically reflects mismatches between projected and actual spending, or the extension of projects over longer time frames.

Other major contributors to the surplus include higher allocations to the National Skills Fund, higher revenue accruing to the South African National Roads Agency Limited and slower capital spend by Sentech Limited. Goods and services and compensation budgets of several other public entities have been curtailed.

Table 3.7 Consolidated budget balance, 2010/11 – 2016/17

R billion	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Main budget balance	-133.2	-144.6	-165.7	-162.9	-179.8	-174.5	-151.0
Social security funds	10.8	15.1	17.8	17.9	15.2	13.1	15.1
Public entities	1.1	13.0	5.6	1.7	8.5	7.0	5.5
Provinces	4.6	6.2	6.6	4.1	3.0	4.1	3.5
RDP Fund	-0.4	-0.5	-0.1	0.4	–	–	–
Consolidated budget balance	**-117.1**	**-110.8**	**-135.9**	**-138.8**	**-153.1**	**-150.3**	**-126.9**

Government's expenditure ceiling is set at main budget level, but the cash flows of social security funds and public entities affect the consolidated deficit. Over the period ahead, the National Treasury will improve its financial oversight of these institutions, and new regulations will enable more accurate projections of the consolidated deficit.

Provincial surpluses remain high, but narrow moderately over the spending period ahead. Provincial underspending is estimated at R6.7 billion in 2013/14. Over the MTEF period, provinces have been asked to budget for surpluses to clear balances and accruals accumulated over several years. Gauteng is also budgeting for a surplus to repay the Gautrain loan.

Fiscal sustainability and risks

A sustainable fiscal outlook, with debt stabilising in the outer year

South Africa's fiscal outlook is sustainable. Despite moderate economic growth, net national debt will stabilise as a share of GDP in 2016/17 and begin to decline thereafter. Broader public-sector sustainability is supported by a moderate stock of public debt, large social security fund surpluses, a fully funded government employee pension system and a narrowing public-sector borrowing requirement. Risks to the fiscal outlook include economic uncertainty and a new round of public-sector wage negotiations.

National debt

Government's net debt as a share of GDP continues to grow, but is expected to level off at 44.3 per cent of GDP in 2016/17. Several factors underpin the sustainable debt position.

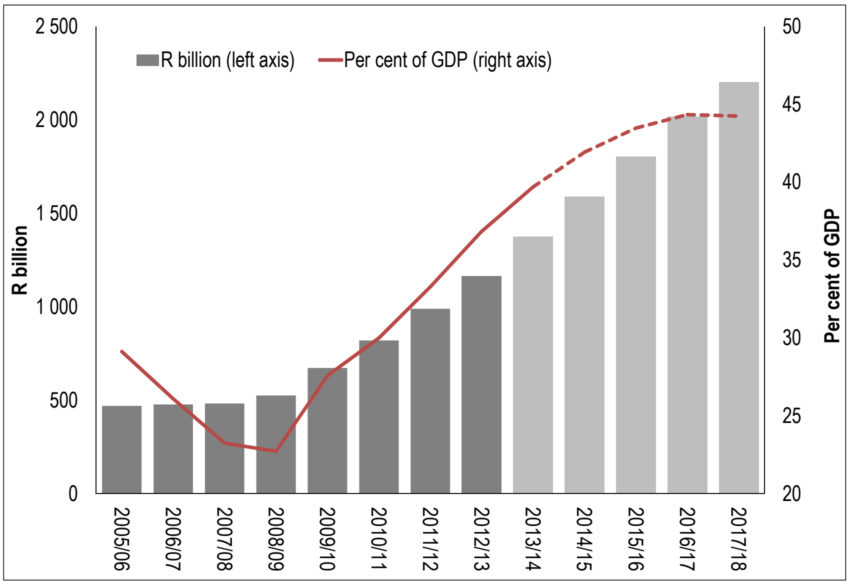
Although global interest rates are expected to rise, domestic rates on new debt issuances remain low by historical standards. Government's debt portfolio is well structured. Debt denominated in foreign currency is only about 10 per cent of the total, which limits the consequences of rand devaluation. A smooth maturity profile, together with an average term-to-maturity of above 13 years, means that the impact of short-term swings in capital markets can be absorbed over time.

Government's debt portfolio has a long-dated maturity structure and a low level of foreign currency liabilities

Despite significant volatility over the last year, government's borrowing programme has continued without interruption, with domestic investors taking advantage of global trends to increase their holdings of South African government paper. As debt stabilises, government is committed to rebuilding fiscal space by reducing the ratio of government debt to GDP.

As debt stabilises, government is committed to rebuilding fiscal space

Figure 3.2 Net government debt, 2005/06 – 2017/18



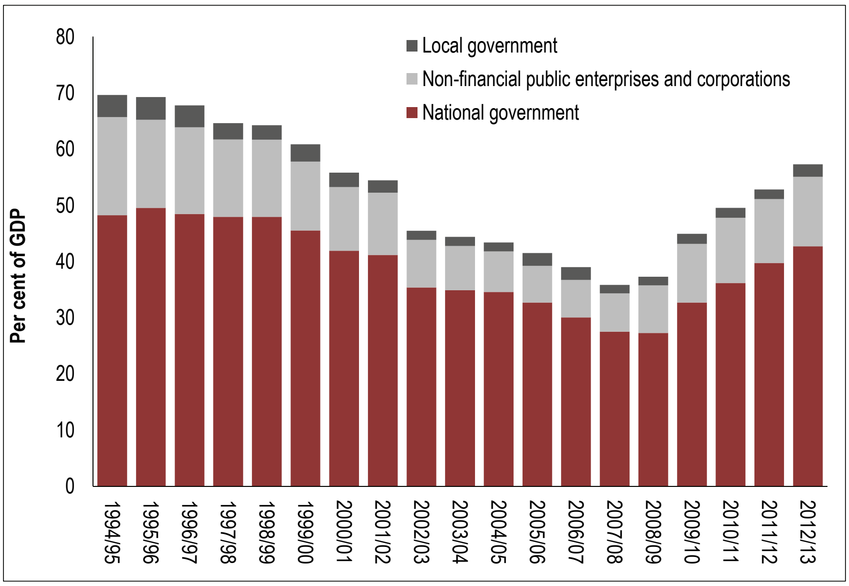
Source: National Treasury

Public-sector borrowing

Total public-sector debt – which includes state-owned companies and local government – was 57.3 per cent of GDP in 2012/13. While this figure is expected to increase, it will do so more slowly than in recent years.

Total public-sector debt will grow more slowly over the medium term

Figure 3.3 Public-sector debt as percentage of GDP, 1994/95 – 2012/13



Source: Reserve Bank

Public-sector borrowing requirement projected to narrow to 4.3 per cent of GDP in 2016/17

The public-sector borrowing requirement peaked in 2009/10 at 9.8 per cent of GDP and is estimated at R227.2 billion, or 6.6 per cent of GDP, in 2013/14. The borrowing requirement is projected to narrow to 4.3 per cent of GDP in 2016/17 as a result of the following factors:

- The main budget deficit declines over the MTEF period and is offset by surpluses held by other institutions, resulting in a lower consolidated borrowing requirement.
- Borrowing by state-owned companies is also projected to decline as a share of GDP, from 2.3 per cent in 2013/14 to 1.3 per cent of GDP in 2016/17. This reflects an increasing reliance on internally generated resources to finance capital spending.
- Local government borrowing remains very low. Many local governments have weak balance sheets and have yet to develop reliable systems for collecting their own revenue, making them increasingly reliant on grants to fund capital expenditure. While several large cities are able to access capital markets, many are nearing their prudential debt limits.

Table 3.8 Public-sector borrowing requirement,[1] 2010/11 – 2016/17

R billion/percentage of GDP	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
		Outcome		Revised estimate	Medium-term estimates		
Main budget	133.2	144.6	165.7	162.9	179.8	174.5	151.0
Social security funds	-10.8	-15.1	-17.8	-17.9	-15.2	-13.1	-15.1
Provinces	-4.6	-6.2	-6.6	-4.1	-3.0	-4.1	-3.5
Public entities	-1.1	-13.0	-5.6	-1.7	-8.5	-7.0	-5.5
RDP Fund	0.4	0.5	0.1	-0.4	–	–	–
Consolidated government	**117.1**	**110.8**	**135.9**	**138.8**	**153.1**	**150.3**	**126.9**
	4.3%	*3.7%*	*4.3%*	*4.0%*	*4.0%*	*3.6%*	*2.8%*
Local authorities	**8.8**	**5.8**	**9.3**	**9.7**	**9.7**	**10.2**	**10.8**
	0.3%	*0.2%*	*0.3%*	*0.3%*	*0.3%*	*0.2%*	*0.2%*
State-owned companies[2]	**47.5**	**28.9**	**65.2**	**78.7**	**68.8**	**82.7**	**57.7**
	1.7%	*1.0%*	*2.0%*	*2.3%*	*1.8%*	*2.0%*	*1.3%*
Borrowing requirement	**173.4**	**145.5**	**210.4**	**227.2**	**231.6**	**243.2**	**195.4**
	6.3%	*4.9%*	*6.6%*	*6.6%*	*6.1%*	*5.9%*	*4.3%*

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

Public-sector sustainability

Social security and pension funds, and state-owned companies, are not sources of fiscal vulnerability

Recent international experience shows that fiscal distress can originate from sources outside the main budget, such as public pension funds or state-owned companies. In many countries, demographic trends are also expected to strain social spending obligations in the years ahead.

In South Africa's case:

- Social security funds hold large surpluses, with the UIF projecting an accumulated surplus of R73 billion in 2013/14.
- The Government Employees Pension Fund has R1.4 trillion in assets under management; according to the fund's actuaries, it is more than fully funded on a best-estimate basis.
- Infrastructure investments have led to a steady increase in the asset base of state-owned companies, from R450.1 billion in 2008/09 to R793.9 billion in 2012/13.
- South Africa's private financial sector is well capitalised, and remains profitable and well regulated.
- Demographic trends are unlikely to place a large burden on current social policies, as shown in the box on social grant expenditure.

Managing risks

The risks to fiscal sustainability include economic uncertainty and pressures emanating from the government wage bill.

If inflation remains stable, faster growth would enable government to attain its fiscal objectives earlier

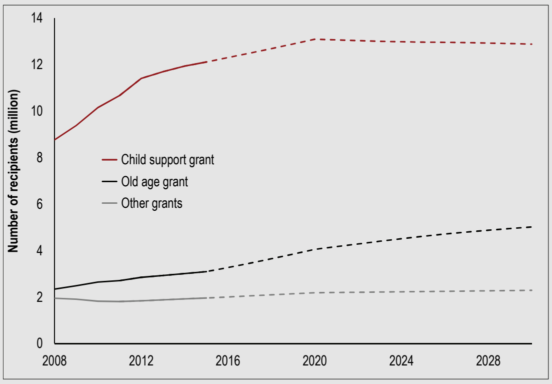
Some risks associated with the economic outlook have partially materialised, as reflected in the inflation outlook and higher interest rates for new and existing debt. To some extent, higher interest payments would be offset by higher revenue as a result of inflated nominal GDP in an inflationary environment. A deterioration in the economic outlook, however, would require government to consider additional expenditure and revenue measures to ensure fiscal sustainability. Faster growth in the context of stable prices would enable government to attain its fiscal objectives earlier.

Long-term sustainability of social grant expenditure

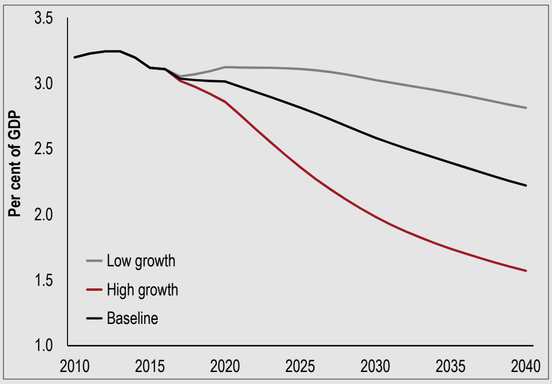
The National Treasury has undertaken long-term modelling of government's largest social expenditures. In 2012/13, government paid over R100 billion in cash grants to support more than 15 million South Africans.

Social grant expenditure is expected to decline as a share of GDP over the next three years. Assuming there are no changes in eligibility criteria, uptake rates for the *child support grant* and the *old age grant* are projected to rise and then stabilise over the coming decade. In line with actuarial population forecasts, the total number of age-eligible children is set to level off over time, while the number of *old age grant* recipients will grow moderately. Over the past decade, social grant values have grown in line with consumer inflation. Assuming that this trend continues, and taking into account population trends, spending on social grants is projected to continue declining as a share of GDP, as shown in the figures below.

Number of recipients of main social grants (actual and projected), 2008–2028



Projected grant spending under three economic growth scenarios, 2010–2040



Source: National Treasury

This finding holds true both in a baseline GDP growth scenario (3.5 per cent growth) and in a high growth scenario (5.0 per cent growth). In a low growth scenario (2.5 per cent), grant expenditure stabilises as a share of GDP.

Higher-than-expected inflation to add to rising wage pressures

The current public-sector wage agreement provides for annual cost-of-living adjustments of inflation plus 1 per cent. While growth in employee compensation has slowed over the past two years, higher-than-expected inflation would add to the wage bill. These pressures are being partially offset by declining headcount growth at national and provincial levels, as government increasingly operates within currently funded staffing levels. Government aims to maintain employee numbers at a constant level over the next three years, with exceptions to this policy requiring a compelling explanation. A further deterioration in the inflation outlook, however, would place additional pressure on the budget. A new round of wage talks will begin later this year on an agreement to take effect in 2015. The National Treasury and the Department of Public Service and Administration are working together to ensure that a fair and sustainable wage agreement is reached.

Conclusion

Government remains committed to countercyclical fiscal policy. The fiscal stance maintains an expenditure ceiling, supported by policies to improve spending efficiency. Together with an improving revenue outlook, fiscal policy balances sustainability with continued support to the economy.