Medium Term

Budget Policy Statement

2014

National Treasury

Republic of South Africa

22 October 2014

ISBN: 978-0-621-43128-5
RP: 311/2014

The *Medium Term Budget Policy Statement* is compiled using the latest available information from departmental and other sources. Some of this information is unaudited or subject to revision.

To obtain additional copies of this document, please contact:

Communications Directorate
National Treasury
Private Bag X115
Pretoria
0001
South Africa

Tel: +27 12 395 6697
Fax: +27 12 315 5126

The document is also available on the internet at: www.treasury.gov.za

Foreword

Since the dawn of democracy just over 20 years ago, government has financed a massive expansion of services to all South Africans, with a focus on the poor. We have done so in a sustainable way, ensuring that our public finances remained healthy so that we could continue building the society envisioned in our Constitution.

Today, we are at a turning point. The world economic recovery remains shallow and structural challenges in our economy have contributed to weak economic growth. This has serious consequences for tax revenue, and our ability to continue funding social and economic programmes.

This year we anticipate GDP growth of 1.4 per cent. While growth is expected to reach 3 per cent in 2017, this is well below the country's potential and has placed the public finances under increasing pressure. Rising debt levels, if left unchecked, would absorb more and more of our spending. The end result would be less money to spend on improving the lives of our people.

The 2014 *Medium Term Budget Policy Statement* provides a roadmap to safeguard the public finances. In response to a worsening debt outlook, government proposes a fiscal package that reduces the expenditure ceiling and raises tax revenue over the next two years. This will reduce the budget deficit and stabilise debt, which is now set to reach R2.4 trillion in 2017/18.

Two years of fiscal consolidation will put the public finances on a sustainable footing. We will also approach budgeting with a greater focus on long-term expenditure planning and alignment with government's policy objectives.

In considering these proposals, we must emphasise that restraining expenditure growth will not compromise front-line services. National, provincial and local government will need to continue identifying savings and improving the way they spend money. Key social programmes will be protected. Government will continue to roll out its capital investment programme. We will encourage private-sector participation in infrastructure delivery.

While expenditure ceilings are being reduced, the budget will continue to grow in real terms. Government will spend R4.4 trillion over the next three years. Allocation of these funds will be in line with the medium-term strategic framework, which gives expression to the National Development Plan.

I would like to thank the President and all of my Cabinet colleagues for their contributions to shaping the proposals before us, as well as the Ministers' Committee on the Budget, which has brought tremendous insight into the process. I would also like to acknowledge the officials of the National Treasury, who are working with their colleagues across government to ensure that our public finances remain sound.

The choice we face in considering these proposals is a difficult one. But we believe that this course can no longer be postponed.

NHLANHLA NENE

Nhlanhla Musa Nene
Minister of Finance

Contents

Chapter 1	**Sustaining investment and safeguarding the public finances**	**1**
	Introduction	1
	Towards faster economic growth	2
	Sustaining public expenditure	5
Chapter 2	**Economic outlook**	**9**
	Growth and structural reform	9
	The world economy	10
	Domestic economic outlook and trends	13
	Structural changes under way in South Africa	16
Chapter 3	**Fiscal policy**	**19**
	A sustainable foundation for the public finances	19
	Fiscal course adjustment	20
	Fiscal package to reinforce sustainability	21
	The fiscal framework	23
	Risks to the fiscal outlook	25
Chapter 4	**Expenditure priorities and the division of revenue**	**27**
	Spending plans for the next three years	27
	Medium-term expenditure framework	28
	Division of revenue	37
	Conclusion	40
Technical annexure		**41**
Glossary		**53**

Tables

1.1	Macroeconomic projections, 2013 – 2017	3
1.2	Consolidated government fiscal framework, 2013/14 – 2017/18	5
1.3	Division of revenue, 2014/15 – 2017/18	5
1.4	Consolidated government expenditure, 2014/15 – 2017/18	8
2.1	Macroeconomic projections, 2013 – 2017	10
2.2	Annual percentage change in GDP and consumer price inflation, selected regions/countries, 2013 – 2016	11
2.3	Major export destinations for South African products, 2000 – 2014	12
2.4	Balance of payments, 2007 – 2014	13
2.5	Macroeconomic performance and projections, 2011 – 2017	14
2.6	Macroeconomic performance and projections, 2011/12 – 2017/18	14
2.7	Sector growth trends, 2012 – 2014	16
3.1	Main budget non-interest expenditure, 2011/12 – 2017/18	21
3.2	Consolidated fiscal framework, 2011/12 – 2017/18	23
3.3	Consolidated current and capital balances, 2013/14 – 2017/18	24
4.1	Consolidated government expenditure, 2013/14 – 2017/18	31
4.2	Funding for employment programmes, 2011/12 – 2017/18	36
4.3	Division of revenue, 2014/15 – 2017/18	37

Figures

2.1	Current account and fiscal balances, 2014 forecasts	13
2.2	Investment by sector, percentage growth, 2010 – 2014	15
3.1	Projected change in debt-to-GDP ratio, 2009 – 2019	20
3.2	Main budget non-interest spending	24
3.3	Main budget primary balance	24
3.4	Net national government debt, 2007/08 – 2020/21	25
4.1	Average annual growth by function, 2011/12 – 2017/18	34

What is the Medium Term Budget Policy Statement?

The *Medium Term Budget Policy Statement* (MTBPS) is a government policy document that communicates to Parliament and the country the economic context in which the forthcoming budget will be presented, along with fiscal policy objectives and spending priorities over the three-year expenditure period.

The policy statement is an important part of South Africa's open and accountable budget process. It empowers Parliament to discuss and shape government's approach to the budget.

The Money Bills Amendment Procedure and Related Matters Act (2009) requires government to table the MTBPS in Parliament at least three months before the national budget is presented. The statement must include:

- A revised fiscal framework for the current financial year and the proposed fiscal framework for the next three years.
- An explanation of the macroeconomic and fiscal policy position, and macroeconomic projections and assumptions underpinning the fiscal framework.
- The spending priorities of government for the next three years.
- The proposed division of revenue between national, provincial and local government for the next three years.
- Any substantial proposed adjustments to conditional grant allocations to provinces and local governments.
- A review of spending by each national department and each provincial government between 1 April and 30 September of the current financial year.

The revised fiscal framework for the current year, the proposed medium-term fiscal framework, the explanation of the macroeconomic and fiscal policy position, and the projections and assumptions are referred to Parliament's finance committees. National spending priorities for the next three years, the proposed division of revenue between spheres of government and adjustments to conditional grant allocations are referred to the appropriation committees.

These committees report to their respective houses of Parliament on the proposed fiscal framework and division of revenue. A report may include amendments to the proposed fiscal framework and division of revenue. The adopted reports serve as a mandate for government to prepare the forthcoming budget in accordance with the policy approach of the MTBPS.

1

Sustaining investment and safeguarding the public finances

The Constitution requires government to act within its available resources to progressively realise fundamental social and economic rights. Over the past decade, government spending has doubled in real terms, funding a large expansion of the social wage and capital budgets. These investments, alongside political change, have transformed South Africa.

A decade of rapid expansion in public budgets was supported first by strong economic growth, and then by using the fiscal space that had been built up to stimulate the economy as the global crisis took hold.

Today, South Africa faces a difficult economic environment. The consumption-led, debt-financed economic growth of recent years has reached its limits, and growth has slowed. The growth rate is set to improve over the next several years as new energy and transport investments start to operate, exports increase and investment recovers. Yet weak economic performance has put a great deal of pressure on the fiscus, with revenue insufficient to cover expenditure. The budget deficit is high, debt levels have approached the limits of sustainability and the economy is vulnerable to global volatility.

Government therefore proposes a package of fiscal measures to re-establish a sustainable foundation for the public finances, and to build a platform for investment-led growth in the future. The proposals include a lower spending ceiling, reduced government consumption expenditure and increases in revenue. The most important public spending programmes – those that help poor South Africans – will remain in place and will be protected from inflation.

These proposals are necessary to sustain social progress and to improve the lives of all South Africans.

Introduction

The 2014 *Medium Term Budget Policy Statement* signals a shift in fiscal policy. Government proposes a series of measures to reduce the budget deficit and stabilise public debt. These steps are necessary to ensure the sustainability of South Africa's most important public spending programmes in a weaker economic environment. The proposals complement reforms under way to moderate consumption, boost savings and expand productive investment.

A sustainable foundation for the public finances can open the way for investment-led growth

In a mixed economy, the burden of development cannot be carried by the fiscus alone

In promoting these objectives, two challenges stand out over the next several years. The first is to encourage greater private-sector investment in the economy. Private investment has remained subdued since the opening of the global financial crisis in 2008, and this is reflected in economic performance. In a mixed economy, vibrant markets and private investment complement public action to improve people's lives and sustain progress. The burden of development cannot be carried by the fiscus alone. Removing obstacles to private investment must be a priority for government at all levels.

The second challenge is to improve the state's capacity to plan, manage and maintain its programmes and infrastructure. Recent supply failures in electricity, water and postal services, for example, hurt the economy and wear down public confidence. Greater state capacity and efficiency are prerequisites for more rapid development.

MTSF sets out five-year roadmap to tackle urgent challenges as part of long-term development plan

Government's medium-term strategic framework (MTSF) for the period 2014-2019 provides a roadmap to address these challenges. It is the first five-year policy framework designed in sync with the 2030 vision of the National Development Plan. The MTSF aims to improve policy coherence, alignment and coordination across government. It highlights the need for partnerships between a capable developmental state, a thriving business sector and a strong civil society. It identifies employment, education and enhancing the capacity of the state as core policy objectives.

MTSF priorities for structural reform over the period ahead include:

- Building the capacity of the public sector, particularly at local government level, through the "back-to-basics" approach, focused on improving service delivery, accountability and financial management.
- Reshaping South Africa's urban environment through integrated spatial planning and an expansion of the municipal debt market.
- Improving the quality of the education system, starting with greater attention to human resources management and annual assessment of learners to benchmark progress.
- Enhancing dispute-resolution mechanisms in industrial relations.
- Strengthening competition policy.
- Enacting immigration reform to enable people with skills to work in South Africa more easily.

As the MTSF points out, achieving a higher developmental trajectory and building a more equitable society will require a strong social compact. Government, business and labour need to work together to improve public services, revive investment and avoid lengthy production stoppages.

Towards faster economic growth

GDP growth forecast to improve as infrastructure constraints ease and private investment recovers

South Africa's economic performance has deteriorated over the past several years. Gross domestic product (GDP) growth of 1.4 per cent is estimated in 2014, down from 3.6 per cent in 2011. GDP growth is forecast to improve over the medium term as infrastructure constraints ease, private investment recovers and exports grow. However, recent trends have led to understandable concern about the country's growth prospects.

Table 1.1 Macroeconomic projections, 2013 – 2017

Calendar year	2013 Actual	2014 Estimate	2015	2016 Forecast	2017
Percentage change unless otherwise indicated					
Final household consumption	2.6	1.9	2.3	2.8	3.0
Gross fixed capital formation	4.7	2.7	3.6	4.7	5.1
Real GDP growth	**1.9**	**1.4**	**2.5**	**2.8**	**3.0**
CPI inflation	5.8	6.3	5.9	5.6	5.4
Current account balance (% of GDP)	-5.8	-5.6	-5.4	-5.2	-5.0

Source: Reserve Bank and National Treasury

Faster economic growth is both a key objective of the National Development Plan and a necessary condition to raise the resources needed to fund the country's social and economic transformation. The plan targets 5 per cent annual GDP growth as the minimum requirement to create employment, overcome poverty and reduce inequality. It seeks to achieve this through significant investment in South Africa's people and infrastructure over an extended period.

South Africa needs higher investment, reduced consumption and growing exports

The approach to macroeconomic policy outlined in the MTSF and the National Development Plan can be summed up as follows:

- Sustaining high levels of public investment and increasing private investment.
- Reducing consumption so that a greater share of investment can be financed from domestic savings.
- Supporting rapid growth in exports, and maintaining a competitive real exchange rate to boost economic output and job creation.

Sustaining public-sector infrastructure investment

Completion of energy, transport and logistics projects will boost growth potential

Investment has risen to nearly 20 per cent of GDP. This trend has been supported by the sustained expansion of public infrastructure spending. The completion of major energy, transport and logistics projects over the medium term will boost the growth potential of the economy.

But high levels of consumption and poor growth outcomes have seen domestic savings lag behind. Government consumption contributes to a persistent deficit on the current account, which reached 6.2 per cent of GDP in the second quarter of this year. This makes South Africa over-reliant on foreign savings and vulnerable to shifts in global sentiment.

Two things are required to sustain high levels of public-sector capital investment. First, government needs to moderate its consumption spending, which accounts for 56 per cent of consolidated non-interest expenditure in 2014/15. Moderating consumption will create fiscal space to sustain investment and reduce reliance on foreign savings. Second, greater space must be created for partnerships that draw private capital into public-sector infrastructure projects. Initiatives such as the independent power producer programme will grow in the years ahead, and will promote greater confidence in private investment in the broader economy.

Support for state-owned companies will depend on sound business plans

Most major economic infrastructure investments are financed on the balance sheets of state-owned companies. Over the next two years, financial support provided to these companies, including capital injections for Eskom, will be provided in a manner that does not affect the budget balance. Where government agrees that resources are required to firm up balance sheets, funds will be raised through the disposal of non-strategic assets held by the state, or from private investors. Support will depend on state-owned firms making a sound and sustainable business case, and strengthening internal governance.

Supporting Eskom to ensure electricity supply

A strong, sustainable electricity generation sector is necessary for the economy to grow more rapidly. Over the medium term, significant improvements to the reliability and performance of the distribution, transmission and generation system are being made, and additional power is being procured.

Government's financial support to Eskom will take several forms:

- A direct allocation to the utility of at least R20 billion, raised through the sale of non-strategic state assets. This will have no impact on the budget deficit; funds will be appropriated as they are realised.
- National government will work with municipalities to ensure that the equitable share is targeted to help poor households cope with increased electricity tariffs.
- Eskom's additional borrowing, expected to be about R50 billion over the medium term, will be accommodated within the existing guarantee facility. No new guarantees will be issued.

In the short term, greater priority will be given to cogeneration to relieve pressure on the grid. The successful execution of maintenance and refurbishment plans, timely completion of power stations under construction and the transition to a more efficient business backed by cost-reflective tariffs are needed to secure and sustain electricity supply. Government will closely monitor Eskom's financial position and, if necessary, could consider providing additional support to the utility by converting its existing subordinated loan to equity. Steps will also be taken to expand private investment in electricity.

The energy policy white paper sets a target of 30 per cent private-sector participation in electricity generation. Opportunities for independent power producers are being expanded to include other generation technologies, drawing private capital and expertise into meeting the country's energy needs.

Reviving investment in cities

Policy seeks to reshape urban landscape, renewing investment in affordable housing

Public policy seeks to reshape the urban landscape, and revive investment in affordable housing in partnership with the private sector. Improved spatial planning will help transform South Africa's urban spaces, encouraging greater integration of housing, employment and trade.

South Africa's large municipalities require massive investment to stimulate growth, maintain infrastructure and ensure that basic services are provided for growing populations. Over the next three years, government will roll out a new approach to local government infrastructure financing. Incentives will encourage large urban municipalities to promote more compact, efficient and equitable cities. Planning will focus on developing mixed-use precincts that can help to catalyse economic activity, and on upgrading informal settlements.

Reforms to grants will improve the uptake of available resources for social infrastructure. National government will work with municipalities to expand their direct contributions to investment, and the grant system will allow for more flexibility in the design of locally appropriate solutions. Greater integration between the capital investment plans of state-owned companies and city development strategies will be encouraged.

Lenders will be encouraged to expand debt-finance market for municipal infrastructure

Government will also work with private investors and development finance institutions to expand debt financing for municipal infrastructure. The Development Bank of Southern Africa is examining ways to encourage greater private investment in the municipal infrastructure market through infrastructure bonds, municipal bond underwriting, project finance and various contracting models. Any new initiatives will complement the Bank's own loan disbursements, which currently total R17.8 billion over the next three years. These initiatives will aim to improve liquidity and extend maturities in the municipal bond market – and to encourage, rather than crowd out, private investment.

Sustaining public expenditure

Fiscal consolidation can no longer be postponed. Ensuring continued progress towards a better life obliges government to safeguard the public finances by acting within fiscal limits that can be sustained over the long term. To do otherwise would risk exposing the country to a debt trap, with damaging consequences for development for many years to come.

Postponing fiscal consolidation could expose South Africa to a debt trap

Over the last five years, expansionary policies cushioned South Africa from the effect of the global crisis. Public debt is now approaching the limits of sustainability. Debt-service payments consume a growing share of the national budget, narrowing the space to expand public services and investment. Sustaining deficits while the economy is unresponsive can worsen the current account deficit, push up inflation and interest rates, and reduce the competitiveness of the currency. Over time, these conditions undermine growth and employment.

Table 1.2 Consolidated government fiscal framework, 2013/14 – 2017/18

	2013/14	2014/15	2015/16	2016/17	2017/18
R billion/Percentage of GDP	**Outcome**	**Revised**	**Medium-term estimates**		
Revenue	**1 012.7**	**1 093.9**	**1 199.5**	**1 323.0**	**1 434.6**
	29.4%	*29.5%*	*29.7%*	*30.2%*	*30.0%*
Expenditure	**1 147.4**	**1 247.1**	**1 344.0**	**1 437.1**	**1 553.4**
	33.3%	*33.6%*	*33.3%*	*32.8%*	*32.5%*
Budget balance	**-134.7**	**-153.2**	**-144.5**	**-114.1**	**-118.7**
	-3.9%	*-4.1%*	*-3.6%*	*-2.6%*	*-2.5%*
Total net loan debt	**1 379.5**	**1 588.8**	**1 799.1**	**1 989.7**	**2 192.1**
	40.0%	*42.8%*	*44.6%*	*45.4%*	*45.9%*

Source: National Treasury

Table 1.3 Division of revenue, 2014/15 – 2017/18

	2014/15	2015/16	2016/17	2017/18	Average
R billion	**Revised**	**Medium-term estimates**			**annual growth 2014/15 – 2017/18**
National allocations	494.7	523.1	553.2	585.0	5.7%
Provincial allocations	440.2	468.5	496.8	527.0	6.2%
Equitable share	*360.2*	*383.0*	*405.6*	*429.3*	*6.0%*
Conditional grants	*80.0*	*85.4*	*91.2*	*97.7*	*6.9%*
Local government allocations	91.1	99.2	103.9	110.0	6.5%
Total allocations	**1 026.0**	**1 090.8**	**1 153.9**	**1 222.0**	**6.0%**

Source: National Treasury

Spending and revenue measures

Proposals enable government to remain broadly in line with deficit path announced in 2014 Budget

Restoring sustainability to the fiscus while protecting core social and economic programmes requires a combination of spending and revenue adjustments over the next two years. Moderating expenditure growth, combined with tax measures to increase revenue, will improve the fiscal position by R22 billion in 2015/16 and R30 billion in 2016/17. This approach will enable government to remain broadly in line with the deficit path announced in the 2014 Budget, stabilising public debt despite weaker economic growth.

Proposed reductions to planned expenditure ceilings will be targeted to avoid cuts in front-line service delivery. Budgets for non-essential goods and services will be frozen, resulting in substantial savings over the next two years. For example, across national departments, planned expenditure on travel and subsistence has been cut by R555 million. Advertising and communications budgets have been reduced by R240 million. Lower spending on consultants will generate savings of R370 million, while spending on venues and catering will be R150 million lower than previously planned. Building on the cost-containment guidelines, government at all levels will need to identify opportunities to increase efficiency and reduce waste.

Restraint in growth of government's wage bill is needed to ensure fiscal rebalancing

Restraining the growth of government's wage bill is an important aspect of this rebalancing. Wage settlements should protect workers' purchasing power, with any upward adjustments matched by productivity improvements. If increases in public-sector wages significantly outpace inflation, government will be forced to curtail service delivery – either by reducing social spending or capital budgets, or by trimming staff numbers.

Over the period ahead, government will approach budgeting with a greater focus on the scope and quality of long-term expenditure planning. Indicative allocations in the third year of the framework have been restrained. A comprehensive assessment will examine baseline estimates for the outer year, emphasising value for money and alignment with longer-term policy priorities. Pending the outcome of this assessment, significant resources are left unallocated in the third year of the framework. These funds are intended to serve as a buffer against fiscal and economic shocks; a portion may also be held back to finance high-impact programmes aligned with core MTSF objectives.

Tax proposals will take into account implications for economic growth and job creation

The recommendations of the Davis Tax Committee will inform proposals that will be tabled with the 2015 Budget in February. Government's proposals will balance several policy objectives. These include enhancing the progressive character of the fiscal system, improving tax efficiency and realising a structural improvement in revenue. The short- and long-term implications for economic growth and job creation will be a key consideration.

By acting now to re-establish a sustainable foundation for the public finances, government can rebuild fiscal space in the years ahead. From this more stable base, the expansion of social budgets and public investment can proceed in line with long-term economic growth.

Government acknowledges that the proposed measures may have a dampening effect on economic growth in the short term, but they are essential to sustain investment and revive growth over the longer term. In combination with structural reforms already under way, restoring fiscal stability can open a new period of investment-led economic growth.

Improving government services and delivery

Massive expansion of national budget over past 10 years has funded large growth in social wage

The resources available in the national budget have increased from R378.2 billion in 2004/05 to R1.136 trillion in 2014/15. Increased public spending has funded a large expansion of the social wage, rising public-sector salaries and increased capital budgets. Government remains committed to maintaining the value of core social expenditure programmes while sustainably increasing capital investment.

Budgets for health, education and social grants will keep pace with inflation over the medium term. Allocations to employment programmes, technical training and skills development, as well as housing and social infrastructure, will continue to grow in real terms.

Most priorities of the five-year MTSF are financed within the three-year medium-term expenditure framework (MTEF). Where funds are needed to expand programmes or to introduce new ones, savings must be sourced from within baselines, or implementation will have to be phased in more gradually.

Better alignment and coordination can improve programme effectiveness

Better alignment and coordination across government has the potential to improve programme effectiveness without requiring additional funds. Accordingly, over the medium term, national budgets will emphasise:

- Improving the use of public resources and identifying savings to finance policy priorities without affecting service delivery.
- Restructuring the way departments and agencies work together to eliminate inefficient resource allocation and overlapping mandates.
- Reinforcing cost-containment. The 2015 Budget will pay particular attention to reducing line items that are not critical for service delivery or that do not support MTSF objectives.

In addition, government will encourage expanded partnerships between public agencies, or with the private sector, where such initiatives can bring about more efficient outcomes.

Combating corruption

Efforts to improve value for each rand spent will include strengthened measures to identify, prevent and combat corruption in both the public and private sectors. Government's anti-corruption task team has been investigating 169 criminal cases involving 945 individuals. By September of this year, these investigations had led to 54 convictions, with R1.8 million in assets frozen and R105 million in assets forfeited.

South Africa has the benefit of world-class audit and accounting institutions. Financial accounting and control systems are being strengthened, resulting in improved reporting of unauthorised, irregular or wasteful spending. Effective responses will distinguish between technical infractions and illegal activity.

Nationally negotiated contracts to be expanded over next three years

Establishing centralised oversight of public procurement will improve efforts to root out tender fraud. Over the next three years, the Office of the Chief Procurement Officer will build a foundation for more cost-effective operations in the public sector. The range and scope of nationally negotiated contracts will be expanded, a national price-referencing system will be introduced, and government will draw on private-sector expertise and best practice in procurement systems.

The fight against corruption also depends on an active citizenry, which the National Development Plan stresses is a precondition for South Africa to achieve its ambitious social and economic objectives.

Table 1.4 Consolidated government expenditure, 2014/15 – 2017/18

R billion	2014/15 Revised	2015/16	2016/17 Medium-term estimates	2017/18	Average annual growth 2014/15 – 2017/18
Basic education	188.0	201.5	212.8	226.1	6.3%
Health	145.5	154.6	163.8	175.1	6.4%
Defence, public order and safety	163.9	171.6	181.7	193.1	5.6%
Post-school education and training	53.3	59.5	64.7	68.1	8.5%
Economic affairs	195.0	202.4	217.7	227.2	5.2%
Local development and social infrastructure	176.4	199.6	208.8	221.5	7.9%
General public services	67.1	68.3	67.8	71.4	2.1%
Social protection	143.4	154.9	165.4	176.3	7.1%
Total expenditure by function	**1 132.6**	**1 212.4**	**1 282.6**	**1 358.7**	**6.3%**
Debt-service costs	114.5	126.5	139.4	149.7	9.3%
Unallocated reserves	–	5.0	15.0	45.0	
Total expenditure	**1 247.1**	**1 344.0**	**1 437.1**	**1 553.4**	**7.6%**

Source: National Treasury

2

Economic outlook

In brief

- Economic growth has deteriorated but is expected to improve moderately over the next three years, reaching 3 per cent in 2017.
- The improved outlook is supported by investments in energy and transport, a gradual pick-up in global growth, rising exports to the African continent and a recovery in private investment.
- The medium-term strategic framework prioritises initiatives that will boost investment, including major projects in rail, energy and ports, as well as immigration reform and efforts to improve dispute-resolution mechanisms in the labour relations environment.
- The global rebalancing of trade provides opportunities for South Africa to broaden exports beyond its traditional reliance on minerals, metals and agricultural exports.
- South Africa's low level of domestic savings and high investment requirements increase the economy's reliance on, and vulnerability to, foreign capital flows. Proposed fiscal measures will help to address these deficits and ensure the long-term sustainability of the public finances.

Growth and structural reform

Over time, structural reforms under way will boost economy's growth potential

South Africa's economic performance has weakened since the beginning of 2014. The National Treasury projects gross domestic product (GDP) growth of 1.4 per cent in 2014, down from 3.6 per cent in 2011. The slowdown has highlighted structural constraints in the economy. A number of factors that were perceived as temporary have become embedded into expectations. These include tightness in electricity supply, labour tensions, skills shortages and transport constraints. Nevertheless, important structural changes are occurring in major economic sectors and need to be accelerated. Achieving faster growth and job creation will require growing private-sector investment, as well as structural reforms that enhance the labour-intensity of growth.

Economic growth is expected to rise gradually over the medium term, reaching 3 per cent by 2017. The improving outlook will be supported by moderate global growth, rising exports to the rest of the continent, the easing of transport and logistics constraints as infrastructure projects are completed, a stabilisation of electricity supply and a recovery in private investment.

MTSF initiatives boost investment in electricity and transport, and encourage private investment

South Africa's longer-term economic prospects are tied to successful implementation of the reforms described in the medium-term strategic framework (MTSF) and the National Development Plan. These include large public-sector infrastructure investments in electricity and transport; expanded partnerships to encourage private-sector investment; special economic zones to boost exports; programmes to encourage more dynamic, integrated cities; and initiatives to improve the quality of education and skills development.

Critical MTSF interventions over the medium term include:

- Expanding energy supply through public and private investment, including procuring 2.5GW of privately supplied baseload electricity and signing cogeneration agreements for over 800MW to be added to the national grid.
- Expanding rail capacity for coal exports between Mpumalanga and the Richards Bay Coal Terminal, building a new heavy-haul rail line from the Waterberg region, and increasing port capacity for iron exports via Saldanha and the Northern Cape corridor.
- Enhancing the performance of sea ports and inland terminals, revising and consolidating port charges, establishing a single transport regulator and reducing cross-subsidisation in transport pricing.
- Preparing to exploit on- and offshore oil and gas by developing an exploratory drilling plan and legislation.
- Improving dispute-settlement mechanisms in labour relations.
- Enabling immigration reform to encourage people with skills to work in South Africa.

Underpinning all these initiatives is the recognition that the state must urgently step up the provision of critical services and infrastructure, and improve its capacity to plan, manage and maintain its programmes and assets.

Table 2.1 Macroeconomic projections, 2013 – 2017

Calendar year	2013	2014	2015	2016	2017
		Estimate		Forecast	
Percentage change unless otherwise indicated					
Final household consumption	2.6	1.9	2.3	2.8	3.0
Gross fixed capital formation	4.7	2.7	3.6	4.7	5.1
Real GDP growth	**1.9**	**1.4**	**2.5**	**2.8**	**3.0**
CPI inflation	5.8	6.3	5.9	5.6	5.4
Current account balance (% of GDP)	-5.8	-5.6	-5.4	-5.2	-5.0

Source: Reserve Bank and National Treasury

The world economy

Moderately improving economic growth rates in developed markets are expected to contribute to stronger global demand and international trade. Yet the world economic outlook is fragile and uneven. Employment is a major concern in both developed and developing economies. Global trade growth has slowed to just 3.8 per cent in 2014, revised down from a forecast 4.3 per cent in April of this year. A range of geopolitical risks could trigger increased volatility.

Economic growth in sub-Saharan Africa will remain above 5 per cent over medium term

Economic recovery in the United States has gathered pace, but growth in Europe and Japan has slowed. The International Monetary Fund (IMF) forecasts that emerging markets and developing economies will grow at 5 per cent in 2015, but estimates have been reduced since the beginning of this year. Concerns about slower growth in the Chinese economy, and the resultant consequences for commodity prices, feature prominently in the global forecast. The outlook for growth in sub-Saharan Africa remains above 5 per cent.

During 2014, monetary policy in advanced economies has remained broadly supportive of economic growth, but there is a growing policy divergence. While Europe is likely to continue easing monetary policy, the US Federal Reserve is expected to begin raising interest rates. With prospects of improved returns in many advanced economies, investor sentiment is turning. Rising interest rates in advanced economies may prompt currency depreciation and higher bond yields in emerging markets. If rates rise sharply because of adverse market shocks, it could prompt a broad withdrawal of capital from countries with external vulnerabilities.

Table 2.2 Annual percentage change in GDP and consumer price inflation, selected regions/countries, 2013 – 2016

Region / country	2013	2014	2015	2016	2013	2014	2015	2016
Percentage	GDP projections[1]				Consumer price index projections[1]			
World	**3.3**	**3.3**	**3.8**	**4.0**	**3.9**	**3.8**	**3.9**	**3.8**
Advanced economies	**1.4**	**1.8**	**2.3**	**2.4**	**1.4**	**1.6**	**1.8**	**2.0**
US	2.2	2.2	3.1	3.0	1.5	2.0	2.1	2.1
Euro area	-0.4	0.8	1.3	1.7	1.3	0.5	0.9	1.2
UK	1.7	3.2	2.7	2.4	2.6	1.6	1.8	2.0
Japan	1.5	0.9	0.8	0.8	0.4	2.7	2.0	2.6
Emerging markets and developing countries	**4.7**	**4.4**	**5.0**	**5.2**	**5.9**	**5.5**	**5.6**	**5.2**
Brazil	2.5	0.3	1.4	2.2	6.2	6.3	5.9	5.6
Russia	1.3	0.2	0.5	1.5	6.8	7.4	7.3	6.0
India	5.0	5.6	6.4	6.5	9.5	7.8	7.5	6.7
China	7.7	7.4	7.1	6.8	2.6	2.3	2.5	3.0
Sub-Saharan Africa	**5.1**	**5.1**	**5.8**	**6.0**	**6.6**	**6.7**	**7.0**	**6.5**
South Africa[2]	1.9	1.4	2.5	2.8	5.8	6.3	5.9	5.6

1. IMF World Economic Outlook, October 2014
2. National Treasury forecasts

In the wake of the global financial crisis, the focus of recovery has been on stimulating demand through fiscal and monetary policy, and changing patterns of world trade and investment. Commodity-exporting countries, including South Africa, have until recently benefited from strong growth in demand and rising terms of trade. Loose monetary policy and low-cost borrowing supported consumption demand and investment. Over the period ahead, while emerging markets with flexible exchange rates can take advantage of US dollar strength to improve competitiveness, they will also have to contend with the consequences of continued shifts in global trade patterns.

The world economy and South Africa

Opportunities to broaden South Africa's exports beyond minerals, metals and agricultural exports

While declining commodity prices and weakness in South Africa's largest export market – the European Union – put pressure on exports, other opportunities are emerging. Trade and financial links with sub-Saharan Africa have grown and South African firms are well positioned to expand on the continent. The global rebalancing of growth also provides opportunities for South Africa to broaden beyond its traditional reliance on minerals, metals and agricultural commodities to manufactured exports with greater value addition, supported by the more competitive exchange rate.

Strong growth in manufactured exports to SADC region

In recent years there has been particularly strong growth of exports of manufactured products to Southern African Development Community countries. In contrast, exports to Japan and the US, which historically included large quantities of platinum, have declined. Exports to China were flat in 2014, weighed down by decreased demand for minerals and metal products. Import growth has been muted in line with modest economic activity and investment.

Table 2.3 Major export destinations for South African products, 2000 – 2014

	2013	2014[1]	2000	2012	2013	2014[1]
	Contribution to export growth		% Share			
EU	3.0	4.3	31.3	20.6	21.0	23.5
Germany	*0.6*	*0.9*	*7.8*	*5.4*	*5.3*	*5.9*
UK	*0.6*	*0.9*	*8.9*	*3.9*	*4.0*	*4.4*
Netherlands	*0.8*	*0.7*	*3.3*	*3.5*	*3.8*	*4.5*
India	-0.3	1.2	1.4	4.3	3.6	4.8
Brazil	-0.0	-0.0	0.7	0.9	0.8	0.8
China	4.0	-0.0	2.0	11.6	13.9	12.6
SADC	2.5	1.3	9.8	12.9	13.7	13.6
Mozambique	*1.1*	*0.5*	*2.3*	*2.7*	*3.4*	*3.7*
Zimbabwe	*0.5*	*0.3*	*2.2*	*2.7*	*2.8*	*2.8*
Zambia	*0.6*	*0.4*	*2.0*	*2.9*	*3.1*	*3.2*
US	0.5	-0.2	12.0	8.8	8.3	8.1
Japan	1.2	-0.7	8.1	6.3	6.7	5.7
Unallocated[2]	-1.4	-1.6	15.2	11.0	8.5	7.1
Other[3]	2.8	2.1	19.6	23.7	23.5	23.8
Total	**12.4**	**6.5**	**100.0**	**100.0**	**100.0**	**100.0**

1. First seven months of 2014
2. Commodities, such as gold, sold through exchanges
3. Includes Hong Kong, Korea, Singapore, Malaysia, Australia, Nigeria, Ghana, Angola, Egypt and United Arab Emirates
Source: Quantec

After narrowing in 2010 and 2011, the deficit on South Africa's current account has returned to a range of about 5.5 per cent of GDP over the past two years. The main factor in this deterioration has been the rising trade deficit, only partially offset by declining service and dividend income outflows. Global investment appetite for South African assets has remained strong, supported by the broader exposure to the region provided by many local firms. Monetary conditions in advanced economies have also sustained capital inflows.

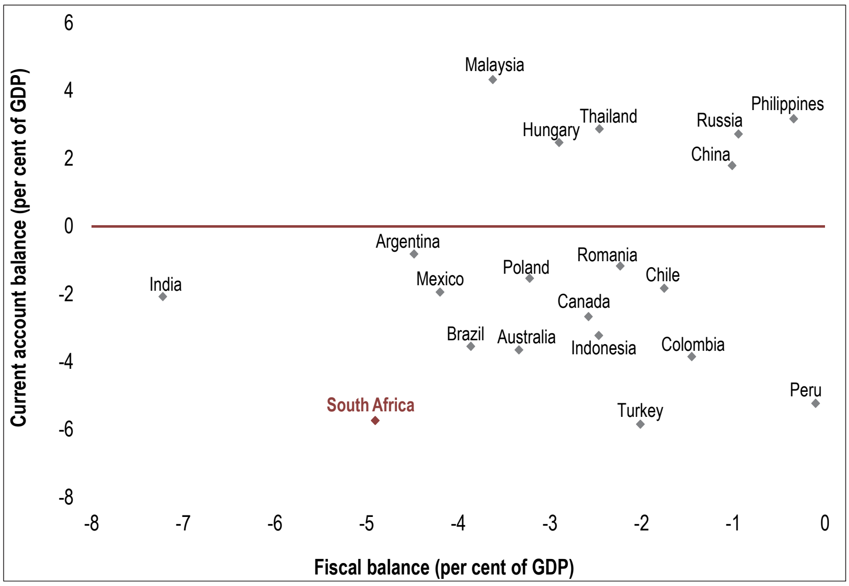
To date, capital flows have been sufficient to finance investment. The inflation-targeting regime has helped to minimise the impact of currency movements on prices, and to prevent real competitiveness gains from being eroded by inflation. The country's strong monetary and financial market institutions continue to provide stability to the economy.

However, the low level of domestic savings and high investment requirements increase the economy's reliance on, and vulnerability to, foreign capital flows. South Africa's "twin deficits" – a reference to the current account and fiscal balances – are larger than those of many of its emerging market peers.

Government's proposed fiscal package will reduce external vulnerability

The fiscal proposals set out in Chapter 3 will help to reduce external vulnerability by moving government towards a positive savings position over the medium term.

Figure 2.1 Current account and fiscal balances, 2014 forecasts



Source: IMF World Economic Outlook October 2014

Table 2.4 Balance of payments, 2007 – 2014

Percentage of GDP	2007	2008	2009	2010	2011	2012	2013	2014[1]
Total current account	**-7.0**	**-7.2**	**-4.0**	**-2.0**	**-2.3**	**-5.2**	**-5.9**	**-5.4**
Trade balance	-1.8	-1.6	0.1	1.9	1.6	-1.3	-2.2	-2.5
Net services, income and transfer receipts	-5.2	-5.6	-4.1	-3.8	-3.9	-4.0	-3.7	-2.9

1. First six months of 2014
Source: Reserve Bank

Domestic economic outlook and trends

Economic growth to improve over medium term as energy and transport projects are completed

GDP growth is projected to rise gradually from an estimated 1.4 per cent in 2014 to 3 per cent in 2017. Factors weighing on short-term economic performance include electricity and other infrastructure constraints, low levels of business and consumer confidence, and moderate employment and personal disposable income growth. Economic performance is expected to improve in the years ahead, as energy generation and transport infrastructure projects are completed, and as export markets recover.

Strong investment growth in manufacturing and, more recently, in construction

Although domestic economic demand has been generally robust, in recent quarters demand has trended lower in line with lower growth in consumption, personal income and credit. Investment growth has also been muted, averaging just 3 per cent per year since 2010. While investment growth in residential and non-residential buildings has declined, spending on machinery and equipment has shown strong average growth of 7.2 per cent per year since 2011. Investment growth has been particularly strong in manufacturing. Growth in mining and the tertiary sectors has been weak. Over the past three quarters the value of construction works has picked up dramatically, underscoring growth in the sector and progress in infrastructure delivery.

Table 2.5 Macroeconomic performance and projections, 2011 – 2017

Calendar year	2011	2012	2013	2014	2015	2016	2017
		Actual		Estimate		Forecast	
Percentage change unless otherwise indicated							
Final household consumption	4.9	3.5	2.6	1.9	2.3	2.8	3.0
Final government consumption	4.3	4.0	2.4	1.8	1.5	1.5	1.5
Gross fixed capital formation	4.2	4.4	4.7	2.7	3.6	4.7	5.1
Gross domestic expenditure	4.6	4.0	2.2	0.9	2.6	3.0	3.3
Exports	6.8	0.4	4.2	3.1	4.2	4.7	5.2
Imports	10.0	6.0	4.7	1.0	4.1	5.0	5.6
Real GDP growth	**3.6**	**2.5**	**1.9**	**1.4**	**2.5**	**2.8**	**3.0**
GDP inflation	5.9	4.5	5.8	6.1	5.8	5.7	5.6
GDP at current prices (R billion)	**2 932.7**	**3 139.0**	**3 385.4**	**3 642.6**	**3 952.6**	**4 295.8**	**4 675.6**
Nominal GDP growth	**9.7**	**7.0**	**7.8**	**7.6**	**8.5**	**8.7**	**8.8**
Headline CPI inflation (Dec 2012 = 100)	5.0	5.7	5.8	6.3	5.9	5.6	5.4
Current account balance (% of GDP)	-2.3	-5.2	-5.8	-5.6	-5.4	-5.2	-5.0

Source: Reserve Bank and National Treasury

Table 2.6 Macroeconomic performance and projections, 2011/12 – 2017/18

Fiscal year	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
		Actual		Estimate		Forecast	
Percentage change unless otherwise indicated							
Real GDP growth	3.3	2.2	1.9	1.6	2.6	2.9	3.1
GDP inflation	5.0	5.0	5.8	5.9	5.9	5.7	5.6
Headline CPI inflation (Dec 2012 = 100)	5.6	5.6	5.8	6.2	5.8	5.5	5.3
GDP at current prices (R billion)	2 981.8	3 198.6	3 449.0	3 712.3	4 033.6	4 386.4	4 775.1

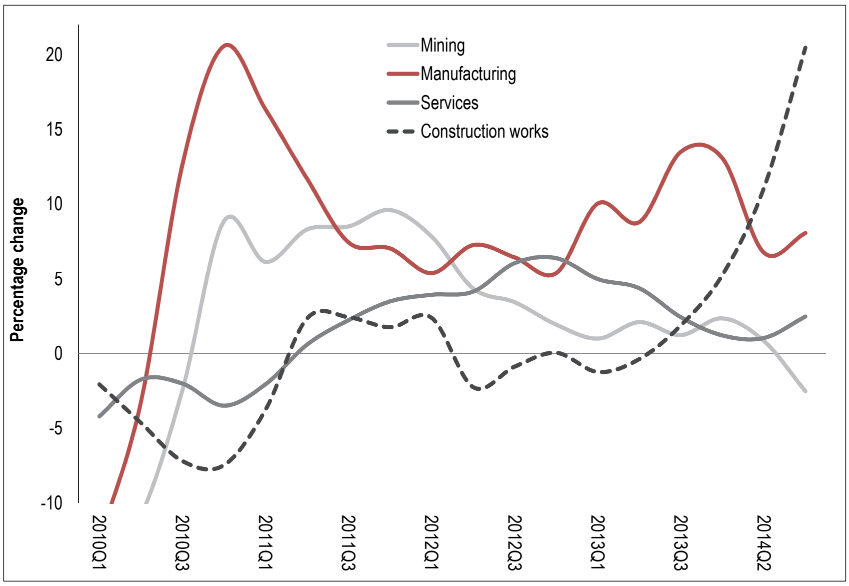
Source: Reserve Bank and National Treasury

Over the medium term, higher investment should be supported by continued strong demand from African export markets and expanding partnerships with the private sector.

If sustained, competitive rand exchange rate will help to boost exports

The more competitive rand exchange rate, if sustained in real terms and not eroded by wage settlements that outpace productivity gains, will help to boost exports and support further investment in tradable sectors, including manufacturing. Private investment growth is projected to reach 3.9 per cent in 2015 and 5.8 per cent in 2016.

Figure 2.2 Investment by sector, percentage growth, 2010 – 2014[1]



1. Real 2005 prices, year-on-year percentage change

Source: Reserve Bank

Unemployment rate remains at about 25 per cent

The unemployment rate remains at about 25 per cent, or 35 per cent if discouraged job seekers are included. The 2014 June Quarterly Labour Force Survey indicated that 403 000 jobs had been created since June 2013, but the Quarterly Employment Survey suggests that formal employment creation was more moderate. Temporary employment associated with national and provincial elections in May 2014, and growth in public-employment programmes, appears to account for a large share of growth recorded in 2014.

Weak employment outcomes are reflected in slowing real disposable income growth. As household balance sheets come under strain, credit extension has declined, reducing the pace of household consumption growth.

Monetary policy and subdued demand have helped to keep inflation stable

The consumer price index (CPI), which stayed mostly within the 3 to 6 per cent target band over the past four years, rose to 6.4 per cent in August 2014. This was caused by a spike in domestic maize and wheat prices, and the impact of the weaker rand on petrol prices. Monetary policy and subdued demand conditions have helped to keep inflation levels stable. In comparison to countries with similar growth rates, however, inflation remains elevated, suggesting stubborn levels of core inflation and structural imbalances in the economy.

Over the period ahead, food inflation is expected to recede from current levels thanks to buoyant global and domestic production. Together with an expected moderation in global oil prices, these forces should partially offset increases in electricity prices. Headline inflation is expected to return within the target band in the first quarter of 2015, and core inflation is likely to remain close to current levels of 5.8 per cent in 2015. Further rand depreciation would pose an upside risk to the inflation forecast.

The growth outlook is expected to improve over the medium term in line with a gradual normalisation of electricity supply as the availability of existing plant improves and new generating capacity is added to the grid.

Other infrastructure projects, such as those taking place in the transport and logistics sector, will also be completed, reducing output constraints.

Structural changes under way in South Africa

MTSF programmes complement structural shifts already under way in the economy

The National Development Plan acknowledges that growth and job creation must be underpinned by a shift from consumption to investment. The MTSF outlines programmes and investments to improve productivity and competitiveness, particularly in core productive sectors and new areas with potential, such as on- and offshore oil and gas, and green technology. These reforms will complement structural shifts that are already under way in the main sectors of the economy.

As a result of some of these structural changes, the labour intensity of production continues to decline. While reductions in labour intensity boost unit labour productivity and can enhance competitiveness, the economy is not creating jobs at a sufficient pace to absorb new entrants in the workforce, or to substantially reduce unemployment.

Table 2.7 Sector growth trends, 2012 – 2014

	2012	2013					2014		
Percentage	**Year**	**Q1**	**Q2**	**Q3**	**Q4**	**Year**	**Q1**	**Q2**	**Year[1]**
Agriculture, forestry and fishing	2.0	-4.4	-3.0	3.6	6.4	2.3	2.5	4.9	3.3
Mining and quarrying	-3.6	13.4	-5.4	11.4	15.7	3.1	-24.7	-9.4	-2.6
Manufacturing	2.1	-7.9	11.7	-6.6	12.3	0.8	-4.4	-2.1	1.2
Electricity and water	-1.6	-2.8	5.1	3.8	-5.6	-0.4	0.1	-0.6	0.1
Construction	2.3	2.5	2.3	2.1	3.1	2.8	4.9	5.0	3.4
Wholesale and retail trade, hotels and restaurants	3.8	2.1	3.1	1.3	2.3	2.2	2.1	-0.2	1.8
Transport and communication	2.4	2.1	1.5	2.6	1.6	1.9	1.7	4.0	2.1
Finance, real estate and business services	3.7	3.3	3.5	1.2	1.5	2.4	2.0	1.5	1.8
Personal services	2.1	1.2	1.6	1.6	1.3	1.8	1.0	1.2	1.3
General government	2.8	0.1	0.2	0.4	0.9	1.5	1.7	2.9	1.2
GDP	*2.5*	*0.8*	*3.2*	*0.7*	*3.8*	*1.9*	*-0.6*	*0.6*	*1.4*

1. Year-to-date growth trend
Source: Reserve Bank

Government employment programmes can complement private-sector job creation. Over the past five years the Expanded Public Works Programme created 4 million jobs of short- to medium-term duration. The Department of Environmental Affairs runs several programmes that create jobs and train people. The Department of Trade and Industry provides incentives to create jobs in areas such as business process outsourcing and offshoring, which has created 9 000 jobs to date.

Early indications suggest successful take-up of employment tax incentive

Initial reports suggest that the employment tax incentive, implemented at the beginning of this year, has begun to improve job prospects for young workers. As at August 2014, about 23 500 employers had claimed the incentive for at least 209 000 employees. From inception to date the Jobs Fund has approved 93 projects and allocated R5 billion in grant funding. This has leveraged a further R6.1 billion from project partners. Total employment in these projects amounts to 167 847, of which 56 356 are new placements into vacant positions. Over 185 000 beneficiaries will receive work-related training.

Manufacturing

Growth in manufactured exports suggests competitiveness and efficiency gains

The manufacturing sector has struggled to recover from the 2009 recession and the slowdown in Europe, with output affected by electricity and transport constraints, as well as labour stoppages. Manufacturing has, however, invested more than any other sector over the past four years, increasing gross fixed capital formation by 9.2 per cent per year from the first half of 2010 to the first half of 2014. The sector's lower value add and employment performance can be partly explained by the long lead times involved in large investments, but also by changing patterns of investment between sub-sectors and productivity improvements.

Growth in manufactured exports has risen, suggesting competitiveness and efficiency gains, partly through upgrading of obsolete capital equipment, supported by industrial policies and incentives such as the Manufacturing Competitiveness Improvement Programme. This has helped to realign the sector with changing global patterns of demand and competition, and should lead to higher output and growth as other constraints are eased.

Agriculture

Labour-intensive horticultural exports growing as share of total agricultural output

Agriculture has grown strongly in 2014, due mainly to large increases in maize and livestock production, favourable weather conditions and higher prices. The sector has also gone through significant structural changes since 2000, shifting away from traditional crops, becoming more commercial and export focused. While this has reduced employment, labour-intensive horticultural exports (such as grapes, citrus and tree nuts) are now growing as a share of total agricultural output, replacing highly mechanised grain exports such as maize and wheat. The largest exporting subsector, horticulture, grew its exports to Africa by 24 per cent, while global citrus exports grew by 29 per cent.

Exports from manufacturing and agriculture are responding to growing demand in sub-Saharan Africa and elsewhere, which should help to boost export performance over the medium term.

Energy

Economy's energy-intensity is decreasing in response to price effects and availability

South Africa's electricity shortage has been a primary constraint to growth and investment, but it has also forced structural changes in the energy sector and across the economy. Through both price effects and availability constraints, the energy intensity of the economy, measured as units of energy required per unit of GDP, has declined. Between 2008 and 2011, electricity intensity decreased by 7.4 per cent. The use of solar panels, compact fluorescent light bulbs, smart buildings, cogeneration and other efficiency measures has increased, with economy-wide investments tending to shift towards less energy-intensive sectors.

The gradual shift to lower energy intensity has been supported by increased diversity in the energy mix – both in terms of fuels used and the sources of energy (public and private, local and regional). The Renewable Energy Independent Power Producer Programme has now connected 1GW of electricity generation capacity, awarded another 1.4GW and is in the final stages of allocating a further 1.5GW. Energy imports from Mozambique's Cahora Bassa hydroelectric plant and the Aggreko temporary power plant have grown, as have short-term electricity purchases from municipalities, like the Kelvin power station in Gauteng. Private supply for own use has also increased, with some large firms building their own power plants. The Department of Energy will soon issue a formal request for proposals inviting independent power producers to submit bids to generate coal-fired electricity.

Mining

Over the past several years protracted labour disputes, electricity shortages and maintenance issues have resulted in large swings in mining output. Production has shifted away from gold towards iron ore and platinum. While the share of mining as a percentage of GDP has been declining since the 1970s, the sector accounts for just under 50 per cent of South Africa's exports, and its linkages with the rest of the economy remain strong. As South Africa diversifies away from its reliance on mineral exports in an era of declining commodity prices, a number of activities outlined in the MTSF will support improved productivity and output.

Financial sector regulation

Government continues to strengthen financial sector reforms

Government is continuing work to strengthen the financial sector in line with a series of reforms announced in the 2011 paper *A safer financial sector to serve South Africa better*. In 2014, draft regulations for over-the-counter derivatives, credit agreements, hedge funds and insurance were released. Substantial progress has been made with retirement reforms. The second draft of legislation to implement a "twin-peaks" model of financial regulation has been completed and will soon be tabled in Parliament.

African Bank curatorship

Over the past several years, a growing pattern of unsecured lending for personal loans boosted temporary access to credit, but also proved expensive to consumers. Earlier this year, African Bank Limited, which accounted for 2 per cent of banking assets, began to founder. The Reserve Bank acted to forestall contagion of the broader banking system, and the Minister of Finance placed African Bank under curatorship. The restructuring, which involves the private sector, is proceeding well. Government has not provided any funds to bail out African Bank, but has provided a R7 billion backstop to the Reserve Bank in line with international practice. It is unlikely that the Reserve Bank will draw on this facility, and no costs to the taxpayer are expected.

Transport and telecommunications

Freight rail investments to improve turnaround times, with growing capacity to produce rolling stock in passenger rail

Large capital investments under way in transport will result in higher productivity over time. In the case of Transnet, turnaround times for rapid loading facilities, grain elevators, branch lines, specialised wagons and consolidated terminals will improve efficiency in freight rail. The Passenger Rail Agency of South Africa's R53 billion investment in commuter rail will progressively increase domestic capacity to produce rolling stock, while improving the quality of public transport. Telecommunications investments such as the completion of FibreCo's 2000km fibre-optic network, Vodacom and Cell C's network upgrades, and the rollout of municipal WiFi hotspots will expand broadband access and speed. Reduced cellphone termination rates have already contributed to lower prices in the telecoms sector, while the launch of new service providers is expected to increase competition in the sector.

3

Fiscal policy

In brief

- Government proposes a comprehensive package of measures to narrow the budget deficit, stabilise debt and begin to rebuild fiscal space.
- Moderating expenditure growth, combined with tax measures to increase revenue, will improve the fiscal position by R22 billion in 2015/16 and R30 billion in 2016/17.
- Expenditure on core social and economic programmes will be maintained, with reductions focused on non-essential goods and services.
- Personnel budgets of national government will be frozen and funding for vacancies will be reviewed.
- Despite weak economic growth, the fiscal proposals will enable government to remain broadly in line with the deficit path announced in the 2014 Budget, stabilising national debt at 46 per cent of GDP in 2017/18.

A sustainable foundation for the public finances

Fiscal course adjustment responds to weaker-than-expected economic growth and moderate outlook

Government proposes a medium-term fiscal policy package to re-establish a sustainable foundation for the public finances in the decade ahead. The proposals represent a course adjustment in line with weak economic growth over the past several years and the moderate outlook for GDP. Over the medium-term expenditure framework (MTEF) period, government's fiscal objectives are to:

- Reduce the budget deficit in line with the targets announced in the 2014 Budget. This will require slower expenditure growth and tax reforms to increase revenue collection.
- Stabilise debt to ensure fiscal sustainability, and shift resources away from interest payments to service delivery.
- Continue to shift spending towards government's priorities as set out in the National Development Plan and the medium-term strategic framework (MTSF).
- Contain growth in budgets for goods and services, and compensation of employees.

Government remains committed to the fiscal principles of countercyclicality, debt sustainability and intergenerational equity. Over the period ahead, the focus will shift to debt sustainability, allocative efficiency and obtaining value for money in public spending.

Fiscal course adjustment

Favourable conditions that supported high expenditure growth rates are no longer present

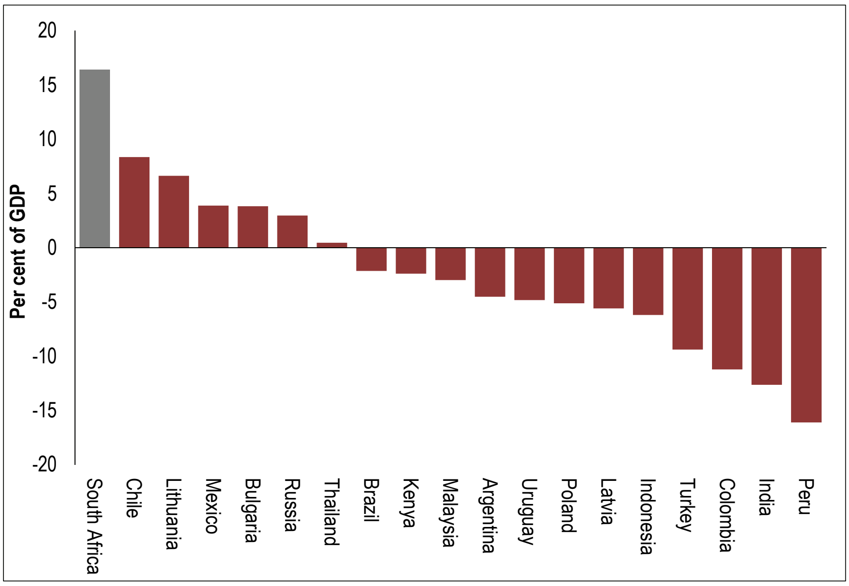
South Africa's weaker-than-expected economic performance and outlook pose new fiscal challenges. When the economy was in recession in 2009, fiscal space built up during preceding years enabled government to respond with a large spending package on the assumption that revenue would rebound in line with an improving economy. Low international interest rates helped government to finance its borrowing requirement, inflation was moderate and high commodity prices buoyed tax revenues.

The favourable conditions that supported high expenditure growth rates are no longer present. Commodity prices are declining and the rand's depreciation has pushed up inflation. After falling sharply during the 2000s, interest rates on newly issued government debt have stabilised and are projected to rise over the medium term.

South Africa's debt-to-GDP ratio increase is comparatively high among emerging markets

Despite government's success in maintaining the expenditure ceiling over the past three years, the main budget deficit remains at about 5 per cent of GDP. Weak economic growth has entrenched a structural imbalance between revenue and expenditure. Even after taking the fiscal package into account, the increase in South Africa's debt-to-GDP ratio between 2009 and 2019 is the highest among its emerging-market peers.

Figure 3.1 Projected change in debt-to-GDP ratio, 2009 – 2019



Source: South African data from National Treasury; all other data from IMF

Gross national debt is expected to reach R2.4 trillion in 2017/18

Over the next three years, government's gross debt stock is projected to increase by R590 billion, bringing total debt to R2.4 trillion. At the same time, redemptions on debt issued over the past decade will add R194 billion to the medium-term borrowing requirement. Government's gross financing requirement will escalate sharply from 2017, as bonds issued in the wake of the global financial crisis fall due.

Without action to narrow the deficit, public debt will continue to grow beyond the medium term. While prudent levels of government borrowing play an important role in supporting the economy and protecting spending priorities, continued borrowing at the current level is unsustainable. Without an adjustment, it is likely that South Africa's sovereign debt would be downgraded to "sub-investment grade", risking impaired access to credit markets as gross financing requirements escalate.

Fiscal consolidation can no longer be postponed

The 2012 *Medium Term Budget Policy Statement* pointed out that if the economic and fiscal outlook were to deteriorate, a reconsideration of expenditure and revenue plans would be warranted. In the 2013 Budget, government trimmed its spending plans and reduced the unallocated contingency reserve. Eight months ago, the 2014 Budget stated that additional measures to ensure fiscal sustainability would be required if the economic outlook were to worsen.

That turning point has been reached.

Fiscal package to reinforce sustainability

Proposals to narrow deficit and stabilise debt include spending and tax measures

Government proposes a series of measures to narrow the deficit and stabilise debt over the medium term. The five elements of the fiscal package are as follows:

- Reduce growth in spending. Government will lower its 2014 Budget expenditure ceiling by R25 billion over the next two years.
- Adjust tax policy and administration. Proposals will be introduced in the 2015 Budget to generate additional revenue of at least R27 billion over the next two years.
- Strengthen budget preparation. Government will place greater emphasis on longer-term planning and efficient resource allocation, within a fiscal framework that links aggregate expenditure and economic growth beyond the medium term.
- Freeze government personnel headcounts. Government will also review funded vacancies.
- Adopt a deficit-neutral approach to financing state-owned companies. Over the next two years, government will ensure that any capitalisation required does not widen the budget deficit.

Lowering the expenditure ceiling

The expenditure ceiling has been in place since 2012/13 and, since then, government has stayed within its spending targets.

Table 3.1 Main budget non-interest expenditure, 2011/12 – 2017/18

R million	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
2012 Budget Review	814 554	879 977	953 024	1 030 539			
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	
2014 MTBPS				1 021 855	1 095 761	1 168 940	1 267 025

Source: National Treasury

In aggregate, expenditure will continue to grow in real terms by 1.8 per cent a year

The 2014 Budget limited non-interest expenditure to R1.028 trillion in 2014/15, R1.106 trillion in 2015/16 and R1.184 trillion in 2016/17. Government proposes to reduce this ceiling by R10 billion in 2015/16 and R15 billion in 2016/17. Decreases in indicative baselines will be allocated proportionately across national, provincial and local government, according to their share of national revenue. In aggregate, expenditure will continue to grow in real terms by 1.8 per cent a year. All government departments and agencies will need to reduce inefficiency and waste, and minimise the impact on front-line service delivery, by targeting non-essential items and uncommitted resources. Spending on core social obligations will be protected.

To effect the lower ceiling, national government will:

- Freeze budgets of non-essential goods and services at 2014/15 levels.
- Withdraw funding for posts that have been vacant for some time.
- Reduce the rate of growth of transfers to public entities, particularly those with cash reserves.

The provincial equitable share will also be reduced. Reductions in provincial and local conditional grants will target patterns of underexpenditure. The local government equitable share will be protected to ensure the provision of free basic services.

Changes to tax policy and administration

Structural revenue increase is proposed

Government proposes a structural increase in revenues over the medium term. Policy and administrative reforms will raise at least R12 billion in 2015/16, R15 billion in 2016/17 and R17 billion in 2017/18. The details of proposed changes will be announced by the Minister of Finance in February when he tables the 2015 Budget in Parliament.

The proposals will enhance the progressive character of the fiscal system, improve tax efficiency and realise a structural improvement in revenue. The short- and long-term implications for economic growth and job creation will be a key consideration.

Reforms to medium-term budgeting

Acting now to reduce deficit will allow government to rebuild fiscal space in future

Acting now to re-establish a sustainable foundation for the public finances will enable government to rebuild fiscal space in the years ahead. Once debt has stabilised, spending growth will match long-term economic growth trends.

Over the next two years, during which there is little scope to augment resources, the budget process will be refocused. A new approach to budget preparation will extend the scope and quality of long-term expenditure planning. A comprehensive assessment will examine baseline estimates for the outer year, emphasising value for money and alignment with longer-term policy priorities. Indicative allocations in the third year of the budget framework have been restrained, and there are substantial unallocated resources. These resources will be available to build a buffer against economic and fiscal shocks in the years ahead. A significant amount may also be considered for allocation to high-impact programmes.

Freeze on personnel expansion and review of vacancies

To contain compensation budget pressures, government personnel headcounts will be frozen for the next two years. Any increase in personnel will be funded from existing allocations. The National Treasury, the Department of Performance Monitoring and Evaluation, the Department of Public Service Administration and officials from other departments will conduct a review over the next year to consider the permanent withdrawal of funded vacancies. Natural attrition will create space for new appointments. Exceptions will be considered for critical positions, with the onus on departments to justify exceptions. Provincial governments will be strongly encouraged to follow the same approach.

Increases in departmental personnel will be funded from existing allocations

Deficit-neutral financing of state-owned companies

Over the next two years, capital injections for Eskom and funding for other state-owned companies will be raised in a way that has no effect on the budget deficit. In some instances, government will dispose of non-strategic assets to raise resources for financial support. Such assets could include property, direct and indirect shareholdings in listed firms, non-strategic government shareholdings in state-owned companies and surplus cash balances in public entities.

Capitalisation will not be automatic, but will depend on demonstration of sound business plans

Private investment to strengthen the balance sheets of state-owned entities will also be explored. Funding allocations will not be automatic, but will depend on entities demonstrating sound business plans and greater efficiencies. Any capitalisation will only take place once the proceeds of asset sales are deposited into the National Revenue Fund, and will require a special appropriation bill tabled by the Minister of Finance.

The fiscal framework

Table 3.2 summarises the fiscal framework.

Table 3.2 Consolidated fiscal framework,[1] 2011/12 – 2017/18

R billion/Percentage of GDP	2011/12	2012/13	2013/14	2014/15		2015/16	2016/17	2017/18
		Outcome		Budget	Revised	Medium-term estimates		
Main budget								
Revenue	**745.3**	**799.2**	**886.1**	**962.8**	**956.6**	**1 055.1**	**1 169.4**	**1 272.9**
Expenditure	**889.9**	**965.5**	**1 047.8**	**1 142.6**	**1 136.3**	**1 222.3**	**1 308.4**	**1 416.7**
of which								
Non-interest allocations	*813.5*	*877.4*	*946.6*	*1 024.7*	*1 021.9*	*1 090.8*	*1 153.9*	*1 222.0*
Debt-service costs	*76.5*	*88.1*	*101.2*	*114.9*	*114.5*	*126.5*	*139.4*	*149.7*
Unallocated reserves	*–*	*–*	*–*	*3.0*	*–*	*5.0*	*15.0*	*45.0*
Main budget balance	**-144.6**	**-166.3**	**-161.7**	**-179.8**	**-179.7**	**-167.2**	**-139.0**	**-143.8**
	-4.9%	*-5.2%*	*-4.7%*	*-4.7%*	*-4.8%*	*-4.1%*	*-3.2%*	*-3.0%*
Cash balances of social security funds, public entities and provinces	33.8	30.1	27.0	26.7	26.5	22.7	25.0	25.0
Consolidated budget balance	**-110.8**	**-136.2**	**-134.7**	**-153.1**	**-153.2**	**-144.5**	**-114.1**	**-118.7**
	-3.7%	*-4.3%*	*-3.9%*	*-4.0%*	*-4.1%*	*-3.6%*	*-2.6%*	*-2.5%*

1. Further details of the fiscal framework can be found in the technical annexure
Source: National Treasury

The framework, which takes into account government's fiscal policy package, allows for moderate real growth in spending over the next three

Fiscal framework allows for moderate real growth in spending over medium term years, enabling government to maintain its core social and economic programmes. A comprehensive presentation of the fiscal framework appears in Table A.3 of the technical annexure.

2014/15 budget deficit projected at 4.1 per cent of GDP

The 2014/15 budget deficit is projected at 4.1 per cent of GDP. Gross tax revenue has been revised downwards by R10 billion in the current year, owing to underperformance on corporate income tax, customs duties, value added tax and the fuel levy – and downside risks remain.

Lower tax revenue estimates have been partly offset by higher-than-anticipated receipts from financial transactions, reflecting premiums on inflation-linked bonds and higher revaluation profits on foreign-currency transactions. The borrowing requirement is also eased by projected underspending of R6.2 billion in the current year.

Figure 3.2 Main budget non-interest spending

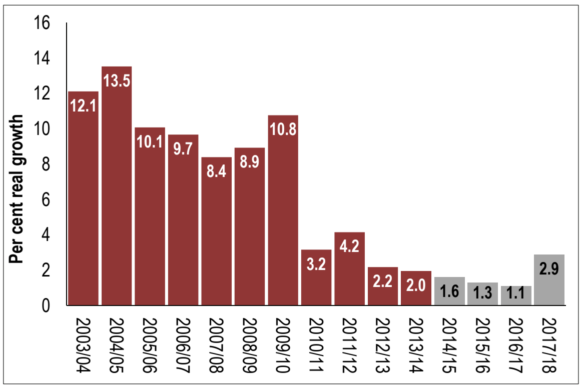
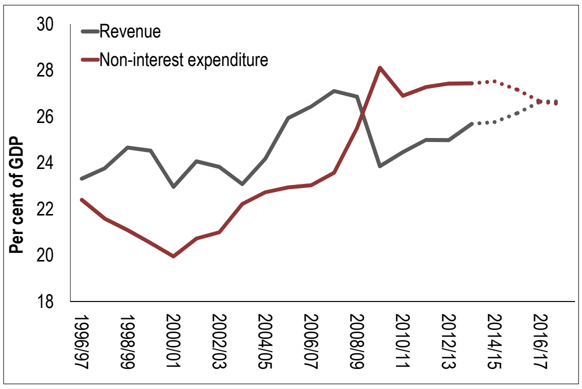


Figure 3.3 Main budget primary balance



Source: National Treasury

The slower rate of spending growth allows the main budget deficit to narrow to 3 per cent by 2017/18, helping to stabilise the debt-to-GDP ratio. The expenditure ceiling in the outer year of the framework includes R45 billion in unallocated reserves. These funds will serve as a fiscal buffer, though a portion could also be used to fund high-impact programmes.

The current balance, which shows how much government must borrow to finance non-capital spending, is an indicator of how public finances affect national savings. As Table 3.3 shows, government is projected to close the current deficit in 2015/16. By taking these steps, government will finance part of its capital budget from savings, rather than borrowing.

Table 3.3 Consolidated current and capital balances, 2013/14 – 2017/18

	2013/14	2014/15	2015/16	2016/17	2017/18
R billion/Percentage of GDP		**Estimate**	**Medium-term estimates**		
Current balance	**-8.9**	**-9.3**	**24.1**	**68.7**	**107.0**
	-0.3%	*-0.3%*	*0.6%*	*1.6%*	*2.2%*
Capital borrowing requirement	**-136.6**	**-149.8**	**-163.8**	**-174.5**	**-184.2**
	-4.0%	*-4.0%*	*-4.1%*	*-4.0%*	*-3.9%*

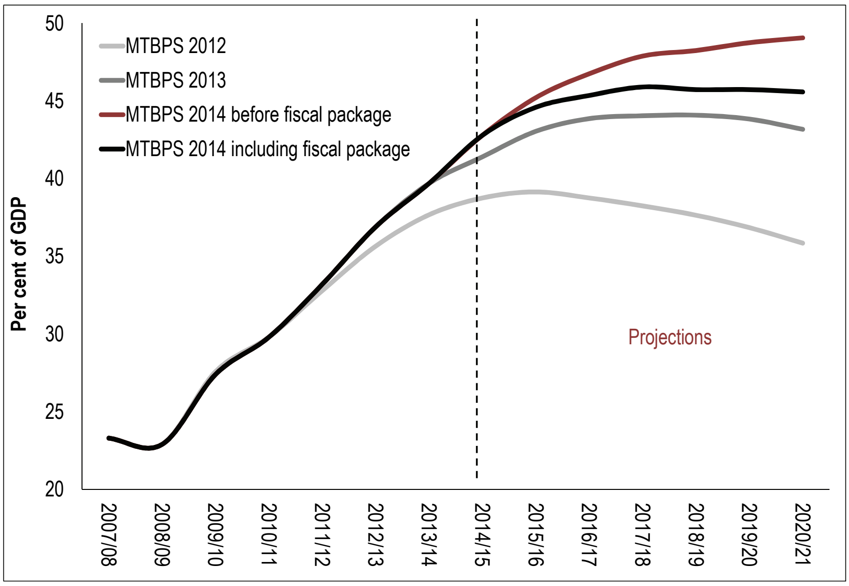
Source: National Treasury

Managing government's debt portfolio

Together with government's prudent debt management strategy, the fiscal package will ensure the sustainability of South Africa's debt stock. Before the proposed changes, national government's net debt – gross debt less surplus cash – was projected to continue growing as a share of GDP beyond 2021. The fiscal package results in debt stabilising at 45.9 per cent of GDP in 2017/18 and declining thereafter. More details on the financing of national government borrowing appear in Tables A4 and A5 of the technical annexure.

Net debt projected to peak at 45.9 per cent of GDP in 2017/18

Figure 3.4 Net national government debt, 2007/08 – 2020/21



Source: National Treasury

Risks to the fiscal outlook

The main risks to the fiscal outlook are economic performance, the public-sector wage bill and the balance sheets of state-owned companies.

Economic outlook

Over the past three years, fiscal consolidation has been hampered by lower-than-expected economic growth and revenue collections. Rand depreciation and higher inflation have pushed up the level of debt and debt-service costs on foreign-currency denominated and inflation-linked bonds, but have also helped to offset the weaker revenue outlook. Concerns about a rising global interest-rate cycle have put upward pressure on domestic interest rates, increasing the costs of issuing debt. The current account deficit remains persistently high, making South Africa more vulnerable to shifts in investment flows and market sentiment.

High current account deficit makes South Africa more vulnerable to shifts in investment flows

The fiscal package will mitigate some of these risks, including helping to reduce the current account deficit. Deterioration in the economic outlook, however, would require consideration of additional measures. More rapid economic growth in the context of stable prices would enable government to attain its fiscal objectives earlier.

Wage bill

Budgets planned on neutral assumption that cost of living adjustments will track consumer price index

Negotiations for a new public-sector wage agreement are under way. Budgets have been planned on the neutral assumption that cost-of-living adjustments will track consumer price index (CPI) projections. The budget also assumes that overall headcount numbers will stabilise at current levels. In previous budget cycles resources were available to accommodate unanticipated wage pressures, but given current constraints, there is little scope to provide more resources over the MTEF period. Any departure from the path of CPI-linked cost-of-living adjustments will require either a reallocation of resources from other spending areas (capital, goods and services, transfers), or prompt a need to reduce government employment.

State-owned companies and public entities

Financially sound state-owned companies are needed to broaden social and economic development

State-owned companies and public entities play important roles in realising government's economic and social mandate. They need to be financially sound and operationally effective, contributing to development without draining the fiscus.

Government is proposing a new framework for funding state-owned companies that will distinguish purely commercial activities from the costs of exercising their developmental mandates. It will include closer monitoring to ensure efficient delivery on government priorities, while simultaneously promoting improved commercial performance. Government has also introduced more stringent financial reporting requirements for public entities.

Capitalisation will be funded from sale of non-strategic state assets, and will not be drawn from tax revenue

Over the medium term, any funding of state-owned companies will be contingent on the implementation of sound restructuring plans with strong government oversight. Given fiscal constraints over the next two years, capitalisation will only be funded by the sale of non-strategic state assets, and will not be drawn from tax revenue or added to the debt of national government. Government policy remains that state-owned companies should operate on the strength of their balance sheets.

In line with the successful restructuring of the Development Bank of Southern Africa, reforms are being undertaken at South African Airways, South African Express, the South African Post Office and the Land Bank.

4

Expenditure priorities and the division of revenue

In brief

- Government proposes expenditure growth of 7.6 per cent a year over the next three years, reaching R1.55 trillion by 2017/18.
- The proposed fiscal package reduces previously announced indicative budgets for 2015/16 and 2016/17 by R10 billion and R15 billion respectively.
- In line with the medium-term strategic framework, the largest allocations over the three-year spending period ahead are to basic education (15 per cent), health (11 per cent) and social protection (11 per cent).
- Spending by function will grow most rapidly in post-school education and training, and employment, labour affairs and social security funds.
- Debt-service costs will grow at 9.3 per cent per year – faster than the budget as a whole – reaching about R150 billion in 2017/18.

Spending plans for the next three years

In line with the economic outlook discussed in Chapter 2, and the fiscal policy considerations set out in Chapter 3, government has adjusted its plans for the three-year spending period ahead. Moderate real growth in spending will enable government to finance most of the key priorities of the National Development Plan as expressed in the medium-term strategic framework (MTSF).

Moderate real growth in spending will enable government to finance most MTSF priorities

Expenditure will remain focused on social services (education and skills development, health and social protection), which will account for about 42 per cent of allocated spending over the medium-term expenditure framework (MTEF) period. About 18 per cent of spending will be directed towards the provision, management and regulation of social and economic infrastructure. Government will continue to pursue greater efficiency and value for money in achieving its goals.

Lowering the previously announced expenditure ceiling necessitates some downward adjustment to spending plans over the next two years, and a comprehensive assessment of baselines may result in the reconfiguration

Spending ceilings have been lowered for 2015/16 and 2016/17 of the composition of spending in 2017/18. Cost-containment measures announced in the 2014 Budget are being reinforced.

This chapter discusses the policy considerations that will inform the division of revenue over the medium term and outlines government's approach to funding the first three years of the MTSF.

Medium-term expenditure framework

Policy goals

The 2014-2019 MTSF guides the coordination of policy and resource distribution through 14 *outcomes* that shape allocations to government's functions.

Outcomes targeted in the medium-term strategic framework

1. Quality basic education
2. A long and healthy life for all South Africans
3. All people in South Africa are and feel safe
4. Decent employment through inclusive growth
5. A skilled and capable workforce to support an inclusive growth path
6. An efficient, competitive and responsive economic infrastructure network
7. Vibrant, equitable, sustainable rural communities contributing to food security for all
8. Sustainable human settlements and improved quality of household life
9. Responsive, accountable, effective and efficient local government
10. Protect and enhance our environmental assets and natural resources
11. Create a better South Africa, and contribute to a better Africa and a better world
12. An efficient, effective and development-oriented public service
13. A comprehensive, responsive and sustainable social protection system
14. A diverse, socially cohesive society with a common national identity

Public spending trends

Public spending grew faster than economy as a whole over past decade

Long-term trends in public spending reflect the expansion of service delivery to poor households and the development of a social wage. They also show how fiscal space has closed as growth has weakened and debt costs have risen:

- Public spending has increased faster than inflation, with nominal annual spending growth averaging 11.7 per cent between 2005/06 (when the main budget was R421 billion) and 2014/15 (R1.14 trillion).
- Between 2005/06 and 2014/15, public spending grew faster than the economy as a whole. Public spending on the main budget now accounts for 31 per cent of GDP, up from 26 per cent in 2005/06.
- Expenditure growth has concentrated on social and economic infrastructure, as well as programmes that contribute to the social wage, such as education and health care. Together, spending on these functions has risen from 51 per cent of the main budget in 2005/06 to 59 per cent in 2014/15. Much of this growth is accounted for by the doubling of the proportion of spending allocated to housing and municipal infrastructure and services, from about 6 per cent in 2005/06 to 12 per cent in 2014/15.
- Growth in spending on capital goods has outpaced growth in current spending.

- Compensation of employees has grown relatively quickly. As a result, growth in spending on goods and services, and transfers to households, now accounts for a smaller share of spending.
- Although expenditure on state debt costs grew more slowly than total spending over the past decade, interest payments have grown rapidly in the past few years, and now absorb more than 10 per cent of the budget, up from about 8 per cent in 2008/09 and 2009/10.

Laying the foundations for growth

To achieve the principal goals of the National Development Plan, including the creation of 11 million new jobs by 2030, the economy must grow rapidly over an extended period. Public spending can help lay the necessary foundations for growth both directly and by encouraging greater private-sector investment. In this regard, government is focusing on several policy goals.

To create 11 million jobs by 2030, economy must grow more rapidly

Dynamic cities

Well-planned and well-managed urbanisation can accelerate economic growth. Proposed reforms to the structure and conditions of infrastructure grants to local government will scale up provision of well-located and affordable social housing, and strengthen the upgrading of informal settlements. Public investments in housing and infrastructure should also be designed to crowd-in additional private-sector and household investment. Government will work with development finance institutions to expand the municipal debt market.

Proposed reforms to local government infrastructure grants aim to help reconfigure cities

Government is providing support to enable cities to promote growth and urban spatial transformation:

- A project preparation facility helps municipalities prepare plans that are ready for implementation.
- The infrastructure delivery management system is being expanded from provinces to large cities.
- Technical assistance will support the review of borrowing strategies.

Including the local government equitable share, about R560 billion has been made available for service delivery, municipal infrastructure development and housing over the next three years, with annual allocations growing at 8.1 per cent a year. In addition, nearly R230 billion has been allocated for economic infrastructure and network regulation.

Increasing competitiveness and employment

South Africa needs to boost exports to help finance development. To this end, government has increased support for the function group responsible for industrial development, trade and innovation at a rate considerably faster than that of overall spending in recent years. Key incentive programmes run by the Department of Trade and Industry, for example, have grown by nearly 18 per cent a year over the past three years. Over the MTEF period, proposed allocations in excess of R18 billion support the competitiveness of the manufacturing sector, and government is looking to improve the design of the support offered.

Support for industrial policy has increased more rapidly than overall spending in recent years

Expanded public works, employment tax incentive, Jobs Fund contribute directly to job creation

Government supports employment growth directly in a variety of ways:

- Improved management of the Expanded Public Works Programme, combined with rapid growth in allocations, means that government is on track to achieve its target of 6 million short- to medium-term jobs between 2014 and 2019.
- The employment tax incentive, which provides firms with incentives to hire young workers, is already supporting at least 209 000 young workers in about 23 500 firms.
- The Jobs Fund, which will spend about R3.9 billion over the next three years, will partner with the private sector and non-governmental organisations on projects expected to create more than 167 000 jobs.
- To create platforms for the growth of export-oriented firms, a number of special economic zones are to be established, complementing existing incentives for industrialisation.

Education and skills

Over the next three years, government proposes to allocate R833 billion to basic education and skills development. New tools for monitoring educational outcomes – such as the annual national assessments – are establishing platforms to address longstanding challenges. In combination with greater attention to teacher training and human resource management, these approaches will help to improve teaching and learning. Post-school education and training, which had the fastest-growing budget over the past three years, continues to expand.

Medium-term spending proposals

Spending is projected to grow at 7.6 per cent a year over the MTEF period

Over the next three years, a more constrained fiscal environment means that proposed spending growth, at 7.6 per cent a year, will slow relative to the period between 2011/12 and 2014/15, when annual growth averaged 9.4 per cent.

Government proposes to place significant resources for 2017/18 into an unallocated reserve to serve as a buffer against economic and fiscal shocks. This amounts to R45 billion, a portion of which can also be used to fund high-impact programmes. Because these funds are not yet allocated to functions, average annual growth rates for spending programmes are generally lower than the growth rate proposed for total spending.

Considering only allocated funds, the fastest-growing programmes are post-school education and training; employment, labour affairs and social security funds; and housing development and social infrastructure. Below-average growth is proposed for general public services. Lower-than-average growth is also proposed for economic infrastructure and network regulation, where spending grew rapidly between 2011/12 and 2014/15 and is now levelling off.

Table 4.1 Consolidated government expenditure,[1] 2013/14 – 2017/18

R billion	2013/14 Outcome	2014/15 Revised	2015/16 Medium-term estimates	2016/17	2017/18	Average annual growth 2014/15 – 2017/18
FUNCTION GROUPS						
Basic education	**176.8**	**188.0**	**201.5**	**212.8**	**226.1**	**6.3%**
Health	**134.2**	**145.5**	**154.6**	**163.8**	**175.1**	**6.4%**
Defence, public order and safety	**153.9**	**163.9**	**171.6**	**181.7**	**193.1**	**5.6%**
Defence and state security	45.0	47.9	50.0	52.9	56.0	5.4%
Police services	74.2	78.5	82.4	87.0	93.0	5.8%
Law courts and prisons	34.7	37.6	39.1	41.7	44.1	5.5%
Post-school education and training	**51.2**	**53.3**	**59.5**	**64.7**	**68.1**	**8.5%**
Economic affairs	**176.4**	**195.0**	**202.4**	**217.7**	**227.2**	**5.2%**
Industrial development, trade and innovation	59.5	63.3	67.8	72.4	74.1	5.4%
Employment, labour affairs and social security funds	48.4	57.6	64.1	68.9	72.8	8.1%
Economic infrastructure and network regulation	68.5	74.1	70.5	76.4	80.2	2.7%
Local development and social infrastructure	**159.1**	**176.4**	**199.6**	**208.8**	**221.5**	**7.9%**
Housing development and social infrastructure	141.4	156.9	179.6	187.0	198.3	8.1%
Rural development and land reform	10.1	10.4	10.7	11.6	12.3	5.7%
Arts, sport, recreation and culture	7.6	9.1	9.3	10.2	10.9	6.2%
General public services	**63.4**	**67.1**	**68.3**	**67.8**	**71.4**	**2.1%**
Social protection	**131.2**	**143.4**	**154.9**	**165.4**	**176.3**	**7.1%**
Allocated by function	**1 046.2**	**1 132.6**	**1 212.4**	**1 282.6**	**1 358.7**	**6.3%**
Debt-service costs	101.2	114.5	126.5	139.4	149.7	9.3%
Unallocated reserves	–	–	5.0	15.0	45.0	
Consolidated expenditure	**1 147.4**	**1 247.1**	**1 344.0**	**1 437.1**	**1 553.4**	**7.6%**
ECONOMIC CLASSIFICATION						
Current payments	**692.9**	**750.9**	**797.7**	**847.4**	**902.3**	**6.3%**
Compensation of employees	407.6	440.7	470.6	501.8	533.5	6.6%
Goods and services	177.8	189.5	193.8	200.2	213.0	4.0%
Interest and rent on land	107.5	120.8	133.3	145.3	155.9	8.9%
of which: Debt-service costs	*101.2*	*114.5*	*126.5*	*139.4*	*149.7*	*9.3%*
Transfers and subsidies	**370.3**	**402.0**	**440.2**	**470.8**	**495.1**	**7.2%**
Provinces and municipalities	91.1	96.2	107.3	113.2	119.4	7.5%
Departmental agencies and accounts	20.7	25.3	27.7	29.0	29.1	4.9%
Higher education institutions	23.8	25.3	27.1	29.2	30.6	6.5%
Foreign governments and international	2.7	2.2	2.3	2.4	2.4	3.2%
Public corporations and private	27.3	27.9	30.9	33.1	32.9	5.6%
Non-profit institutions	27.0	28.9	29.4	31.4	33.1	4.7%
Households	177.7	196.2	215.4	232.7	247.4	8.0%
Payments for capital assets	**80.3**	**90.2**	**97.7**	**103.6**	**110.6**	**7.0%**
Buildings and other capital assets	63.8	73.1	80.0	84.9	89.5	7.0%
Machinery and equipment	16.5	17.2	17.8	18.6	21.1	7.1%
Payments for financial assets	**3.8**	**4.0**	**3.4**	**0.3**	**0.3**	
Total	**1 147.4**	**1 247.1**	**1 339.0**	**1 422.1**	**1 508.4**	**6.5%**
Unallocated reserves	–	–	5.0	15.0	45.0	
Consolidated expenditure	**1 147.4**	**1 247.1**	**1 344.0**	**1 437.1**	**1 553.4**	**7.6%**

1. Consisting of national, provincial, social security funds and public entities

Total expenditure by economic classification indicates relatively rapid growth in spending on state debt costs, transfers to households, transfers to provinces and municipalities, and the acquisition or construction of capital assets.

Wage settlement that outpaces inflation would require corresponding adjustments in other spending areas

Compensation spending is budgeted to grow at 6.6 per cent a year over the medium term, but depends on the outcome of public-sector salary negotiations. Should the outcome of wage negotiations result in faster growth in compensation for employees, corresponding adjustments will be required in other spending areas. Below-average spending growth is proposed for the goods and services budget.

Spending priorities, by function group, are discussed below.

Basic education

This function group is responsible for MTSF *outcome 1: quality basic education*. Spending is driven largely by provincial allocations, a high proportion of which is for compensation of employees. Provincial personnel budgets are being reviewed to ensure they reflect medium-term spending estimates.

Basic education accounts for nearly 15 per cent of all spending

Over the 2015 MTEF period, proposed allocations to basic education exceed R640 billion, accounting for nearly 15 per cent of all spending. The rate of spending growth over the medium term is projected at an average of 6.3 per cent a year.

Allocations proposed over the MTEF period for school infrastructure will ensure that gazetted norms and standards are met by 2016.

Post-school education and training

Skills development allocation amounts to R200 billion

This function group has significant responsibility for the attainment of MTSF *outcome 5: a skilled and capable workforce to support inclusive growth*. Allocations cover universities and colleges, sector education and training authorities, and the National Skills Fund. The latter two are funded by ring-fenced payroll taxes. Underscoring government's commitment to addressing skills constraints, medium-term spending on post-school education and training, which grows more strongly than other spending programmes, will amount to nearly R200 billion. Of this, 55 per cent will consist of subsidies to universities and contributions to the National Students Financial Aid Scheme, allowing for an additional 116 000 university enrolments by 2016/17.

The MTSF projects a large expansion of access to technical, vocational and adult education centres, as well as universities. Given the scale of needs identified, an interdepartmental team will develop financing proposals. Expanded access should be matched by improvements in the quality of training provided.

Achieving a reduction in baseline allocations

Government proposes to lower previously announced spending ceilings for 2015/16 and 2016/17 by R10 billion and R15 billion respectively, with reductions proportionate to the division of nationally raised revenue (47 per cent from national government, 44 per cent from provincial government and 9 per cent from local government). For national departments, savings will be achieved by:

- Extending cost-containment measures announced earlier this year by freezing the budgets of certain non-essential goods and services at 2014/15 levels, and allowing others to increase at the rate of inflation.
- Withdrawing allocated personnel budgets where posts have been vacant over an extended period.
- Reducing the rate of growth of transfers to public entities, particularly those with cash reserves.

Of the reduction in the national government spending ceiling over the next two years, about two-fifths will come from curtailing spending growth on non-essential goods and services. A further 40 per cent of savings will be achieved by reducing the rate of growth of transfers to public entities. The remaining savings will come from the withdrawal of funding for non-essential vacant posts.

Provincial governments retain considerable authority to allocate their own resources, but it is anticipated that they will follow a similar approach in adjusting their budgets to accommodate the reduction in the equitable share. National government will work with provinces to ensure that pro-poor social services are fully protected. Adjustments to local government spending will take place mainly through reducing allocations to conditional grants that do not finance operations, some of which have recorded significant underspending.

Health

Almost R500 billion, or nearly 11 per cent of total spending, will be allocated to health over the MTEF period. This will help achieve *outcome 2: a long and healthy life for all South Africans*.

HIV treatment programme now reaches 2.7 million people

A large share of spending growth covers the expanding provision of antiretroviral drugs, which now reach 2.7 million people. The *comprehensive HIV and AIDS conditional grant* will grow by about 13 per cent a year over the medium term. Expenditure growth in provinces is driven largely by compensation of employees, which has grown by about 10 per cent a year over the past three years. This must be managed to ensure continued funding for other essential inputs.

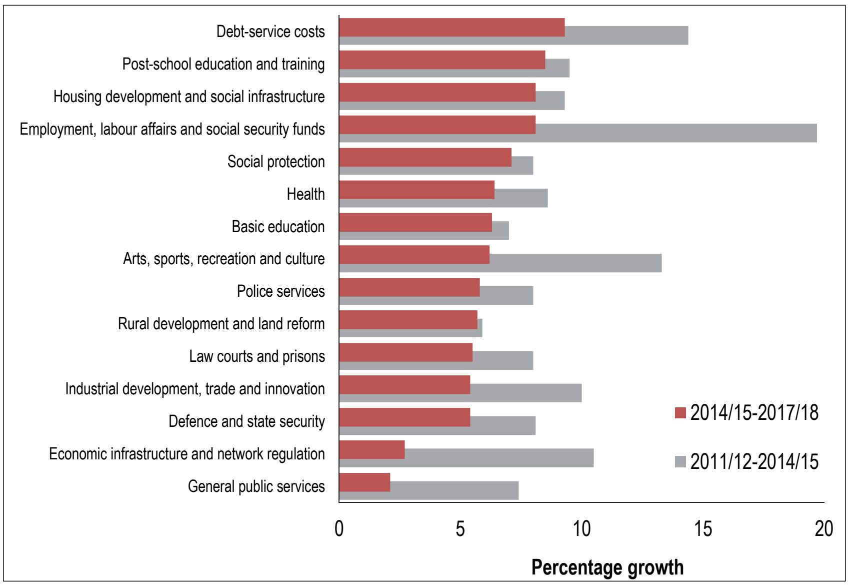
The future introduction of national health insurance could imply a significant restructuring of intergovernmental fiscal relations in the health sector. These considerations will be examined by a high-level working group that will make recommendations to the Ministers' Committee on the Budget.

Social protection

Social grants will soon reach about 17.3 million South Africans

Government proposes to allocate just under R500 billion to social protection over the medium term. Social grants, which are expected to reach 17.3 million people by 2017/18, will account for nearly 85 per cent of this spending. This will help achieve MTSF *outcome 13: a comprehensive, responsive and sustainable social protection system*. The MTSF focuses on enhancing the legislative and policy framework to improve service delivery and access to social assistance. The national department will also improve regulation and oversight of the sector. Removal of the means test for access to the old-age grant has been deferred and will form part of comprehensive social security reforms.

Figure 4.1 Average annual growth by function, 2011/12 – 2017/18



Source: National Treasury

Defence, public order and safety

In line with MTSF *outcome 3: all people in South Africa are and feel safe*, the priorities for defence, public order and safety remain fighting crime and corruption. The budget for the cluster, which accounts for 13 per cent of total spending, will grow at an annual average of 5.6 per cent, reaching over R190 billion in 2017/18. About 67 per cent of proposed spending is to be allocated to compensation.

Resources shifted to Public Protector and Financial Intelligence Centre

Within the function group, resources will be shifted to priority programmes and institutions, including the Public Protector, the Financial Intelligence Centre, family advocates, public defenders, and the prosecution service. Funds have also been reallocated to expand the Office of the Chief Justice, as envisaged in the Superior Courts Act (2013). The departments of Defence and Police have shifted funds in response to a shortfall in employee compensation owing to higher-than-expected inflation-linked salary adjustments.

Economic infrastructure and network regulation

Economic infrastructure will account for 5 per cent of spending over the MTEF

This function group is primarily responsible for MTSF *outcome 6: an efficient, competitive and responsive economic infrastructure network*. In line with the National Development Plan, the expansion of South Africa's energy, transport, water and communications infrastructure is under way. Economic infrastructure will account for 5 per cent of spending over the next three years, amounting to about R230 billion.

Apart from growing budget allocations, increased attention is needed to improve efficiency in the provision of infrastructure and, crucially, to plan and conduct regular maintenance. Complementary investments by the private sector will also be encouraged.

Government proposes to shift funds from existing road allocations at provincial and national level to the Moloto Road project. In addition, funds will be shifted from the solar water heater programme, where capacity constraints have led to underspending, to support the rollout of broadband infrastructure. To respond to critical service delivery pressures in bulk water and reticulation, surpluses in the Water Trading Account will shift to these priorities.

Housing development and social infrastructure

Funding for municipal services and infrastructure includes focus on sanitation

Funding for housing and social infrastructure such as electricity, potable water, sanitation and public transport supports MTSF *outcome 8: sustainable human settlements and improved quality of household life*. Medium-term priorities include balancing support for urban growth and delivering rural services. Government aims to transform South Africa's urban spaces, encouraging greater integration of residential areas, employment and trade. Over the three-year spending period, more than R560 billion is expected to be allocated to this function, with most of the funds supporting municipal services and infrastructure. Average annual spending growth of 8.1 per cent in this function is driven mainly by investments in commuter rail transport.

Funds shifted to manage disasters and effects of acid mine drainage

Government proposes to shift funds within this function group to support high-priority infrastructure projects, including the repair and restoration of infrastructure damaged in natural disasters and floods, and to manage the effects of acid mine drainage.

Addressing apartheid's spatial legacy requires considerably more coordination and alignment in planning and delivering infrastructure and services. The current approach to housing is also being reviewed to develop an approach that is more effective and affordable, and which will help to densify cities.

Industrial development, trade and innovation

This function group promotes industrialisation, economic transformation and sustainable resource management, and is partly responsible for achieving MTSF *outcome 4: decent employment through inclusive growth*. About R215 billion, or 5 per cent of total spending, will be allocated to these activities over the next three years. Relatively slow growth in projected allocations is largely the result of moderating spending on the economic competitiveness support package, which was designed to support the economy temporarily in the wake of the global financial crisis.

Tax rebates supporting industrial development amount to about R20 billion per year

Expenditure on incentives accounts for about one-third of overall spending in this function group. Although not reflected on the expenditure side of the budget, a range of tax rebates amount to about R20 billion a year. The bulk of these rebates support the automotive industry, as well as clothing manufacture and textiles.

Allocations are also proposed to develop the regulatory architecture for shale gas exploration and policies to develop the oceans economy.

Employment, labour affairs and social security funds

Employment growth also falls under MTSF *outcome 4*. Expenditure by this function group, totalling just over R205 billion over the MTEF, will grow by 8.1 per cent annually. Spending by the statutory social security agencies, which are financed by levies rather than directly through the National Revenue Fund, accounts for 80 per cent of this amount, and grows by 8 per cent a year. A further 15 per cent is allocated to state employment programmes, which grow by 10 per cent a year over the spending period ahead.

Over the next three years, the budget group will focus on two MTSF targets to be achieved by 2019: creating 6 million short- to medium-term jobs through the Expanded Public Works Programme and a 30 per cent increase in statutory workplace inspections by the Department of Labour.

By 2017, Community Work Programme will be rolled out to every municipality

Strong spending growth is proposed in the Community Work Programme, which will be rolled out to every municipality by 2017. The Expanded Public Works Programme is expected to achieve its targets without additional resources because municipalities and provinces are incorporating expanded public works jobs into their infrastructure projects.

Table 4.3 shows funding for employment programmes up to 2017/18.

Table 4.2 Funding for employment programmes, 2011/12 – 2017/18

R million	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	Average annual growth 2014/15 – 2017/18
		Outcome		Estimate		Medium-term estimates		
National								
Community Work Programme	624	1 290	1 731	2 258	2 385	3 254	4 016	21.2%
Expanded Public Works Programme management unit	210	237	262	262	266	284	298	4.4%
Non-state sector	154	283	438	477	485	600	630	9.7%
Tourism programmes	301	314	291	320	493	631	633	25.5%
Environmental programmes	1 977	2 705	2 835	3 286	3 399	3 950	4 039	7.1%
Jobs Fund	272	590	953	1 339	1 318	1 387	1 318	-0.5%
National Rural Youth Service Corps	289	536	862	678	343	473	437	-13.6%
Provincial								
Incentive grant for provincial infrastructure	225	293	354	349	357	412	432	7.4%
Incentive grant for social sector	200	217	256	258	268	375	393	15.1%
Local government								
Incentive grant for municipal infrastructure	364	662	611	595	619	706	741	7.6%
Total	**4 617**	**7 126**	**8 593**	**9 822**	**9 931**	**12 071**	**12 939**	**9.6%**

Source: National Treasury

Rural development and land reform

Funds reprioritised to manage and investigate new land claims

This function group – responsible for *outcome 7: vibrant, equitable, sustainable rural communities contributing to food security for all* – has a proposed medium-term allocation of about R35 billion, largely to support agricultural development, land restitution and reform. The reopening of the land reform process has resulted in the lodging of new land claims. Reprioritising funds already on its budget, the Department of Rural Development and Land Reform is expected to allocate R1.1 billion over the spending period to manage and investigate these claims. Where appropriate, government will also address duplication of activities by departments and agencies working on rural development.

Arts, sport, recreation and culture

Government will spend about R30 billion over the medium term to promote the arts, sport, recreation and culture. This is in pursuit of *outcome 14: a diverse, socially cohesive society with a common national identity*. Priorities include repositioning arts and culture to contribute to economic growth and job creation, and developing new heritage projects. Sport and Recreation will focus on implementing the national sport and recreation plan.

Government to spend about R30 billion to support arts, sport and culture

General public services

Outcome 12: an efficient, effective and development-oriented public service, is a core goal of government generally, with specific responsibilities distributed among several national departments. The baseline allocation to this function group amounts to about R210 billion over the next three years, with budgets expected to grow relatively slowly. The most rapid spending growth is associated with government's international commitments, the costs of which have risen with the depreciation of the exchange rate. Within the overall budget, funds have been made available for the Community Survey 2016, data from which will inform policy planning and resource allocation.

The launch of the Property Management Trading Entity will redefine institutional arrangements in the state's immovable property portfolio, and should support greater efficiency in national infrastructure investments.

New entity to manage state property portfolio, resulting in greater efficiency

Division of revenue

Over the MTEF period ahead, national departments are allocated 48 per cent of available non-interest expenditure, provinces are allocated 43 per cent, and local governments are allocated 9 per cent. Medium-term allocations to national departments will increase by an average annual rate of 5.7 per cent, provincial resources grow by 6.2 per cent and local government allocations grow by 6.5 per cent (7.2 per cent including all indirect grants).

Table 4.3 Division of revenue, 2014/15 – 2017/18

R billion	2014/15	2015/16	2016/17	2017/18	Average annual growth 2014/15 – 2017/18
National allocations	494.7	523.1	553.2	585.0	5.7%
Provincial allocations	440.2	468.5	496.8	527.0	6.2%
Local government allocations	91.1	99.2	103.9	110.0	6.5%
Total allocations	**1 026.0**	**1 090.8**	**1 153.9**	**1 222.0**	**6.0%**
Percentage shares					
National departments	48.2%	48.0%	47.9%	47.9%	
Provincial	42.9%	42.9%	43.1%	43.1%	
Local government allocations	8.9%	9.1%	9.0%	9.0%	

Source: National Treasury

Funding provincial government

Over the MTEF period, provinces are allocated R1.49 trillion. Of this amount, 81.6 per cent will take the form of unconditional transfers through the provincial equitable share, and 18.4 per cent through conditional grants transferred by national departments.

Spending adjustments will not be allowed to disrupt front-line services

The focus of provincial financing will be on improving efficiency in core areas of responsibility: basic education, health, roads, and social development. The lower expenditure ceiling means that baseline allocations for the provincial equitable share will be reduced by R2.6 billion in 2015/16 and R4 billion in 2016/17, with baseline allocations for direct and indirect conditional grants reduced by R1.8 billion and R2.6 billion in those years. National government will work with provinces to ensure that spending adjustments do not disrupt front-line services.

Savings can be achieved by reducing non-core staff, and ensuring recruitment and retention of skills

As personnel-related expenditure is the largest category of spending in provinces (62 per cent in 2014/15), tight management of compensation spending will be essential to improve efficiency. Savings can be achieved by reducing non-core staff, and by ensuring the recruitment and retention of appropriate skills. The National Treasury has been working with provincial treasuries to improve management of personnel spending. As a result, provincial staff numbers declined from 931 471 in December 2012 to 917 061 in August 2014. Although staff costs have risen as average wages have increased, slower growth in headcount saw compensation spending remain within budget in 2012/13 for the first time since 2007/08.

Over the next three years, greater emphasis will be placed on achieving efficiencies in goods and services budgets. Provinces should be able to identify areas where efficiency can be improved from expenditure reviews undertaken by the National Treasury and provincial treasuries, as well as reforms driven by the Office of the Chief Procurement Officer.

Modernising public procurement

Modernising procurement systems will lead to more cost-effective operations in the public sector. Design of a national price-referencing mechanism is complete. Piloting with selected provinces and large national departments will begin in the next few months, and the system should be fully operational by 1 April 2015.

Over the next three years, the Office of the Chief Procurement Officer will roll out a new national approach to procurement. Its main features will include:

- Publishing national norms and standards for procurement.
- Creating a national database to enable public monitoring of procurement plans and tenders.
- Creating a database of suppliers, service providers and contractors to streamline compliance requirements and reduce costs for small businesses.
- Establishing a formal process to consider complaints and refer cases to appropriate legal authorities.

The number of nationally negotiated contracts will be significantly expanded. Centralised contracting will be considered for a range of common goods and services, including air travel and hotel accommodation; standard equipment used in schools and clinics; information and communications technology infrastructure; professional services; and leasing and accommodation.

To promote more efficient delivery of infrastructure for schools and health facilities, government is phasing in an incentive-based funding approach. The first such allocations will be awarded in 2015/16, based on provinces' performance in meeting planning requirements. Support is being provided to those provinces that are not yet meeting the required standards.

Funding local government

A call for municipalities to get back to basics in delivering services and funding infrastructure

The division of revenue promotes the goal of MTSF *outcome 9: responsive, accountable, effective and efficient local government*. The Minister of Cooperative Governance and Traditional Affairs has called for municipalities to get back to basics. Medium-term allocations to local government support this call by funding the infrastructure needed to deliver basic services and to subsidise the provision of free basic services.

Transfers to local government total R313 billion over the MTEF period, with 61.4 per cent transferred as unconditional allocations such as the equitable share and sharing of the general fuel levy. The remainder is allocated through conditional grants. The lower expenditure ceiling means that baseline allocations for local government conditional grants will be reduced by R920.6 million in 2015/16 and R1.4 billion in 2016/17.

Local government financing takes account of varied obligations of urban and rural municipalities

The structure of local government financing continues to emphasise a differentiated approach in responding to the different capacities and obligations of urban and rural municipalities. Cities, which raise up to 80 per cent of their own revenues from property rates and service charges, are treated differently than rural municipalities, some of which rely on transfers to fund up to 80 per cent of their budgets.

Following years of rapid growth in the value of local government transfers, the rate of growth will moderate over the period ahead. A review of infrastructure grants is intended to maximise the impact of these transfers, while several reforms are aimed at enabling cities to achieve more with their own revenues.

Improving the performance of local government infrastructure grants

The National Treasury is leading a collaborative review of the local government infrastructure grant system. It aims to make evidence-based reforms that maximise value for money from existing resources, while improving the sustainability of the system and the assets created.

Work on the review will continue in 2015 but has already produced proposals for reform in three areas:

- Rationalising the number of grants that each municipality receives, while introducing greater differentiation in the types of grants and accompanying levels of oversight for different types of municipalities.
- Life-cycle asset management to sustain the functionality of existing infrastructure.
- Strengthening administrative oversight to avoid ad-hoc proliferation of grants, standardising reporting to increase accountability, and improving monitoring and benchmarking of performance.

The details of how these reforms will affect each grant and the system as a whole will be refined in 2015, and implemented over the course of the 2016 MTEF period.

The local government equitable share continues to fund the cost of providing free basic amounts of electricity, water, sanitation and refuse removal to the approximately 59 per cent of households that have incomes below the value of two old-age grants. In many municipalities, greater emphasis will be placed on ensuring that free basic services are extended to reach all poor households.

Further details of provincial and local government allocations and changes to conditional grants are set out in the technical annexure.

Conclusion

While reduced spending envelopes will require difficult choices, pro-poor spending will be protected

Over the next three years, expenditure will continue to grow in real terms, but at a slower rate than in the recent past. Reduced spending ceilings over the next two years will affect national, provincial and local government. While this will involve difficult choices, pro-poor expenditure in areas such as education, health and social services will be protected. The reductions, while substantial, are small relative to total government spending. Improvements in service delivery will come through efficiency gains and reducing waste.

Glossary

Above-the-line	Expenses or revenue that are regular and expected, having a direct effect on an income statement.
Adjustments estimate	Presentation to Parliament of the amendments to be made to the appropriations voted in the main budget for the year.
Appropriation	The approval by Parliament of spending from the National Revenue Fund, or by a provincial legislature from the Provincial Revenue Fund.
Balance of payments	A summary statement of all the transactions of the residents of a country with the rest of the world over a particular time period.
Baseline	The initial allocations used during the budget process, derived from the previous year's forward estimates.
Budget balance	The difference between expenditure and revenue. If expenditure exceeds revenue, the budget is in deficit. If the reverse is true, it is in surplus.
Capital flow	A flow of investments in and out of a country.
Conditional grants	Allocations of money from one sphere of government to another, conditional on certain services being delivered or on compliance with specified requirements.
Consolidated government expenditure	Total expenditure by national and provincial government, social security funds and selected public entities, including transfers to municipalities, businesses or other entities. See also *main budget*.
Consumer price index (CPI)	The main measure of inflation, charting the price movements of a basket of consumer goods and services.
Consumption expenditure	Expenditure on goods and services, including salaries, which are consumed within a short period of time – usually a year.
Contingency reserve	An amount set aside, but not allocated in advance, to accommodate changes to the economic environment and to meet unforeseen spending pressures.
Core inflation	A measure of the change in price level that excludes temporary shocks and represents the long-run trend of the price level.
Countercyclical fiscal policy	Policy that has the opposite effect on economic activity to that caused by the business cycle, such as slowing spending growth in a boom period and accelerating spending in a recession.
Crowding-in	Increase of private investment as a result of government spending.
Crowding-out	A fall in private investment or consumption as a result of increased government expenditure.

Current account (of the balance of payments)	The difference between total exports and imports, including service payments and receipts, interest, dividends and transfers. This account can be in deficit or surplus. See also *trade balance.*
Current balance	The difference between revenue and current expenditure, which consists of compensation of employees, goods and services, and interest and rent on land.
Debt-service cost	The cost of interest on government debt.
Debt redemption	Repayment of the principal and any outstanding interest on a bond.
Depreciation (capital)	A reduction in the value of fixed capital as a result of wear and tear or redundancy.
Depreciation (exchange rate)	A reduction in the external value of a currency.
Division of revenue	The allocation of funds between the spheres of government as required by the Constitution.
Economic cost	The cost of an alternative forgone to pursue a certain action.
Equitable share	The allocation of revenue to the national, provincial and local spheres of government as required by the Constitution.
External imbalance	An excessively positive or negative current account balance, reflecting an excess or deficit of domestic investment over domestic savings.
Financial account (of the balance of payments)	A statement of all financial transactions between a country and the rest of the world, including portfolio and fixed investment flows and movements in foreign reserves.
Financial and Fiscal Commission	An independent body established in terms of the Constitution to make recommendations to Parliament and provincial legislatures about financial issues affecting the three spheres of government.
Financial year	The 12 months according to which companies and organisations budget and account. Government's financial year runs from 1 April to 31 March.
Fiscal policy	Policy on taxation, spending and borrowing by government.
Fiscal space	The ability of a government's budget to provide additional resources without jeopardising fiscal sustainability.
Flexible exchange rate	Determination of currency exchange rates by market forces.
Foreign direct investment	The acquisition of long-term business interests in another country, usually involving management, technology and financial participation.
GDP inflation	A measure of the total increase in prices in the whole economy. Unlike CPI inflation, GDP inflation includes price increases in goods that are exported and intermediate goods such as machines, but excludes imported goods.
Gold and foreign exchange account	A Reserve Bank account that reflects its losses and profits on holdings of foreign currency and gold reserves, driven by changes in the rand/$ exchange rate and the gold price.
Gross domestic product (GDP)	A measure of total national output, income and expenditure in the economy.

Gross fixed capital formation	The addition to a country's fixed capital stock over a specific period, before provision for depreciation.
Headline inflation	A measure of the increase in price level that includes temporary price shocks to the economy, such as one-time price changes.
Independent power producer	Electricity generated by the private sector for the national grid.
Indirect grant	A grant allowing a national department to perform a function on behalf of a province or municipality. No funds are transferred, but the end-product of the grant, such as infrastructure built, is generally transferred to provincial or municipal ownership.
Inflation	An increase in the general level of prices.
Inflation targeting	A monetary policy framework intended to achieve price stability over a certain period of time. The Reserve Bank and government agree on a target rate or range of inflation to be maintained.
Labour force participation	The ratio of employed and unemployed workers (the labour force) relative to the working age population.
Main budget expenditure	National government expenditure and transfers to provincial and local government financed from the National Revenue Fund, excluding revenues and spending related to social security funds, extra-budgetary institutions and provincial own revenue. See also *consolidated government expenditure*.
Medium-term Expenditure Committee	The committee responsible for evaluating the budget submissions of national departments and recommending allocations.
Medium-term expenditure framework (MTEF)	The three-year spending plans of national and provincial governments published at the time of the Budget.
Medium-term strategic framework	The five-year strategy of government coinciding with the electoral term.
Monetary policy	The actions taken by a country's monetary authority (e.g. the Reserve Bank), normally focused around money supply and interest rates.
Money supply	The total stock of money in an economy.
National budget	The projected revenue and expenditure flowing through the National Revenue Fund. It does not include spending by provinces or local government from their own revenues.
National Development Plan	A national strategy to eliminate poverty and reduce inequality.
National Revenue Fund	The consolidated account of national government into which all taxes, fees and charges collected by the South African Revenue Service and departmental revenue must be paid.
Nominal exchange rate	The current rate of exchange between the rand and foreign currencies.
Non-interest expenditure	Total expenditure by government less debt-service costs.
Presidential Infrastructure Coordinating Commission	A body overseeing selection, planning, monitoring and coordination of large infrastructure projects, composed of representatives selected from national, provincial and local government.

Primary deficit/surplus	The difference between total revenue and non-interest expenditure. When revenue exceeds non-interest expenditure there is a surplus.
Primary expenditure	Non-interest expenditure by government.
Primary sector	The agricultural and mining sectors of the economy.
Private-sector credit extension	Credit provided to the private sector by banks. This includes all loans, credit card balances and leases.
Productivity	A measure of the amount of output generated from every unit of input over a period of time. Typically used to measure changes in labour efficiency.
Public entities	Companies, agencies, funds and accounts that are fully or partly owned by government or public authorities and regulated by law.
Public-private partnership (PPP)	A contractual arrangement in which a private party performs part of a government function and assumes the associated risks. In return, the private party receives a fee based on predefined performance criteria.
Public-sector borrowing requirement	The consolidated cash borrowing requirement of general government and non-financial public enterprises.
Purchasing managers' index (PMI)	A composite index measuring the change in manufacturing activity compared with the previous month.
Real effective exchange rate	A measure of the rate of exchange of the rand relative to a trade-weighted average of South Africa's trading partners' currencies, adjusted for price trends.
Real expenditure	Expenditure measured in constant prices, i.e. after taking account of inflation.
Real interest rate	The level of interest after taking account of inflation.
Repurchase (repo) rate	The rate at which the Reserve Bank lends to commercial banks.
Reserves (foreign exchange)	Holdings of foreign exchange, either by the Reserve Bank only, or by the Reserve Bank and domestic banking institutions.
Rollover	Funds not spent during a given financial year that flow into the following year's budget.
Seasonally adjusted and annualised	The process of removing the seasonal volatility (monthly or quarterly) from a time series. This provides a measure of the underlying trend in the data. Annualised: to express a rate as if it were applied over one year.
Social wage	Social benefits available to all individuals, funded wholly or partly by the state.
Southern African Customs Union (SACU) agreement	An agreement that allows for the unrestricted flow of goods and services, and a sharing of customs and excise revenue, between South Africa, Botswana, Lesotho, Namibia and Swaziland.
Southern African Development Community (SADC)	A regional intergovernmental organisation that promotes collaboration, economic integration and technical cooperation throughout Southern Africa.

Sovereign debt	Debt issued by a government.
Special economic zone	A designated area where infrastructure and incentives are provided to clusters of businesses to encourage private investment and employment growth.
Switch (auction)	Auctions to exchange bonds to manage refinancing risk or improve tradability.
Terms of trade	An index measuring the ratio of export prices to import prices.
Trade balance	The monetary record of a country's net imports and exports of physical merchandise. See also *current account.*
Twin deficit	A budget deficit in combination with a deficit on the current account.
Twin peaks	An approach to organising financial sector regulation and supervision involving two regulators. One is responsible for ensuring financial services firms sell their products in an appropriate way. The other is responsible for ensuring financial firms remain financially sound and are generally prudent.
Undercapitalisation	Lack of sufficient funds (capital) to conduct day-to-day operations.
Unit labour costs	The cost of labour per unit of output, calculated by dividing average wages by productivity (output per worker per hour).
Unsecured lending	A loan that is not backed or secured by any type of collateral to reduce the lender's risk.
Yield	A financial return or interest paid to buyers of government bonds.

Technical annexure

Introduction

This annexure presents the budget framework, expenditure outcomes for 2013/14, mid-year estimates of expenditure for 2014/15 and the division of revenue.

The budget framework consists of the fiscal framework, government spending priorities, the division of resources between national, provincial and local government, and a tabulation of the major conditional grants. The budget framework enables national departments, provinces and municipalities to prepare their detailed budgets for the following year. South Africa has a multi-year budgeting process, so the framework covers the present fiscal year and the three subsequent years.

The fiscal framework

The fiscal framework sets out government's revenue projections, spending estimates, borrowing requirements and assumptions concerning debt-service costs. The consolidated fiscal framework comprises the main budget, as well as spending by provinces, social security funds and public entities financed from own revenue.

Revenue considerations

The revenue outcome for 2013/14, revised estimates for 2014/15 and the estimates for 2015/16 are presented in Table A.1.

The tax revenue outcome for 2013/14 was R900 billion, a 10.6 per cent increase on collections in 2012/13 and R1 billion higher than the 2014 Budget target. Some drivers of revenue growth were temporary, such as higher customs duties associated with the depreciating rand exchange rate.

Given downward revisions to nominal GDP, gross tax revenue has been revised downwards by R10 billion in 2014/15, R19.1 billion in 2015/16 and R31.8 billion in 2016/17 compared with the projections tabled in the 2014 Budget. However, after taking account of revenues anticipated from reforms to tax policy and administration to be implemented in 2015/16, the shortfalls are reduced to R7 billion for 2015/16 and R16.8 billion for 2016/17.

Projected revenues from corporate income tax, customs duties, value-added tax (VAT) and the fuel levy have underperformed for the first half of the current fiscal year and consequently been revised downwards. The revisions in customs duties will result in lower payments to South Africa's partners in the Southern African Customs Union (SACU) over the medium-term expenditure framework (MTEF) period. Above-inflation wage settlements have supported stronger personal income tax collection, resulting in an upward revision of R5.6 billion for 2014/15.

Non-tax revenue is expected to be R3.9 billion higher than the 2014 Budget estimate. Mineral royalties are estimated to generate R6.8 billion, a downward revision of R0.4 billion.

Table A.1 Total tax and budget revenue, 2013/14 – 2015/16

	2013/14	2014/15			2015/16
R billion	**Outcome**	**Budget**	**Revised**	**Deviations**	**Estimates**
Persons and individuals	309.8	335.9	341.5	5.6	377.2
Companies	177.3	198.9	192.3	-6.7	211.7
Value-added tax	237.7	267.2	262.7	-4.5	288.5
Dividend withholding tax	17.3	19.2	19.8	0.6	21.3
Specific excise duties	29.0	31.1	32.5	1.5	33.4
Fuel levy	43.7	47.5	46.0	-1.5	47.2
Customs duties	44.2	50.3	45.0	-5.3	49.3
Other	41.0	43.5	43.8	0.4	47.3
Tax policy and administration reforms	–	–	–	–	12.0
Gross tax revenue	**900.0**	**993.7**	**983.6**	**-10.0**	**1 088.1**
Non-tax revenue	29.4	20.9	24.8	3.9	20.0
of which mineral royalties	*6.4*	*7.2*	*6.8*	*-0.4*	*7.4*
Receipts from financial transactions [1]	*11.7*	*2.9*	*8.0*	*5.1*	*2.0*
Estimate of SACU payments[2]	-43.4	-51.7	-51.7	0.0	-52.9
Provinces, social security funds and selected public entities	126.6	136.5	137.3	0.8	144.4
Total budget revenue	**1 012.7**	**1 099.2**	**1 093.9**	**-5.4**	**1 199.5**

1. Consists mainly of premiums and revaluation profits on debt transactions
2. Actual payments will be determined by outcomes of customs and excise revenue collections in line with the Southern African Customs Union agreement
Source: National Treasury

Table A.2 presents outcomes and estimates of receipts and payments from financial transactions. These receipts arise from financial transactions in assets and liabilities that are presented in the 2014 *Adjusted Estimates of National Expenditure* as part of departmental revenue.

Table A.2 Financial transactions receipts and payments, 2013/14 – 2017/18

	2013/14	2014/15		2015/16	2016/17	2017/18
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Receipts	**11 700**	**2 850**	**7 972**	**2 000**	**5 400**	**2 000**
Premiums on loan transactions[1]	5 510	–	4 000	–	–	–
Foreign exchange amnesty proceeds	399	–	–			
Revaluation profits on foreign currency transactions[2]	5 671	2 850	3 930	2 000	5 400	2 000
Liquidation of SASRIA investment[3]	75	–	40	–	–	–
Proceeds from EDIH[4]	37	–	–			
Other[5]	8	–	2	–	–	–
Payments	**-516**	**–**	**-311**	**–**	**–**	**–**
Premiums on loan transactions[1]	-457	–	-243	–	–	–
Saambou bank	-31	–	–	–	–	–
Defrayal of GFECRA losses[6]	-28	–	-68	–	–	–
Total	**11 184**	**2 850**	**7 661**	**2 000**	**5 400**	**2 000**

1. Premiums received or incurred on new loan issues, bond switch and buy-back transactions
2. Revaluation profits or losses on government's foreign exchange deposits at the Reserve Bank when used to meet foreign currency commitments
3. Liquidation of government's investments in the South African Special Risk Insurance Association
4. Proceeds from the Electricity Distribution Industry Holdings
5. Mainly penalties on early withdrawal of retail bonds
6. Realised profits/losses on the Gold and Foreign Exchange Contingency Reserve Account
Source: National Treasury

In 2014/15, total receipts from financial transactions are expected to be R8.0 billion, R5.1 billion above the 2014 Budget estimate of R2.9 billion. This amount is made up of revaluation profits on foreign-currency transactions of R3.9 billion and premiums on loan transactions of R4.0 billion. The increase reflects premiums on inflation-linked bonds resulting from lower-than-expected real yield. It also reflects revaluation profits on foreign-currency transactions resulting from higher drawdowns on foreign-currency reserves due to the timing of new issuances. Over the medium term, provision is made for receipts from financial transactions of R9.4 billion relating to revaluation profits on foreign-currency transactions. At current forecasted bond yields, no premiums on loan transactions are expected to be realised over the MTEF period.

In 2014/15, payments from financial transactions will amount to R311 million, made up of losses on the Gold and Foreign Exchange Contingency Reserve Account (R68 million) and premiums on loan transactions (R243 million). The premiums paid were on an unscheduled bond switch transaction with the Reserve Bank for monetary management purposes. Over the MTEF period no provision has been made for financial transaction payments.

Consolidated framework

Table A.3 summarises the consolidated fiscal framework, including the proposed fiscal policy package outlined in Chapter 3.

Following revised nominal GDP estimates, lower tax revenue projections and projected underspending by national departments in 2014/15, the consolidated budget deficit is forecast at 4.1 per cent of GDP, a slippage of 0.1 percentage points against the 2014 Budget target. In line with fiscal policy proposals, the budget deficit is projected to moderate over the MTEF period, reaching 2.5 per cent of GDP in 2017/18.

The fiscal framework continues to allow for moderate real growth in consolidated non-interest spending over the next two years – averaging 1.3 per cent – with growth increasing to 2.7 per cent in 2017/18. The fastest-growing expenditure item in the consolidated framework continues to be interest payments. Real growth in interest and rent on land is expected to average 3.1 per cent over the MTEF period, slower than the 7.6 per cent recorded in the past three fiscal years. The moderate pace of growth is due to government’s consolidation plans.

Compensation accounts for the largest share of current spending. In 2014/15 compensation is expected to make up 40.3 per cent of total current spending, marginally lower than the 40.5 per cent in 2013/14. The consolidated wage bill increases at a nominal annual average of 6.6 per cent over the MTEF period. Goods and services budgets are expected to decline in real terms over the three-year spending period.

Transfers and subsidies, which account for 31.3 per cent of consolidated current spending, are expected to grow by 7.2 per cent over the three-year period. The nominal growth rate is slower than the 10.0 per cent rate recorded over the past three years. This follows a reduction in growth of transfers to public entities to match the inflation rate.

The current balance shows the gap between revenue and operational spending. The proposed fiscal package is expected to result in a consolidated current surplus of R24.1 billion in 2015/16, increasing to R107 billion in 2017/18. As a share of GDP, the current surplus reaches 2.2 per cent in 2017/18, financing almost 60 per cent of government’s capital borrowing needs. Spending on capital is expected to grow by a real annual average of 1.4 per cent over the MTEF period, driven by expenditure on education, transport and water infrastructure. Even as the deficit consolidates in line with fiscal objectives, the capital finance requirement will remain broadly unchanged at about 4 per cent of GDP.

Table A.3 Consolidated fiscal framework, 2011/12 – 2017/18

R billion	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
		Outcome		Estimate		Medium-term estimates	
Operating account							
Revenue	**830.8**	**893.4**	**997.1**	**1 083.8**	**1 195.8**	**1 315.8**	**1 430.8**
Current payments	**838.3**	**919.1**	**1 006.0**	**1 093.1**	**1 171.6**	**1 247.1**	**1 323.7**
Compensation	345.9	374.8	407.6	440.7	470.6	501.8	533.5
Goods and services	153.8	167.9	177.8	189.5	193.8	200.2	213.0
Interest and rent on land	81.7	93.4	107.5	120.8	133.3	145.3	155.9
Transfers and subsidies	257.0	283.0	313.1	342.3	373.9	399.7	421.4
Current balance	**-7.5**	**-25.6**	**-8.9**	**-9.3**	**24.1**	**68.7**	**107.0**
Percentage of GDP	*-0.3%*	*-0.8%*	*-0.3%*	*-0.3%*	*0.6%*	*1.6%*	*2.2%*
Capital account							
Capital receipts	0.3	0.4	0.9	0.1	0.1	0.1	0.1
Capital payments	62.5	67.3	80.3	90.2	97.7	103.6	110.6
Capital transfers	49.2	53.8	57.2	59.7	66.2	71.1	73.7
Capital financing requirement[1]	**-111.5**	**-120.7**	**-136.6**	**-149.8**	**-163.8**	**-174.5**	**-184.2**
Percentage of GDP	*-3.7%*	*-3.8%*	*-4.0%*	*-4.0%*	*-4.1%*	*-4.0%*	*-3.9%*
Financial transactions[2]	8.2	10.1	10.8	6.0	0.2	6.7	3.4
Unallocated reserves	–	–	–	–	5.0	15.0	45.0
Budget balance	**-110.8**	**-136.2**	**-134.7**	**-153.2**	**-144.5**	**-114.1**	**-118.7**
Percentage of GDP	*-3.7%*	*-4.3%*	*-3.9%*	*-4.1%*	*-3.6%*	*-2.6%*	*-2.5%*
Revenue	**842.3**	**908.9**	**1 012.7**	**1 093.9**	**1 199.5**	**1 323.0**	**1 434.6**
Expenditure	**953.1**	**1 045.1**	**1 147.4**	**1 247.1**	**1 344.0**	**1 437.1**	**1 553.4**
Non-interest expenditure[3]	*871.4*	*951.6*	*1 039.9*	*1 126.3*	*1 210.6*	*1 291.7*	*1 397.5*
Interest payments	*81.7*	*93.4*	*107.5*	*120.8*	*133.3*	*145.3*	*155.9*
Primary balance[4]	***-29.1***	***-42.8***	***-27.1***	***-32.4***	***-11.2***	***31.3***	***37.1***
Percentage of GDP	*-1.0%*	*-1.3%*	*-0.8%*	*-0.9%*	*-0.3%*	*0.7%*	*0.8%*

1. Includes payments for capital assets, receipts from the sale of capital assets and capital transfers
2. Transactions in financial assets and liabilities including net receipts from financial transactions
3. All spending except for consolidated interest payments
4. Revenue less non-interest expenditure
Source: National Treasury

Borrowing requirement and national debt outlook

Table A.4 shows the financing of the national government borrowing requirement for 2013/14, revised estimates for 2014/15 and projections over the medium term. The main budget borrowing requirement is projected to moderate from R179.7 billion in the current fiscal year to R143.8 billion in 2017/18, in line with government's consolidation proposals.

Government's medium-term funding strategy focuses on addressing loans maturing in 2017/18 and beyond. The strategy includes the accumulation of cash using higher borrowing in 2014/15. In addition, government will continue to exchange short-dated bonds for longer-term bonds as market conditions permit.

As cash is accumulated, short-term loans will be reduced to minimise cash balances. The net increase in short-term loan issues in 2014/15 and 2015/16 will be R23 billion compared with R47 billion in the 2014 Budget. In the last two years of the MTEF period, the net increases will be R64 billion to provide for the financing of high loan redemptions.

New bond issuance in 2014/15 will total R187.6 billion, R20.5 billion higher than the 2014 Budget estimate, mainly due to high take-up of non-competitive auctions. Over the next two years new bond issuance will be R14.7 billion lower than the 2014 Budget levels, increasing to R176.9 billion in the outer year. The maturity profile of bonds will continue to favour issuing bonds with longer maturities.

Table A.4 Financing of national government borrowing requirement, 2013/14 – 2017/18

	2013/14	2014/15		2015/16	2016/17	2017/18
R million	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Main budget balance[1]	**-161 701**	**-179 781**	**-179 711**	**-167 187**	**-139 016**	**-143 770**
Financing						
Domestic short-term loans (net)	**23 048**	**23 000**	**10 000**	**13 000**	**24 000**	**40 000**
Treasury bills	20 221	23 000	10 000	13 000	24 000	40 000
Corporation for Public Deposits	2 827	–	–	–	–	–
Domestic long-term loans (net)	**149 414**	**132 098**	**153 926**	**137 712**	**107 694**	**88 845**
Market loans (gross)	172 112	167 103	187 360	165 500	165 500	176 914
Loans issued for switches[2]	-1 135	–	243	–	–	–
Redemptions	-21 563	-35 005	-33 677	-27 788	-57 806	-88 069
Foreign loans (net)	**378**	**1 288**	**8 263**	**5 879**	**3 418**	**12 406**
Market loans (gross)	19 619	16 290	22 952	9 826	16 635	16 005
Redemptions (including revaluation of loans)	-19 241	-15 002	-14 689	-3 947	-13 217	-3 599
Change in cash and other balances[3]	**-11 139**	**23 395**	**7 522**	**10 596**	**3 904**	**2 519**
Total	**161 701**	**179 781**	**179 711**	**167 187**	**139 016**	**143 770**

1. A negative number reflects a deficit
2. Net of loans issued and redeemed in switch transactions
3. A negative change indicates an increase in cash balances
Source: National Treasury

To manage currency risk, government’s foreign borrowing programme will remain focused on financing foreign-currency commitments arising from interest payments and repaying of maturing loans. Over the medium term, US$4 billion will be borrowed in international markets.

Table A.5 shows total national government debt over the period 2013/14 to 2017/18. National government’s net debt is estimated to increase from 42.8 per cent in 2014/15 to 45.9 per cent in 2017/18, while gross debt is projected to remain below 50 per cent of GDP over the MTEF period.

Table A.5 Total national government debt, 2013/14 – 2017/18

As at 31 March	2013/14	2014/15		2015/16	2016/17	2017/18
R billion	**Outcome**	**Budget**	**Revised**	**Medium-term estimates**		
Domestic debt						
Gross loan debt[1]	1 441.1	1 630.7	1 634.0	1 828.5	2 014.4	2 207.2
Cash balances	-120.8	-107.2	-112.1	-112.1	-107.2	-107.2
Net loan debt[2]	1 320.3	1 523.5	1 521.9	1 716.4	1 907.2	2 100.0
Foreign debt						
Gross loan debt[1]	143.7	147.2	155.8	169.6	165.9	172.2
Cash balances[3]	-84.5	-81.7	-89.0	-87.0	-83.4	-80.3
Net loan debt[2]	59.2	65.5	66.8	82.6	82.5	91.9
Total gross loan debt	**1 584.8**	**1 777.9**	**1 789.8**	**1 998.1**	**2 180.3**	**2 379.4**
Total net loan debt	**1 379.5**	**1 589.0**	**1 588.7**	**1 799.0**	**1 989.7**	**2 191.9**
As percentage of GDP:						
Total gross loan debt	*45.9%*	*46.9%*	*48.2%*	*49.5%*	*49.7%*	*49.8%*
Total net loan debt	*40.0%*	*41.9%*	*42.8%*	*44.6%*	*45.4%*	*45.9%*
Foreign debt as percentage of:						
Gross loan debt	*9.1%*	*8.3%*	*8.7%*	*8.5%*	*7.6%*	*7.2%*
Net loan debt	*4.3%*	*4.1%*	*4.2%*	*4.6%*	*4.1%*	*4.2%*

1. Forward estimates are based on projections of exchange and inflation rates
2. Net loan debt is calculated with due account of the cash balances of the National Revenue Fund (bank balances of government's account with the Reserve Bank and commercial banks)
3. Foreign currency deposits revalued at forward estimates of exchange rates
Source: National Treasury

2013/14 outcomes and 2014/15 mid-year estimates

Table A.6 presents a summary of the national and provincial appropriated expenditure outcomes for 2013/14 and estimates for the first half of 2014/15. Details are presented in Tables A.10 and A.11.

Main budget expenditure amounted to R1.048 trillion in 2013/14, which was R1.8 billion lower than the adjusted budget estimate and R1.3 billion lower than the 2014 Budget estimate.

Table A.6 National and provincial expenditure: 2013/14 outcomes and 2014/15 mid-year estimates

	2013/14				2014/15		
R billion	Original budget	Adjusted estimate	Preliminary outcome	Over(-)/ under(+)	Original budget	Adjusted estimate[1]	Actual spending April to September
National Revenue Fund Expenditure	**1 055.1**	**1 049.6**	**1 047.8**	**1.8**	**1 142.6**	**1 136.3**	**551.7**
Debt-service costs	99.7	100.5	101.2	-0.7	114.9	114.5	56.6
Provincial equitable share	337.6	338.9	338.9	–	362.5	362.5	181.2
Other direct charges	25.0	25.1	24.9	0.2	26.8	26.9	11.5
National votes	**592.7**	**585.0**	**582.7**	**2.3**	**638.3**	**632.5**	**302.4**
of which:							
Compensation of employees	*111.9*	*113.4*	*112.0*	*1.4*	*120.4*	*121.0*	*61.0*
Transfers and subsidies	*402.6*	*397.8*	*395.1*	*2.7*	*433.1*	*434.1*	*212.9*
Payments for capital assets	*14.3*	*14.3*	*14.1*	*0.2*	*17.7*	*16.7*	*4.6*
Unallocated reserves	*4.0*	–	–	–	*3.0*	–	–
National government projected underspending	–	*-3.5*	–	*-3.5*	–	*-3.7*	–
Local government repayment to the National Revenue Fund	–	*-0.5*	–	*-0.5*	–	*-0.5*	–
Provincial expenditure	**418.5**	**430.9**	**424.7**	**6.2**	**454.5**	**n/a**	**220.2**
of which:							
Compensation of employees	*251.7*	*254.9*	*254.4*	*0.5*	*275.3*	*n/a*	*136.1*
Transfers and subsidies	*57.7*	*61.2*	*60.5*	*0.7*	*62.5*	*n/a*	*31.0*
Payments for capital assets	*29.1*	*32.5*	*30.2*	*2.3*	*31.4*	*n/a*	*13.3*

1. Provinces will table adjusted estimates during November 2014
Source: National Treasury

For 2014/15, main budget spending was revised down by R6.3 billion to R1.136 trillion compared with the 2014 Budget estimate. This represents an increase in expenditure of 8.5 per cent over the 2013/14 outcome. Of the appropriations to national departments, spending amounted to R582.7 billion in 2013/14, or 99.9 per cent of the February 2014 revised estimate of R583.5 billion. In the first six months of 2014/15, R302.4 billion was spent, or 47.8 per cent of the October 2014 revised estimate of R632.5 billion for the year. Transfers and subsidies form the largest economic category of national government expenditure. This includes transfers to provincial and local government through conditional grants, as well as payments for social grants, housing subsidies and transfers to universities, science councils and public entities.

Provincial expenditure in 2013/14 amounted to R424.7 billion, or 98.6 per cent of the 2014 Budget estimate. Expenditure by provinces was R220.2 billion in the first six months of 2014/15, representing 48.4 per cent of the original budget for the year. Provinces are primarily responsible for the delivery of social services, including basic education and health services. Compensation of employees is consequently the largest economic category of expenditure in provincial budgets, accounting for 61.8 per cent of expenditure in the first half of 2014/15.

Revised national expenditure estimates for 2014/15

The Adjustments Appropriation Bill and the Division of Revenue Amendment Bill set out amendments in the current financial year. The bills include the following proposed changes:

- R66.3 million in funds rolled over arising from commitments related to unspent balances in 2013/14.
- R620 million for digital broadcast migration.
- R350 million to cover the impact of the depreciation of the rand on foreign-currency denominated expenditure.
- R67.4 million for expenditure incurred for the funeral of former President Nelson Mandela.
- R65.7 million for the 2014 national macro organisation of the state.[1]
- R63.1 million for contractual penalties incurred by Denel Aerostructures related to the A400M military aircraft contracts.
- R34.6 million for water infrastructure interventions.
- R32.6 million for the introduction of Ebola control and prevention measures in South Africa, and for the deployment of mobile laboratories, experts, training and technical support to affected countries.
- R15 million for claims received from the Compensation Fund related to the administration of public servant occupational diseases and on-duty injury claims.
- R4.3 million for the relocation of the Gauteng regional office of the Department of Mineral Resources due to fire damage.
- R705.1 million refunded to departments for monies paid directly into the National Revenue Fund from department-specific activities.
- R1 billion that will not be spent in 2014/15 and has been declared as unspent funds by departments.

Revised provincial allocations

- R9.7 million is rolled over from unspent balances in 2013/14.
- R397.7 million is shifted from the indirect *school infrastructure backlogs grant* in the national sphere to the *education infrastructure grant*.
- R262 million is shifted from the indirect *national health grant* (health facility revitalisation component) in the national sphere to the *health facility revitalisation grant*.

Revised local government allocations

- R81.7 million is rolled over from unspent balances in 2013/14.
- R157 million for the repair of infrastructure damaged by natural disasters.

Details of the revised national spending allocations are set out in the 2014 *Adjusted Estimates of National Expenditure*, including rollovers of unspent funds from 2013/14, approved allocations for unforeseeable and unavoidable expenditure, the appropriation of expenditure earmarked in the 2014 Budget Speech for future allocation, other shifts and adjustments, and declared unspent funds. Revised provincial appropriations will be tabled in provincial legislatures before the end of the financial year.

Division of revenue

The largest share of the consolidated fiscal framework is the main budget, made up of all spending from the National Revenue Fund. The main budget is shared between national, provincial and local government. This section outlines the proposed substantial adjustments to provincial and local government allocations not already discussed in Chapter 4.

[1] The national macro organisation of the state gives effect to Presidential proclamations regarding the establishment of new or amended executive portfolios, the renaming and establishment of new departments, and the transfer of legislation between Cabinet ministers in terms of the Constitution.

Table A.7 Main budget framework,[1] 2011/12 – 2017/18

	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
R billion		**Outcome**		**Revised**		**Medium-term estimates**	
Division of available funds							
National departments	**389.2**	**419.5**	**452.6**	**494.7**	**523.1**	**553.2**	**585.0**
Provinces	**356.0**	**381.4**	**411.1**	**440.2**	**468.5**	**496.8**	**527.0**
Equitable share	289.9	311.0	336.8	360.2	383.0	405.6	429.3
Conditional grants	66.1	70.4	74.3	80.0	85.4	91.2	97.7
Local government	**68.3**	**76.4**	**82.8**	**91.1**	**99.2**	**103.9**	**110.0**
Equitable share	33.2	37.1	39.0	44.5	50.2	52.9	55.5
General fuel levy sharing with metropolitan municipalities	8.6	9.0	9.6	10.2	10.7	11.2	11.8
Conditional grants	26.5	30.3	34.3	36.4	38.4	39.8	42.7
Total	**813.5**	**877.4**	**946.6**	**1 026.0**	**1 090.8**	**1 153.9**	**1 222.0**
Percentage shares							
National departments	47.8%	47.8%	47.8%	48.2%	48.0%	47.9%	47.9%
Provinces	43.8%	43.5%	43.4%	42.9%	42.9%	43.1%	43.1%
Local government	8.4%	8.7%	8.8%	8.9%	9.1%	9.0%	9.0%

1. Includes function shifts between spheres
Source: National Treasury

Over the 2015 MTEF period, national departments are allocated 48 per cent of available non-interest expenditure, provinces 43 per cent and local government 9 per cent. Medium-term allocations to national departments increase by an average annual rate of 5.7 per cent, provincial resources grow by 6.2 per cent and local government allocations grow by 6.5 per cent. Slightly faster growth in allocations to provincial and local government reflects the priority placed on front-line services such as health, education and basic services. The proposed changes to the division of revenue for the 2015/16 – 2016/17 period are outlined in Table A.8.

Table A.8 Changes to the division of revenue, 2014/15 – 2016/17

	2014/15	2015/16	2016/17
R billion	**Revised**	**Medium-term estimates**	
Changes to baseline			
National allocations	**-2.0**	**-4.3**	**-5.2**
of which:			
Indirect grants to provinces[1]	*-0.8*	*-0.3*	*-0.4*
Indirect grants to local	*0.1*	*0.7*	*0.7*
Provincial allocations	**0.7**	**-4.0**	**-6.0**
Equitable share	–	-2.6	-4.0
Conditional grants	0.7	-1.4	-2.1
Local government allocations	**-1.5**	**-0.8**	**-1.3**
Total	**-2.8**	**-9.2**	**-12.5**

1. Amounts may be shifted between direct and indirect grants to provinces and local government before the 2015 Budget is tabled
Source: National Treasury

In line with Section 214 of the Constitution and Section 9 of the Intergovernmental Fiscal Relations Act (1997), the Financial and Fiscal Commission tabled its submission on the national budget in Parliament in May 2014. Government will formally respond to matters raised by the Commission when it tables the 2015 Budget.

Changes to provincial allocations

From 2015/16 three functions performed by provinces – further education and training, adult education and training, and the port health function – will be transferred to national government, with funds shifted from the provincial equitable share and the *further education and training colleges grant*.

Table A.9 shows the preliminary equitable share allocations to each province in 2014/15 and over the 2015 MTEF.

Table A.9 Provincial equitable share, 2014/15 – 2017/18

R million	2014/15	2015/16	2016/17	2017/18
Eastern Cape	51 700	54 356	57 415	60 118
Free State	20 661	21 775	22 794	23 999
Gauteng	68 153	73 484	78 311	83 679
KwaZulu-Natal	77 855	82 326	86 961	91 509
Limpopo	43 053	45 412	48 157	50 540
Mpumalanga	29 155	31 054	32 996	35 140
Northern Cape	9 608	10 145	10 737	11 404
North West	24 502	26 173	27 699	29 517
Western Cape	35 549	38 279	40 540	43 349
Total	**360 236**	**383 003**	**405 610**	**429 254**

Source: National Treasury

Changes to provincial conditional grants over the period ahead include the reprioritisation of funds out of the *provincial roads maintenance grant* to the South African National Roads Agency Limited for the upgrading of the R573 (Moloto Road), and out of the *human settlements development grant* to fund the expanded scope of work for planning and developing housing projects, now to be undertaken by the Housing Development Agency. Reprioritisation takes place from the indirect *national health grant*, and the *social sector expanded public works programme grant* for provinces.

A new *maths, science and technology grant* for provinces will be created through the merger of the *technical secondary schools recapitalisation grant* and the *Dinaledi schools grant,* allowing for these similar and overlapping programmes to be better administered and expanded to more schools.

Funding for the immediate costs of disaster response is made available to provinces and municipalities through special conditional grants that remain unallocated until they are disbursed. In recent years, the amounts assigned to these grants have exceeded actual needs. As a result, over the 2015 MTEF, R200 million will be reprioritised out of these grants. Funds for disaster recovery are also provided through conditional grants. In the 2015, MTEF funds for recovery from disasters that took place in 2013 and 2014 will be added to the *municipal disaster recovery grant,* and funds will be reprioritised and ring-fenced in the *provincial roads maintenance grant,* the *human settlements development grant,* the *education infrastructure grant,* the *comprehensive agricultural support programme,* and the *health facility revitalisation grant.* Amounts allocated are based on assessments conducted by the National Disaster Management Centre.

Changes to local government allocations

The fiscal package outlined in Chapter 3 proposes reductions across all spheres of government. For local government, reductions will only be made to conditional grants and not the local government equitable share. Reductions will be spread across the grants, but with larger reductions on grants with a history of underspending and on non-infrastructure grants. This translates to a reduction of baseline allocations for local government conditional grants of R920.6 million in 2015/16 and R1.4 billion in 2016/17.

The *municipal human settlements capacity grant* was introduced in 2014/15 to facilitate the development of capacity to manage human settlements programmes in Cape Town, Ekurhuleni, eThekwini, Johannesburg, Nelson Mandela Bay and Tshwane metropolitan municipalities. While the process of assigning the housing function is being reviewed, strengthening the capacity of these cities to manage the built environment remains a priority. Allocations for this grant will be reduced and the structure and conditions of the grant amended to reflect these changes. Details will be announced in the 2015 Budget.

A new grant is proposed to fund the administrative costs of municipalities in KwaZulu-Natal and Gauteng affected by mergers that will take effect after the 2016 local government elections. Additions are also proposed for the *regional bulk infrastructure grant* and *municipal water infrastructure grant*. These allocations will allow government to accelerate the provision of clean water to households.

While the review of local government infrastructure grants discussed in Chapter 4 will continue in 2015, two changes emerging from the review's recommendations are proposed for 2015/16:

- Rationalising four grants administered by the Department of Water and Sanitation. These grants, which have overlapping objectives, are the *municipal water infrastructure grant, water services operating subsidy grant, rural households infrastructure grant* and *regional bulk infrastructure grant*.
- Merging the *public transport infrastructure grant* and the *public transport network operations grant* into a single grant that provides more flexibility to cities in choosing public transport solutions.

Table A.10 Expenditure by vote, 2013/14 and 2014/15

	2013/14[1]				2014/15		
R million	Main budget	Adjusted budget	Preliminary outcome	Over(-)/ Under(+)	Main budget	Adjusted budget	Actual spending April to September
1 The Presidency	621	621	576	45	1 178	652	288
2 Parliament[2]	1 419	1 419	1 535	-116	1 508	1 508	671
3 Cooperative Governance and Traditional Affairs	58 253	58 459	56 402	2 057	63 213	63 454	23 434
4 Home Affairs	6 568	6 995	6 993	2	6 624	7 224	3 614
5 International Relations and Cooperation	5 548	5 755	5 871	-117	5 754	6 104	2 716
6 Performance Monitoring and Evaluation[3]	–	–	–	–	208	–	–
7 Public Works	6 170	6 175	6 023	153	6 121	6 121	3 014
8 Women, Children and People with Disabilities[3]	–	–	–	–	219	–	–
9 Government Communication and Information System	397	437	441	-4	413	425	209
10 National Treasury	25 556	25 232	25 107	125	27 265	26 704	11 405
11 Public Enterprises	237	294	272	22	260	323	103
12 Public Service and Administration	816	830	809	21	875	875	400
13 Statistics South Africa	1 738	1 742	1 728	13	2 243	2 243	872
14 Arts and Culture	2 915	2 915	2 755	160	3 525	3 525	1 551
15 Basic Education	17 592	17 619	17 011	608	19 680	19 690	10 768
16 Health	30 707	30 528	29 825	703	33 955	33 901	16 212
17 Higher Education and Training	34 322	34 334	34 332	2	36 867	36 867	27 374
18 Labour	2 415	2 445	2 371	74	2 527	2 546	1 202
19 Social Development	120 519	118 539	117 109	1 429	128 799	128 594	63 306
20 Sport and Recreation South Africa	1 073	1 073	1 073	–	970	970	412
21 Correctional Services	18 748	18 748	18 700	48	19 721	19 722	9 291
22 Defence and Military Veterans	40 243	40 658	40 448	211	42 831	42 857	18 713
23 Independent Police Investigative Directorate	217	217	193	24	235	235	86
24 Justice and Constitutional Development	14 134	14 206	13 731	476	15 162	15 162	6 602
25 Police	67 917	68 791	68 791	–	72 507	72 507	34 320
26 Agriculture, Forestry and Fisheries	6 178	6 182	6 111	71	6 692	6 692	3 441
27 Communications	2 044	2 372	2 363	9	1 593	2 237	872
28 Economic Development	771	771	771	–	697	697	318
29 Energy	6 598	6 503	6 477	26	7 416	7 438	3 514
30 Environmental Affairs	5 431	5 207	5 200	7	5 668	5 680	2 409
31 Human Settlements	27 930	27 975	27 443	532	30 521	29 418	11 423
32 Mineral Resources	1 394	1 394	1 387	7	1 471	1 476	832
33 Rural Development and Land Reform	9 460	9 460	9 454	6	9 455	9 455	4 459
34 Science and Technology	6 198	6 198	6 169	29	6 470	6 480	3 609
35 Tourism	1 501	1 521	1 513	8	1 662	1 583	994
36 Trade and Industry	9 573	9 516	9 380	135	9 835	9 919	4 001
37 Transport	42 275	42 402	43 037	-635	48 727	48 771	25 938
38 Water Affairs[3]	–	–	–	–	12 480	–	–
39 Planning, Monitoring and Evaluation[3]	665	665	647	18	–	734	363
42 Water and Sanitation[3]	10 367	10 656	10 506	150	–	13 647	3 566
43 Women[3]	171	171	163	8	–	185	77
Total appropriation by vote	**588 682**	**589 026**	**582 719**	**6 306**	**635 349**	**636 619**	**302 381**
Plus:							
Direct charges against the National Revenue Fund							
President and Deputy President salary (The Presidency)	3	3	3	–	3	5	2
Members' remuneration (Parliament)[2]	454	454	402	52	481	481	193
Debt-service costs (National Treasury)	99 741	100 485	101 185	-700	114 901	114 485	56 563
Provincial equitable share (National Treasury)	337 572	338 937	338 937	–	362 468	362 468	181 234
General fuel levy sharing with metropolitan municipalities (National Treasury)	9 613	9 613	9 613	–	10 190	10 190	3 397
National Revenue Fund payments (National Treasury)[4]	–	200	516	-316	–	311	311
Skills levy and sector education and training authorities (Higher Education and Training)	12 403	12 300	12 090	210	13 440	13 200	6 416
Judges' and magistrates' salaries (Justice and Constitutional Development)	2 576	2 576	2 299	277	2 730	2 730	1 207
Total direct charges against the National Revenue Fund	**462 363**	**464 567**	**465 044**	**-478**	**504 213**	**503 871**	**249 322**
Unallocated reserves	4 030	–	–	–	3 000	–	–
National government projected underspending	–	-3 500	–	-3 500	–	-3 650	–
Local government repayment to the National Revenue Fund	–	-500	–	-500	–	-500	–
Total	**1 055 075**	**1 049 593**	**1 047 764**	**1 829**	**1 142 562**	**1 136 340**	**551 703**

1. Adjusted to include function shifts

2. The preliminary outcome for Parliament is converted from accrual to cash

3. Funds appropriated in the main budget shifted to newly created department with historical numbers adjusted accordingly

4. Previously classified as extraordinary payments

Source: National Treasury

Table A.11 Expenditure by province, 2013/14 and 2014/15

R million	2013/14 Main budget	2013/14 Adjusted budget	2013/14 Preliminary outcome	2013/14 Over(-)/ Under(+)	2013/14 Deviation from adjusted budget	2014/15 Main budget	2014/15 Actual spending April to September[1]
Eastern Cape	**59 258**	**61 376**	**60 772**	**604**	**1.0%**	**62 141**	**29 880**
Education	26 972	27 539	27 451	88	0.3%	27 935	13 606
Health	16 584	17 184	17 048	135	0.8%	17 509	8 435
Social Development	2 015	2 044	1 965	79	3.9%	2 159	1 056
Other functions	13 687	14 610	14 308	301	2.1%	14 538	6 782
Free State	**26 872**	**27 649**	**27 364**	**285**	**1.0%**	**27 925**	**13 846**
Education	10 456	10 613	10 917	-304	-2.9%	11 259	5 946
Health	7 895	7 992	7 779	213	2.7%	8 155	4 007
Social Development	951	965	963	2	0.2%	973	458
Other functions	7 569	8 079	7 705	374	4.6%	7 538	3 435
Gauteng	**75 965**	**79 596**	**77 334**	**2 262**	**2.8%**	**86 969**	**41 022**
Education	29 276	30 695	30 362	333	1.1%	32 845	16 211
Health	27 993	28 771	27 416	1 355	4.7%	31 524	15 281
Social Development	2 896	2 917	2 900	17	0.6%	3 525	1 569
Other functions	15 800	17 213	16 658	555	3.2%	19 074	7 961
KwaZulu-Natal	**89 792**	**91 966**	**92 009**	**-43**	**-0.0%**	**96 718**	**48 664**
Education	37 009	37 597	37 560	37	0.1%	39 447	20 093
Health	28 648	29 219	29 531	-312	-1.1%	30 914	15 826
Social Development	2 325	2 316	2 330	-14	-0.6%	2 498	1 165
Other functions	21 811	22 834	22 588	246	1.1%	23 859	11 580
Limpopo	**48 435**	**48 407**	**46 597**	**1 810**	**3.7%**	**51 460**	**24 009**
Education	23 475	23 948	23 388	561	2.3%	24 966	12 219
Health	13 077	13 481	13 138	343	2.5%	14 371	6 867
Social Development	1 378	1 381	1 315	66	4.8%	1 469	673
Other functions	10 505	9 597	8 756	840	8.8%	10 655	4 250
Mpumalanga	**33 659**	**34 226**	**33 701**	**524**	**1.5%**	**36 470**	**17 661**
Education	14 897	15 103	14 933	170	1.1%	16 103	8 006
Health	8 085	8 122	8 065	57	0.7%	8 992	4 271
Social Development	1 154	1 170	1 133	37	3.1%	1 232	566
Other functions	9 524	9 831	9 570	261	2.7%	10 143	4 818
Northern Cape	**12 248**	**13 293**	**13 131**	**162**	**1.2%**	**13 123**	**6 727**
Education	4 448	4 528	4 559	-31	-0.7%	4 744	2 469
Health	3 342	3 477	3 402	75	2.2%	3 696	1 934
Social Development	604	608	604	3	0.5%	651	293
Other functions	3 854	4 680	4 565	115	2.5%	4 031	2 030
North West	**28 566**	**30 267**	**30 129**	**137**	**0.5%**	**31 770**	**15 442**
Education	11 321	11 522	11 756	-234	-2.0%	12 423	6 037
Health	7 667	8 353	8 393	-40	-0.5%	8 184	4 274
Social Development	1 082	1 057	1 046	11	1.0%	1 242	550
Other functions	8 495	9 334	8 933	401	4.3%	9 920	4 580
Western Cape	**43 704**	**44 081**	**43 667**	**414**	**0.9%**	**47 935**	**22 945**
Education	15 602	15 669	15 502	167	1.1%	16 425	8 134
Health	15 872	16 030	15 917	113	0.7%	17 338	8 359
Social Development	1 578	1 587	1 580	7	0.4%	1 756	830
Other functions	10 653	10 795	10 668	127	1.2%	12 416	5 623
Total	**418 499**	**430 859**	**424 705**	**6 154**	**1.4%**	**454 511**	**220 195**
Education	173 456	177 214	176 427	787	0.4%	186 147	92 720
Health	129 162	132 629	130 690	1 938	1.5%	140 684	69 254
Social Development	13 984	14 044	13 836	208	1.5%	15 505	7 161
Other functions	101 897	106 972	103 752	3 220	3.0%	112 175	51 060

1. September expenditure numbers obtained from Vulindlela
Source: National Treasury