

REMARKS BY THE DEPUTY MINISTER OF FINANCE, NHLANHLA NENE, AT THE LEGAE SECURITIES BREAKFAST DISCUSSION

12 April 2012

It is indeed a privilege for me to address you this morning.

In February, when we were preparing for this meeting, it was suggested that I address the following topic: *“Is the budget deficit target of 4.6% in 2012/13 achievable given the slower growth outlook and the expansionary fiscal need?”*

Since then fortune has favoured me. The end of the financial year revealed a preliminary deficit of only 4.5% for 2011/12. This was below the 4.8% we had anticipated in the Budget, largely a result of higher-than-anticipated customs receipts. This happy outcome should serve to allay the doubts of those who think the target for 2012/13 is not achievable.

We look forward to an interactive session with you this morning, during which we can look in more detail at fiscal and economic policy issues. By way of introduction, I suggest we think about our fiscal choices from a broader perspective.

While it is important to take note of the deficit outcome for a particular year, we should be concerned with the overall direction of public finances. We are confident that we are on a sustainable fiscal path. Our fiscal policy is anchored around three medium term objectives:

- First, real growth in public spending will remain moderate at 2.6% per annum over the next three years. This is far below any reasonable estimate of GDP growth going forward. It is also a decisive shift in the trajectory of the last few years. Between 2000 and 2009 non-interest expenditure grew on average by 9.2% each year in real terms. Revenue outcomes might please or disappoint in any given year, since they depend on underlying economic conditions. But we are committed to a prudent path of expenditure growth which ensures that we live within our means.

- Second, we are committed to restoring a primary surplus (i.e. the difference between revenue and non-interest spending). A primary balance will ensure the stabilisation of government debt, and we expect to achieve this objective in 2014/15. We said in the last MTBPS that should the economy fail to recover as anticipated, some combination of slower spending growth and policy measures to raise tax revenue would need to be considered.
- A third anchor of our fiscal policy is that we intend to fully cover our operational expenditure with our own revenue. Since the recession of 2008/09, government has been borrowing to finance spending on recurrent costs such as compensation of employees, and goods and services. From 2014/15, new borrowing will finance investment rather than consumption. This will require a shift in the composition of spending towards investment.

It is against these anchors of fiscal policy – rather than the deficit outcome for particular year – that we should judge the sustainability of the fiscus.

The opinions offered by ratings agencies to back their recent decision to place South Africa on a negative watch are not directly related to our fiscal policy, or the current trajectory of public finances. They are concerned with social and political factors, and the impact these might have on fiscal policy in the long term. It is worth noting that South Africa is not unique in this regard. A recent commentary in the Financial Times noted that

“In the past few months, senior officials at the three largest agencies – Moody’s, Fitch and Standard & Poor’s – have quietly recognized that they need to give greater weight to political and sociological factors when rating western sovereign debt. Hence the frequent, albeit subtle, comments on issues such as political stability in their latest statements on Eurozone and US debt. But... senior officials at some agencies are nervous about how to communicate these potentially controversial judgments”¹

¹ Gillian Tett, Why investors must get a grip on ‘granny tax’ and other rows, Financial Times, 23 March 2012

In South Africa's case their comments are far less subtle, for reasons about which we can only speculate. A generous interpretation might be that their brazen views on South African politics reflects a concern that threats to social cohesion are graver than in the OECD countries.

We are all concerned about the need to generate employment and growth to sustain our national progress.

But there are several reasons to be circumspect when translating this into concerns about fiscal sustainability. In the first place, the size of our tax and transfer system is already large and its effect in alleviating poverty and reducing inequality is widely acknowledged. In this context, popular demands and protests do not revolve around the quantum of spending. Instead they tend to focus on the quality of service delivery, the distribution of assets or the reform of market structures.

Over the longer term, South Africa's fiscal outlook is also far more benign than many advanced economies. A youthful population and slowing population growth point to rising per capita incomes. Demographic trends also point towards a stabilisation of spending on safety nets and other social commitments.

This is no reason to be complacent. We all agree on the need for higher rates of economic growth, improving productivity and rising levels of employment. And we know that achieving these goals requires greater common purpose amongst all South Africans. But – unlike the case of Europe or the US – our fiscal trajectory is not unsustainable.

Later this year, National Treasury will publish a long term fiscal report that considers the costs of current policies over the long-term against the backdrop of economic and demographic trends. We are also working on policy proposals that concern the financing of the proposed national health insurance and reforms to social security systems.

Our fiscal house is in order. The most pressing challenge is our ability to spend efficiently the revenue we collect. Government is implementing several interventions to improve planning around large-scale infrastructure. Through proposals such as the establishment of a chief procurement officer we are also making a contribution to reducing waste and corruption.

I hope that during this fiscal year we can improve the quality of government's contribution to the country. This would build a stronger platform on which all of us can help build a brighter future.