FISCAL POLICY FOR SUSTAINABLE PUBLIC FINANCES

South Africa faces difficult choices in a rapidly changing world. Economic growth, which has steadily weakened over the past five years, is likely to increase moderately over the medium term. Yet this rate of growth will not be sufficient to markedly reduce unemployment, poverty and inequality. Government's measured fiscal consolidation is working to narrow the budget deficit and stabilise debt, building confidence in the economy. But substantial revenue under-collection in 2016/17 has imposed sharper limits on public spending. At the same time, the rise of aggressive unilateralism in advanced economies, and mounting uncertainty over the course of world trade, pose serious threats to the global outlook.

Growth outlook has improved, but revenue under-collection imposes sharp fiscal limits

In the context of these pressures, the 2017 Budget sets out a series of proposals to raise additional revenue, sustain core expenditure, improve value for money spent, stabilise the public finances, and contribute to growth and transformation.

Slow economic growth has placed enormous pressure on the public finances. Government remains committed to a measured, prudent course of fiscal consolidation to narrow the budget deficit and stabilise debt. Doing so will reduce the economy's exposure to global volatility.

Government's measured fiscal consolidation will narrow budget deficit and stabilise debt

Fiscal policy measures

South Africa raises tax revenue to fund most public spending. When the budget is in deficit, government borrows to meet the shortfall. The proposed budget for 2017/18 totals R1.56 trillion, of which revenues cover R1.41 trillion. The remainder – R149 billion – will be borrowed.

Proposed budget for 2017/18 totals R1.56 trillion, of which revenue covers R1.41 trillion

Table 1.2 Consolidated government fiscal framework

R billion/percentage of GDP	2016/17 Revised estimate	2017/18	2018/19	2019/20
		Medium-term estimates		
Revenue	**1 297.3**	**1 414.1**	**1 535.2**	**1 668.5**
	29.4%	*29.8%*	*29.9%*	*30.1%*
Expenditure	**1 445.2**	**1 563.1**	**1 677.1**	**1 814.3**
	32.8%	*33.0%*	*32.7%*	*32.7%*
Budget balance	**-147.9**	**-149.0**	**-141.9**	**-145.8**
	-3.4%	*-3.1%*	*-2.8%*	*-2.6%*
Net loan debt	**2 006.1**	**2 226.3**	**2 442.4**	**2 670.1**
	45.5%	*47.0%*	*47.6%*	*48.1%*
Debt-service costs	**146.3**	**162.4**	**180.7**	**197.3**
	3.3%	*3.4%*	*3.5%*	*3.6%*

Source: National Treasury

A measured approach that protects the public finances and creates an enabling environment for faster economic growth is required over the medium term. The 2017 Budget proposals will:

- Reduce the expenditure ceiling by R10 billion in 2017/18 and R16 billion in 2018/19. This will be achieved through reduced national department operating budgets; lower transfers to entities, provinces and local government; and reallocations. Chapter 5 discusses adjustments to government's spending plans.

- Introduce tax policy measures to generate an additional R28 billion in revenue in 2017/18, mainly through higher personal income taxes and fuel levies. Chapter 4 discusses tax policy. Proposals to raise R15 billion in 2018/19 will be announced in the 2018 Budget.

South Africans should not be taxed for today's expenses 20 or 30 years from now

Government is acutely aware of the difficult economic conditions facing the majority of South Africans. However, deferring tax increases by accumulating more public debt would ultimately impose a greater burden on citizens. Government debt now stands at R2.2 trillion, or 50.7 per cent of GDP, and interest payments continue to grow rapidly. By acting now to stabilise debt, government is ensuring that future generations will not be paying taxes for today's expenses 20 or 30 years from now.

R5 billion earmarked for higher education in 2019/20 adds to R32 billion already announced

Over the medium term, government will sustain spending in real per capita terms. In a tight fiscal environment, billions of rands have been shifted to meet new needs. A R5 billion allocation has been earmarked for higher education in the outer year of the framework, adding to the R32 billion in extra funds previously announced. After debt service and post-school education, the fastest-growing spending categories are health, social development, and community and economic infrastructure.

Table 1.3 Consolidated government expenditure by function

R billion	2016/17 Revised estimate	2017/18 Budget estimate	Average growth 2016/17–2019/20
Basic education	226.6	243.0	7.3%
Economic affairs	201.7	215.0	6.6%
Defence, public order and safety	190.0	198.7	5.8%
Human settlements and municipal infrastructure	179.8	195.8	8.0%
Health	170.9	187.5	8.3%
Social protection	164.9	180.0	8.2%
General public services	70.0	70.7	2.6%
Post-school education and training	69.0	77.5	9.2%
Agriculture, rural development and land reform	26.0	26.5	4.7%
Allocated expenditure	**1 298.9**	**1 394.8**	**7.1%**
Debt-service costs	146.3	162.4	10.5%
Contingency reserve	–	6.0	
Consolidated expenditure[1]	**1 445.2**	**1 563.1**	**7.9%**

1. Consisting of national, provincial, social security funds and selected public entities. See Annexure W2 on the National Treasury website for a full list of entities included.
Source: National Treasury

Fiscal pressures and risks

Budget proposals are recommended by MinComBud and approved by Cabinet

The 2017 Budget proposals – recommended by MinComBud and approved by Cabinet – will result in substantial pressures on the spending plans of national, provincial and local government. A reallocation of R21.4 billion over the medium term is proposed alongside expenditure ceiling reductions of R10.2 billion in 2017/18 and R15.9 billion in

2018/19. Resource limits highlight the urgent need to improve the quality of spending so that every rand is used to good effect.

Decision-making authority in the budget process is decentralised across departments, provinces and municipalities. Without resolute action and careful planning to target cuts in the most wasteful and inefficient spending areas, the danger grows that the burden of consolidation will be shifted onto the most vulnerable citizens.

National health insurance fund to be established

All South Africans should have equitable access to quality, affordable healthcare. As allocations for national health insurance pilot sites wind down, new initiatives will build on progress made to date.

During 2017/18 government intends to establish a national health insurance fund. Its initial focus will be to expand access to a common set of maternal health services and make hearing aids and spectacles available through school health programmes. It will offer improved psychiatric care, and services for people with disabilities and the elderly. The service package, delivered through public and private medical practitioners, will be progressively expanded.

The fund will be established through a combination of reorganisation and legislative amendments. Government is exploring a small reduction in the tax credit on medical scheme contributions to provide initial resources for the fund. During 2017/18, the National Treasury and the Department of Health will work with a wide range of stakeholders to publish the final national health insurance white paper, refine the draft implementation plan and revise cost estimates.

Procurement reforms offer possibility of sustained improvement in public spending effectiveness

Government's wage bill has stabilised and headcounts are moderating. Procurement reforms offer the possibility of a sustained improvement in the effectiveness of public spending. Fiscal policy measures in recent years have stabilised the budget deficit. And in 2018/19, government expects to achieve a primary surplus, meaning that revenue will exceed non-interest expenditure, a key milestone on the path to debt stabilisation.

Yet the public finances face growing strains and risks:

- Despite tax increases announced last year, in 2016/17 government expects to collect R30 billion less in revenue than projected in the 2016 Budget – the largest underperformance since the 2009 recession.
- There is heightened uncertainty regarding the path of revenue collection. Risks include general uncertainty about the rate of economic growth, and concerns about tax morality and administration.
- Policy changes without adequate consideration of the budgetary consequences – such as those related to higher education – have required billions of rands to be shifted within tight resource limits, causing other critical programmes to face unanticipated budget cuts.
- Infrastructure projects that are poorly designed or not effectively delivered have resulted in high operating deficits, imposing rising fiscal pressure on implementing agencies. Approving projects without the necessary financial modelling can have far-reaching consequences.
- Financial imbalances are building up in the public sector, particularly in water, electricity and property taxes. There are substantial unsettled bills between national, provincial and local government.
- The public-sector wage bill has increasingly crowded out other areas of expenditure, limiting government's ability to improve the composition of spending in favour of capital budgets.
- Debt-service costs, which amount to R162 billion in 2017/18, continue to be the fastest-growing element of the budget, diverting critical

resources from frontline services. For every R1 collected in tax, 13c must be diverted to service debt.

- Financially distressed or mismanaged state companies have the potential to weaken fiscal sustainability.

Increasing pace of inclusive growth is central policy challenge

Government is monitoring and managing these risks in a systematic manner. The ability of the fiscus to respond, however, is limited in an environment of low growth. Over the long term, unless South Africa returns to a path of rising per capita incomes, it is doubtful that sufficient resources will be available to fund all the policy objectives set out in the NDP. In such a scenario, government would have to adjust its agenda, and determine which policies to implement, downsize or delay.

Increasing the pace of inclusive growth remains the country's biggest challenge. For this to occur, economic transformation must be accelerated.

Strengthening budget execution

To improve in-year monitoring, public entities will submit quarterly reports

Consolidation in the midst of prolonged low growth calls for more vigilance in budgeting, and steps are being taken across government to improve budget execution and the in-year monitoring of spending. National and provincial departments and municipalities submit monthly reports to the National Treasury. To strengthen oversight, a process has been initiated for all national public entities to report on a quarterly basis. This will improve transparency and provide early warnings of budget deviations.

Headcount in the public service has stabilised at about 1.32 million staff. Although some national departments are struggling to maintain their personnel budget limits, preliminary indications are that most are on track to stay within compensation ceilings. Provinces continue to make progress in containing staff headcount, which has declined by 2.8 per cent since the beginning of 2016/17. The proportion of provincial budgets spent on personnel has declined from 60.4 per cent in 2015/16 to 59.8 per cent in 2016/17.

Managing the national and provincial wage bill

Between 2008/09 and 2015/16, national and provincial government salaries rose about 1.8 per cent faster than inflation. In total, salaries have nearly doubled, compared with an increase in the consumer price index of about 70 per cent. Public-service wage settlements generally provide for increases equal to inflation, plus a premium that is not linked to performance.

In recent years, government has withdrawn nearly all identified funding for vacant posts and blocked appointments to non-critical vacant posts on the payroll system, pending the submission of revised human resource plans by departments.

During 2016, national departments were required to develop and submit human resource budget plans to the Medium-term Expenditure Committee (MTEC). The MTEC is composed of senior officials from the National Treasury, the Department of Performance Monitoring and Evaluation, the Department of Cooperative Governance and Traditional Affairs, and the Department of Public Service and Administration. The plans allow the committee to manage headcount and vacancies within set compensation limits. The MTEC continues to monitor the implementation of these plans.

The National Treasury and the Department of Public Service and Administration are working with departments to reduce headcount, including testing the idea of voluntary severance packages.

The 2015 wage agreement put significant pressure on the public finances by crowding out spending on goods, services and infrastructure. Negotiations on a new public-sector wage agreement are due to begin during 2017. An agreement that takes account of fiscal constraints will reduce some of the pressure on staff headcount and enable government to direct a larger portion of expenditure to capital investment.

A wage agreement that takes account of fiscal constraints can reduce headcount pressures

New budgeting facility for multi-year infrastructure projects

Government is proposing a new financing facility for large infrastructure projects that require funding or other state support, such as sovereign guarantees. It will address shortcomings in the planning and execution of infrastructure projects, particularly as they relate to life-cycle budgeting, operations and maintenance costs. The facility will help government build a pipeline of projects that have undergone rigorous technical analysis.

A technical unit will develop government-wide project design and evaluation guidelines that will be issued as a regulation by the National Treasury. Projects will be rigorously appraised from inception until financial closure.

Government budgets over three-year cycles through the medium-term expenditure framework. Large infrastructure projects, however, typically take more than three years to complete. The reform will ensure that full life-cycle, multi-year budgeting takes place in a transparent manner. This will be done by introducing legislation that will govern funding, implementation and reporting requirements for very large projects. The first phase of the facility is expected to begin operating in 2017 with the establishment of a technical unit and governing board.

Government is working with municipalities to strengthen infrastructure and maintenance budgeting. The City Infrastructure Delivery and Management System has been developed by the National Treasury, in collaboration with cities, to improve long-term infrastructure planning and asset management.

While spending remains constrained in real terms, there are many opportunities to improve the quality of state expenditure. Initiatives led by the Office of the Chief Procurement Officer to boost efficiency, eliminate waste and narrow opportunities for corruption in public procurement are discussed in Chapter 5.

Procurement reforms will boost efficiency, curb waste and narrow opportunities for corruption

The Budget Review

The *Budget Review* describes the economic outlook and policies to promote growth; the fiscal policy choices of government; the revenue proposals for 2017/18; national spending proposals; the division of revenue; the financing strategy; and the financial position of public-sector institutions.

Annexures present the Minister of Finance’s report to Parliament; tax expenditures and tax amendments; data on public sector infrastructure and public-private partnerships; and an update on financial-sector regulation and reform.

The full Budget Review, budget data and further information are available at www.treasury.gov.za