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DURING THE DEBATE ON

THE FISCAL FRAMEWORK AND REVENUE PROPOSALS

NATIONAL ASSEMBLY, 12 MARCH 2013

Introduction

The 2013 Budget is about national development and fiscal sustainability. It is the first budget in which government's plans to implement the National Development Plan (NDP) are beginning to take shape. The NDP expresses the central priorities of public policy: eliminating poverty and reducing inequality, with a focus on lowering the costs of living and doing business, increasing exports, creating more jobs and making economic growth more inclusive. Government departments will increasingly align their planning and expenditure with the objectives of the NDP. At the same time, growing collaborative dialogue between government, the private sector, trade unions and civil society is needed to make the plan a reality.

The fiscal framework underpinning the 2013 Budget achieves a number of objectives:

- It supports economic recovery
- It secures fiscal sustainability
- It stabilises the growth of public debt
- It finances government's ambitious infrastructure programme
- It slows the growth of consumption spending

Supporting the economy

Fiscal policy is anchored by the principles of countercyclicality, debt sustainability and intergenerational equity[1].

[1] *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.

Since the recession of 2008, countercyclical policy has supported economic activity. South Africa's fiscal response to the crisis has been larger and sustained for a longer period than the response of similar economies. Despite narrowing fiscal space, Budget 2013 continues to support the economic recovery.

This is not an "austerity" budget. The level of social spending continues to increase in real terms. Moderate tax relief is given, especially for small business. The fastest growing elements of expenditure include actions that support economic growth. These include:

- Infrastructure spending, which grows at 3.4 per cent in real terms. The budget adds R19.2 billion for key infrastructure projects.

- Job creation programmes also grow very rapidly. For instance, funds allocated to the community work programme increase by 23 per cent, from R1.3 billion this year to 2.5 billion in 2015/16.

- Supporting manufacturing competitiveness. The DTI's budget grows by 10.9 per cent a year, to reach R11.4 billion. This includes R5.5 billion for the manufacturing competitiveness enhancement programme and R2.1 billion for special economic zones.

Government commitment to restore economic growth is resolute. But the fiscal space available to do so is narrowing. This implies that we will need to do more with less. The key contribution that government will make in the years ahead is through an improvement in the quality of our spending. Improving the impact of public spending by prioritising capital investment, and reducing waste and inefficiency will be key.

Securing fiscal sustainability

The principles that anchor fiscal policy must be interpreted in a dynamic and complex environment. The fiscal stance established by Budget 2013, which is consistent with our previous Budget statements, seeks to achieve three goals over the next three years:

- Moderate but steady real growth in spending, so that public services expand 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.

Policy-makers do not have the luxury of perfect foresight, and therefore must have the ability to respond flexibly to changing circumstances. In the October *Medium-term Budget Policy Statement (MTBPS)* we indicated that should economic conditions deteriorate, realising our fiscal objectives will require a reconsideration of spending and revenue plans.

Since then, economic weakness has resulted in a pronounced shortfall in revenue, leading to an unavoidable widening of the deficit in 2012/13. Ensuring that we stabilise debt means that countercyclicality in the short term is balanced by a stronger medium-term path of consolidation.

The widening deficit required government to moderate its spending plans over the next three years. This was achieved through several measures taken in response to the revenue shortfall.

- Spending projections of national departments were trimmed.
- The contingency reserve, which caters for unforeseen expenditure and can be used to finance new policy initiatives, was substantially reduced.
- Departments were asked to review their spending, and R52.1 billion was shifted in support of key priorities.

Real non-interest expenditure is now 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. This implies an even narrower scope for new projects and spending programmes than previously anticipated. Unless economic conditions improve significantly, the fiscal framework implies that new spending over the next three years will have to be financed entirely from savings and reprioritisation.

The need to restore fiscal sustainability also requires consideration of the revenue side of the budget. Over the next year, a tax policy review will assess whether present tax policy is appropriate to support government's objectives, including fiscal sustainability.

As the National Development Plan notes, the best way to generate resources to implement the national vision is to grow the economy more rapidly.

Stabilising the growth of public debt

During the mid-2000s, South Africa reduced its public debt substantially. This ample fiscal space 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.

This has a number of negative consequences for South Africa. First, it means that we are vulnerable in the event that economic circumstances take a turn for the worse. The fiscal space available to us is narrower. Second, high levels of government debt put upward pressure on interest rates and can have other effects which undermine growth and investment in the economy. Third, rising debt inevitably leads to rising debt service costs. Interest payments for debt are projected to be the fastest-growing expenditure item over the next three years. In 2015/16 we will spend R118 billion to service our debt. This will be more than the budget for police services in 2015/16, which will be R80 billion, or the salaries of healthcare workers, which will amount to R96 billion.

Many factors influence the path of debt relative to our national income. This includes factors not directly under the control of policy makers such as economic growth, inflation and interest rates. The key factor that is under our control is the primary balance – the gap between revenue and expenditure excluding interest payments.

Budget 2013 secures a path to the stabilisation of debt by narrowing the primary deficit. On current projections, we expect the debt-to-GDP ratio to stabilise in 2015/16 at a level just higher than 40 per cent.

Beyond the medium term, debt sustainability will require that government continues on its current path. At its current level, the burden of debt would still leave the country vulnerable to future economic shocks. Rebuilding the fiscal space we had achieved before the recession will require us to continue along a path of moderate growth in spending. It also means that structural increases in spending – for instance as a result of new policy reforms such as the introduction of a National health insurance scheme – would require concomitant increases in revenue.

Improving the quality of spending

Government is committed to ensuring that a greater share of public funds becomes available for capital investment over time.

Growth in 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 to ensure that budget objectives are met.

The budget also proposes means to eliminate waste in goods and services budgets. 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.

Conclusion

Challenging times require South Africans to unify and give effect to the sound plans that we have adopted. While the global outlook is not expected to improve markedly, there are many areas of opportunity. A sound fiscal framework supports the sustainable financing of government spending, while progressive alignment between departmental budgets and the objectives of the NDP will bolster government's contribution to development.