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# REPLY BY DEPUTY MINISTER OF FINANCE NHLANHLA NENE TO DEBATE ON THE FISCAL FRAMEWORK AND REVENUE PROPOSALS

**2 MARCH 2010**

Madam Deputy Speaker and Honourable Members,

It is indeed a fulfilling and very rewarding moment for me to see the democratisation of our budget process that has evolved over the past decade. I wish to thank all those who have made it possible for us to be at this phase of our constitutional democratic order. Many Members of Parliament have played a role in seeing this legislation reach the stage we are at now. In keeping with the provisions and tenets of this legislation, it is also encouraging to note that Parliament has risen to the occasion to give full meaning to its oversight role.

As Minister Gordhan indicated, the budget we tabled on the 17th of February was a collective statement of government. I want to assure you that he did not ‘run away’ from the DA’s Shadow Minister of Finance. Since the Minister is abroad with the President on a state visit, Minister Pandor is representing the Finance

Ministry as the acting Minister of Finance in this House, and I have been delegated here by the capable Minister Gordhan.

Speakers have come to the podium and spoken about the fiscal framework, and it is very encouraging to see how many spoke in support of the framework in general. I would not want to bore this House by going through each of the speakers' comments and trying to respond, as most members have spoken in support. I do, however, want to focus on four general issues in regard to points that have been raised by some members.

If some of us believe that revenue needs to be higher than what we have estimated, it needs to be a result of three potential factors: firstly, higher economic growth; secondly, faster recovery in corporate income tax; and thirdly, higher tax rates. Dr George, the Treasury's economic focus is based on the latest economic data, mainly the SA Reserve Bank's December quarterly bulletin. This has been interrogated, discussed and ultimately approved by the Minister's committee on the budget and has also been presented to Cabinet for adoption.

The focus is in line with consensus expectations and most commentators have noted that it effectively takes account of the fragile nature of global recovery and associated risks. Corporate income tax information is based firstly on the corporate income tax data until January 2010; and secondly, on our experience of the lags in corporate income tax over the past 15 years and the analysis of the expected recovery in corporate profitability.

The corporate income tax data suggests a deeper decline in the tax than we originally estimated in the Medium Term Budget Policy Statement (MTBPS). While corporate profitability will recover somewhat, the pace of recovery is expected to remain muted as economic activity continues to remain subdued over the next two to three years. Even where the corporate sector successfully returns to profitable positions, losses built up during the economic slump will mean that it may still be a few years until we start seeing income tax revenue from many corporates.

These factors are considered by the Revenue Analysis Working Committee, comprised of SARS, SARB and the National Treasury, and the revenue focus is debated and approved by the Minister’s committee on the budget. The October MTBPS estimated a much more aggressive increase in tax revenue as a percentage of Gross Domestic Product (GDP), and this was partly based on the likelihood of a tax rate increase or introduction of new tax instruments to raise revenue and close the gap between expenditure and revenue.

Since October, higher nominal GDP has allowed us to close the financing gap at a similar rate to what was proposed in the MTBPS, but without as an aggressive increase in tax revenue. This is an extremely positive development and should be welcomed, as it allows the fiscus to continue to operate in a strongly counter-cyclical fashion, supporting development and contributing to demand in the economy while not compromising long-term sustainability. Higher tax rates too soon would have the likelihood of threatening the sustainability of the economic recovery and, by implication, would strongly undermine the long-term sustainability of the fiscus.

The next point is on the fiscal sustainability pact that members and the committee have raised as a recommendation. We welcome the idea of a fiscal sustainability pact and look forward to engaging with Parliament on the likely purpose and form of such a pact. Any fiscal rule or pact must be counter-cyclical in nature. This is notoriously difficult to achieve as illustrated by some of the bigger economies like the UK who, despite a cyclically adjusted sustainability rule, find themselves facing severe fiscal constraints and the likely burden of higher tax interest costs, lower expenditure and higher taxes in the future.

The Chilean experience also, however, points to what can be achieved if a fiscal policy is disciplined and counter-cyclical. Successful fiscal management has enabled Chile to respond to the economic crisis with higher expenditure, placing them on an excellent path to economic recovery and playing an important role in limiting volatility in the Chilean currency.

The third point is on the impact of the Eskom tariff increase as some have even referred to it as double taxation. Let me say that in the 2010 Budget our economic outlook assumed a 35% increase in the electricity price. The impact of the awarded increase being closer to 25% is that real GDP growth would be marginally higher and inflation will be lower in the next three years. As a result, the impact of higher GDP growth would be offset by the lower inflation, and nominal GDP is not expected to change very much as a result of the decision of the regulator. Therefore, the impact on tax revenue and the budget framework is expected to be broadly neutral.

The last point I want to refer to is the issue of how the fiscus will respond if growth remains low and the deficit high, as some of the members had raised this as a possible risk. The 2010 Budget clearly and boldly states that the objective of a sustainable fiscal framework remains the primary goal of fiscal planning. This is to be achieved through stabilising growth in expenditure combined with rising budget revenue, returning the fiscus to primary surplus that allows us to sustainably finance expenditure in the long-run.

The committee report correctly identifies the economic risks to this recovery. Should the economy fail to grow at the rates expected, it is likely that the fiscal position and the trajectories of revenue and expenditure will have to be reevaluated. In this scenario, we will be able to choose from a combination of three options: firstly, we can further reduce spending; secondly, we can meet our revenue targets through additional taxation; and thirdly, we will be able to consider borrowing additional resources.

While all three of these options entail both current and future costs, our first instinct would be to extract further savings and efficiency gains to government spending, as most members have alluded, while attempting to continue to support the economy through continued borrowing. We would also seek to defer tax increases until the economy recovers, but we will obviously have to balance this against the rising interest burden on the fiscus on future generations.

The level and extent to which we wish to provide this support will be a result of the outlook for the economy and the extent to which we expect the economy to recover. Clearly, the longer we continue to borrow, the greater the interest burden. With interest already the fastest growing expenditure item on the budget, any decision to continue borrowing would not be taken lightly. It must also be recognised that while the economic outlook poses a risk in the fiscal trajectory, any additional expenditure requirements on the fiscus would also serve to undermine the sustainability and raise debt costs.

For anyone interested in how we are dealing with the debt sustainability and economic scenarios, let me refer you to the box on page 63 of our Budget Review, which shows the results of Treasury's modelling of various economic and fiscal paths over five years.

With these remarks, I would like to take this opportunity to thank the committees for having dealt with the fiscal framework in the manner that they have and for the time that they have put into it, this being the first fiscal framework that we tabled before you. We hope that today marks the beginning of a much more meaningful way of engaging with the budget process going forward.

Thank you.