The budget process and fiscal policy in South Africa

National Treasury, September 2014

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Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Budgeting-the basics

Step 1: Work out how much money comes into the National Revenue Fund

- Tax revenue
- Non-tax revenue (Provinces, entities, SSF's, RDP)

Step 2: Decide on expenditure envelopes and priorities

- Non-interest expenditure (majority)
- Interest expenditure

Step 3: Check expenditure against revenue to determine borrowing requirement

- Medium-term expenditure framework
  - In 1997, we adopted a multi-year budgeting system
  - We budget for three years, but revise this annually
  - We use the concept of a rolling three-year framework

- We also have a medium-term budget policy statement which sets out:
  - Key priorities
  - Size of the spending envelope
  - Division between 3 spheres
  - Allocations to major conditional grants

Fiscal framework

Policy discussions at Cabinet, Budget Council, MinComBud

Direct Charges against National Revenue Fund

Contingency reserve

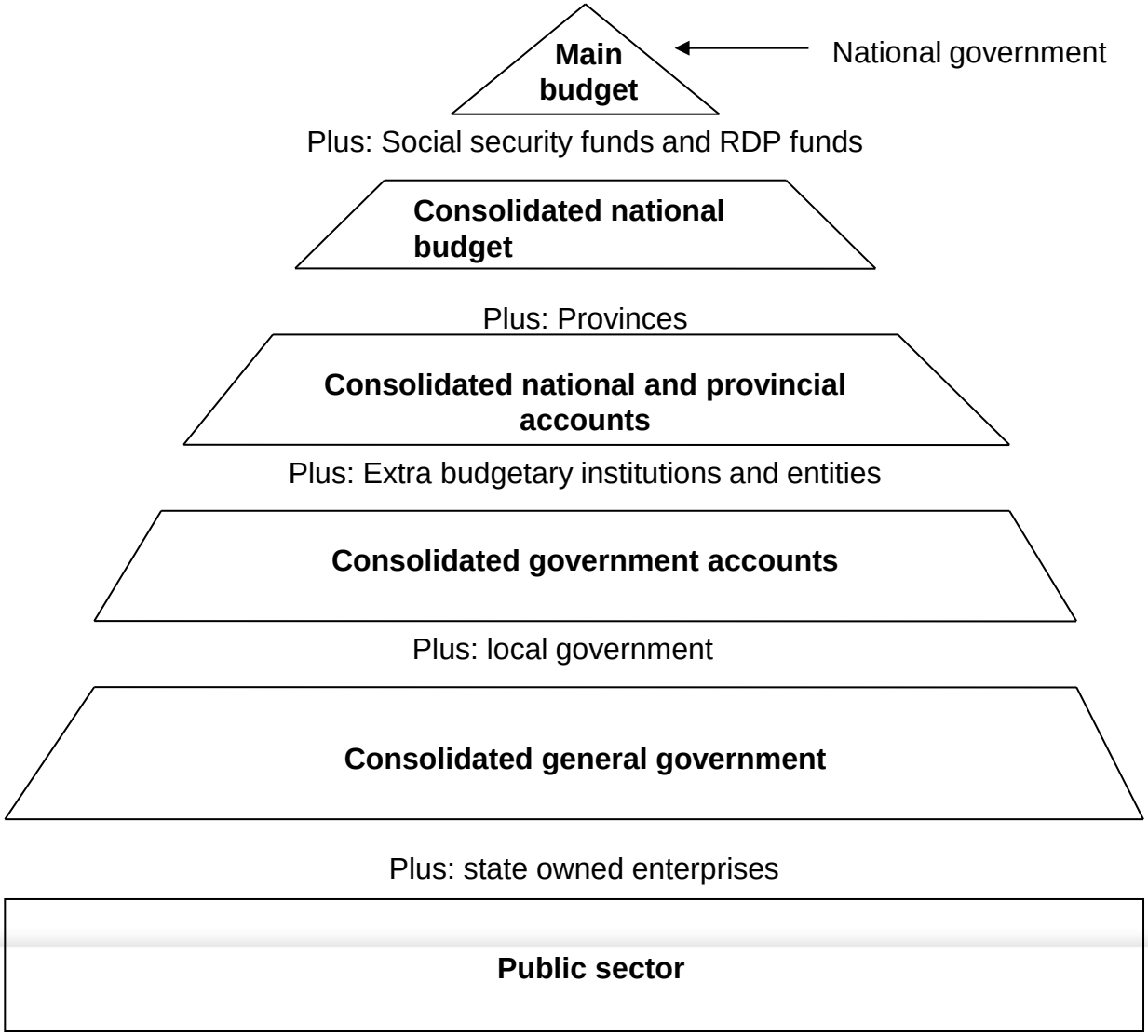
Available Expenditure: Division of Revenue

- **National**
- **Provincial**
- **Local**

Direct Charges include:

- Debt-servicing costs
- Provincial equitable share
- General fuel levy sharing with metros
- Skills development levy
- Other (mainly salaries of MPs, judges and magistrates)

The structure of government accounts



Including macroeconomic developments in the fiscal framework…

- The macroeconomic forecasts are revisited with each release of the SA Reserve Bank's quarterly bulletin
- The macroeconomic forecasts are updated 3 times before the MTBPS and once more for Budget
- The fiscal framework is updated for the following key macroeconomic variables:
    - Real GDP growth
    - Nominal GDP
    - GDP inflation
    - CPI
    - CPI index

Determining tax revenue

- The revenue analysis working committee meets in September, December and January (sometimes in June) to determine revenue projections for the MTEF

- The committee is comprised of representatives from:
  - Budget office (Fiscal Policy)
  - Macroeconomic Modelling
  - Tax Policy
  - SARS
  - SARB

- The committee discusses and debates trends in tax revenue and form a consensus view on the revenue outlook for the new MTEF

Determining expenditure-the baseline for NIE

- Use the framework presented in the previous year's MTBPS as a starting point for the current year's Budget
  - -e.g. framework in MTBPS 2013 is used as a starting point for Budget 2014
- Construct a baseline for total non-interest allocations which includes a new outer year
  - -This is done by expenditure planning in consultation with public finance and fiscal policy
- Usually the previous baseline is grown by a factor determined by public finance and budget office which is reflective of inflation and growth
- In depth analysis is conducted by budget analysts to remove any programmes from the baseline that have been completed

Determining expenditure-changes to NIE

- Following the determination of the non-interest spending baseline:
  - Adjustments are made to reflect positive real growth across the MTEF
  - A contingency reserve is set asides
  - Discussion takes place between several units in the Treasury to determine if there will be additional money available and how much?
  - Division of spending between spheres of government and across functions is finalised following the conclusion of the medium term expenditure committee meetings
  - Additions to baseline may change between MTBPS and Budget, but only in extenuating circumstances.

Determining expenditure-changes to interest spending

Estimates of interest on debt are determined using:

- Changes to debt stock
- Interest rate, inflation and exchange rate assumptions

Budget deficit

The budget deficit is guided by:

- sustainability
- intergenerational equity

Lower borrowing for current spending, alongside sustained spending on capital investment, will improve the composition of the deficit.

Maintaining credibility of the overall budget

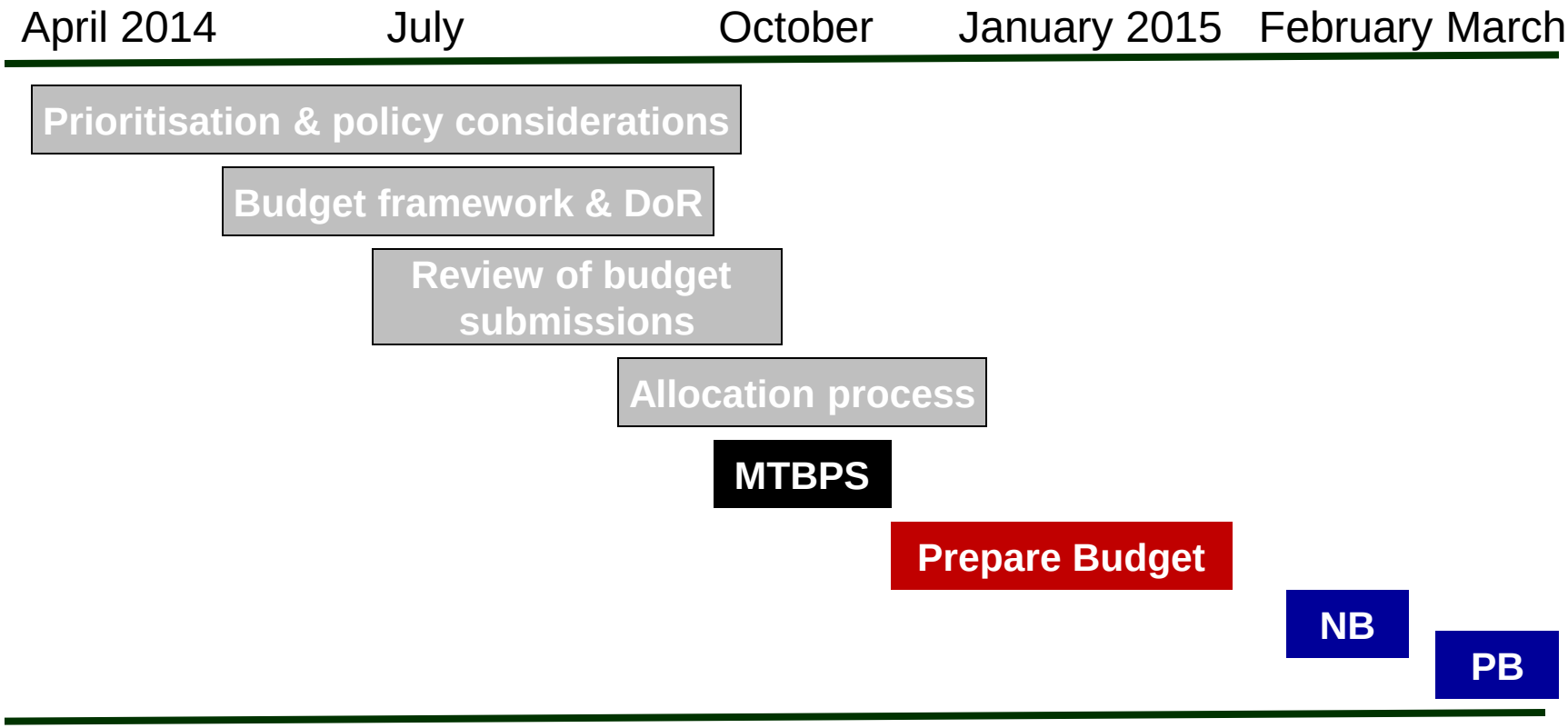
- Budget allocations should be reflective of
  - Government's strategic priorities and aligned to the NDP
  - Inflation in order to maintain the purchasing power of expenditure
  - Growth in the economy and government's intended contribution to future growth

- Debt management considerations
  - Sustainability in the long run
  - What type of expenditure is debt financing?
  - Reflection of the macroeconomic outlook for interest rates, growth, inflation and exchange rate

- Growth in revenue should reflect growth in the economy, with structural changes in expenditure being matched by changes to taxes

- Fiscal sustainability and prudential fiscal management

Summary of key decision stages and outputs



What must be outlined in the MTBPS

The Money Bills Amendment Procedure and Related Matters Act (MBAPRMA) prescribes in S6(2) that the following must be included in the MTBPS:

a) A revised fiscal framework for the present year and proposed fiscal framework for the next three years;
b) An explanation of the macro-economic and fiscal policy position, the macro-economic projections and the assumptions underpinning the fiscal framework;
c) The spending priorities of national government over the next three years;
d) The proposed substantial adjustments to conditional grant allocations to provinces and local government, if any; and
e) A review of actual spending by each national department and each provincial government between 1 April and 30 September of the current financial year

Contents of the MTBPS

The MTBPS document usually covers these in four chapters (though the structure of the document can change)

Chapter	Topics covered	Relevant part of MBAPRMA Section6(2)
1	**Policy overview** • Sets out broad themes and policy direction	
2	**Economic outlook** • Explains the macroeconomic situation and projections	(b)
3	**Fiscal Policy and Trends** • Sets out the fiscal framework	(a)
4	**Medium Term Expenditure Framework and Division of Revenue** • Sets out summary national government spending plans for the MTEF, proposed DoR (including changes to grants) and reviews past expenditure	(c), (d), (e), (f)

Budget 2014

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Reinforcing fiscal policy

- Fiscal policy continues to be guided by the principles of countercyclicality, debt sustainability and intergenerational fairness
- Over the medium term, government will balance continued support for economic recovery with fiscal consolidation
- Composition of spending improves over the MTEF:
  - Capital is the fastest growing item of non-interest expenditure
  - Social wage (spending on health, education and social development) continues to grow in real terms
  - Expenditure on travel, catering, consultants and other administrative payments declines in real terms

Macro projections

Macroeconomic performance and projections, 2010 – 2016

Calendar year	2010	2011	2012	2013	2014	2015	2016
Percentage change		Actual		Estimate		Forecast	
Final household consumption	4.4	4.9	3.5	2.7	2.8	3.2	3.4
Final government consumption	4.4	4.3	4.0	2.5	2.2	2.3	2.4
Gross fixed capital formation	-2.1	4.2	4.4	3.2	4.2	5.3	6.0
Gross domestic expenditure	3.9	4.6	4.0	2.8	2.8	3.4	3.7
Exports	9.0	6.8	0.4	4.8	5.6	6.3	7.0
Imports	11.0	10.0	6.0	7.3	5.3	6.1	7.0
Real GDP growth	**3.1**	**3.6**	**2.5**	**1.8**	**2.7**	**3.2**	**3.5**
GDP inflation	7.7	5.9	4.5	6.1	6.4	6.2	5.9
GDP at current prices (R billion)	**2 674**	**2 933**	**3 139**	**3 391**	**3 706**	**4 063**	**4 456**
CPI inflation	4.3	5.0	5.6	5.7	6.2	5.9	5.5
Current account balance (% of GDF	-2.0	-2.3	-5.2	-6.1	-5.9	-5.8	-5.5

Source: Reserve Bank and National Treasury

Economic outlook: Implications for the fiscus

- Over the past five years:
  - Low international interest rates kept borrowing costs down
  - Moderate domestic inflation limited budget cost pressures
  - Rising commodity prices supported government revenues

- Over the period ahead, South Africa confronts a new set of circumstances:
  - Rising global interest rates have pushed up the cost of servicing government debt
  - Weaker commodity prices has contributed to lower tax buoyancy
  - Rand depreciation has led to rising cost pressures

Tax revenue revisions-MTEF

Revisions to main budget revenue estimates

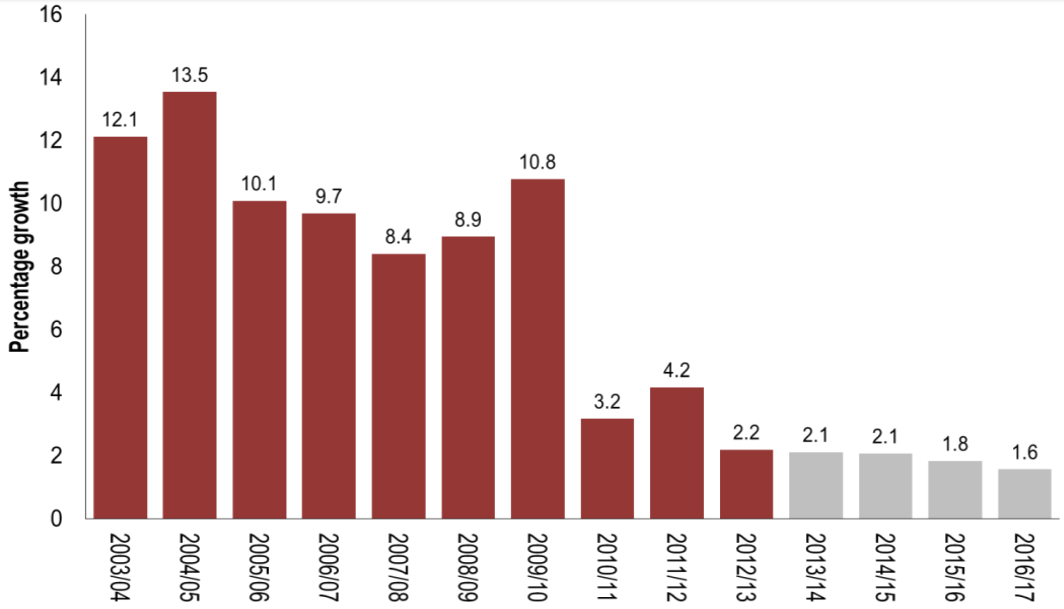
R billion/percentage of GDP	2013/14 2013 Budget	2013/14 2014 Budget	2014/15 2013 Budget	2014/15 2014 Budget	2015/16 2013 Budget	2015/16 2014 Budget
Revenue						
Gross tax revenue	898.0	899.0	991.8	993.7	1 099.0	1 095.1
Non-tax revenue	18.3	18.8	19.1	18.0	20.2	18.7
SACU	-43.4	-43.4	-43.0	-51.7	-48.5	-57.3
National Revenue Fund receipts	5.0	11.8	2.9	2.9	3.1	1.6
Main budget revenue	**878.0**	**886.2**	**970.8**	**962.8**	**1 073.8**	**1 058.1**
Percentage of GDP	*24.9%*	*25.6%*	*25.0%*	*25.4%*	*25.1%*	*25.5%*

Source: National Treasury

- The revenue estimate for 2013/14 presented in the 2013 Budget has been revised upwards by R1 billion to R899 billion
- Gross tax is R85.2 billion or 10.5 per cent higher than actual tax revenue in 2012/13
- Revenue has been revised marginally downwards in 2015/16, reflecting a weaker economic outlook

Containing expenditure growth

Real main budget non-interest expenditure growth, 2003/04 – 2016/17



- Spending continues to grow in real terms, but at a much slower pace.
- The expenditure ceiling introduced in 2012 commits government to spending:
  - R1.03 trillion in 2014/15,
  - R1.11 trillion in 2015/16
  - R1.18 trillion in 2016/17
- Within the expenditure ceiling, resources to fund costs pressures, such as those arising from wage negotiations, will be very limited.

Main budget non-interest expenditure, 2010/11 – 2016/17

R million	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
2012 Budget Review	738 914	814 554	879 977	953 024	1 030 539	–	–
2012 MTBPS	–	811 586	878 669	953 024	1 030 539	1 118 991	–
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

Ensuring spending efficiency

- Cost-containment measures implemented in December 2013 to limit expenditure on conferences, travel, entertainment
- National Treasury and the Department of Performance Monitoring and Evaluation have launched a series of expenditure reviews; initial findings to be released in 2014/15
- The National Treasury is working with provincial treasuries to identify inefficiencies and improve provincial spending
- The Chief Procurement Officer is building a national system for the purchase of high-value goods and services commonly used across government
- Forthcoming regulations will strengthen the National Treasury's oversight of public entities

Consolidated fiscal framework

Consolidated operating and capital accounts, 2010/11 – 2016/17

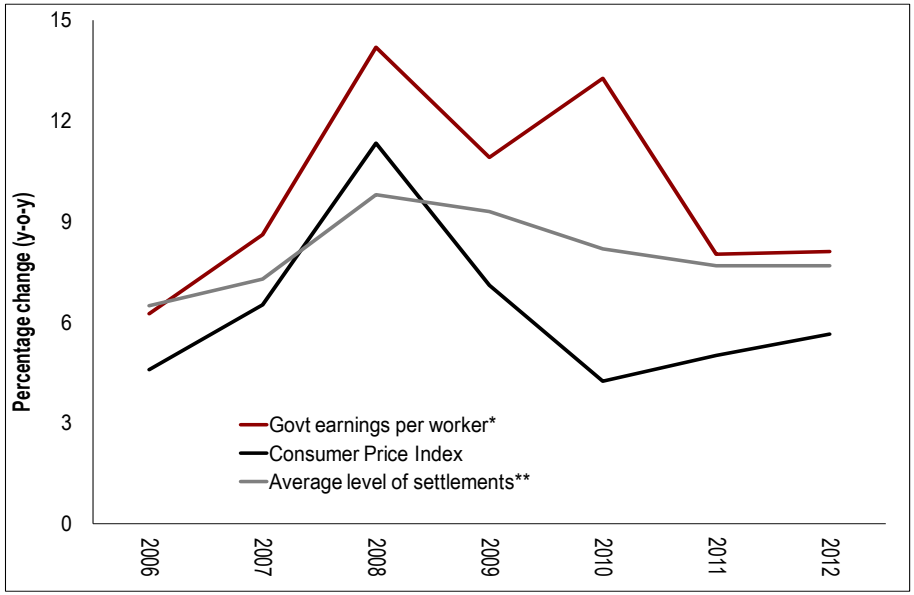
R billion	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
	Outcome			Estimate	Medium-term estimates		
Operating account							
Current revenue	**762.5**	**842.0**	**908.9**	**1 010.3**	**1 099.1**	**1 201.1**	**1 324.5**
Current payments	**756.4**	**838.7**	**920.7**	**1 011.1**	**1 093.8**	**1 176.5**	**1 254.2**
Compensation	309.9	346.0	375.0	411.3	439.4	468.7	498.9
Goods and services	137.7	153.5	167.9	180.0	189.7	199.6	211.4
Interest payments	75.3	81.7	93.5	107.7	121.2	133.5	145.1
Current transfers and subsidies	233.5	257.5	284.4	312.2	343.5	374.7	398.7
Current balance	**6.1**	**3.3**	**-11.8**	**-0.9**	**5.3**	**24.7**	**70.4**
Percentage of GDP	*0.2%*	*0.1%*	*-0.4%*	*-0.0%*	*0.1%*	*0.6%*	*1.5%*
Capital account							
Capital receipts	0.4	0.2	0.3	0.2	0.2	0.2	0.2
Capital payments	56.0	62.8	67.1	78.4	91.3	98.9	105.9
Capital transfers	45.2	48.5	52.4	55.9	60.6	66.9	73.2
Capital financing requirement[1]	**-100.8**	**-111.1**	**-119.2**	**-134.0**	**-151.7**	**-165.6**	**-179.0**
Percentage of GDP	*-3.7%*	*-3.7%*	*-3.7%*	*-3.9%*	*-4.0%*	*-4.0%*	*-3.9%*
Financial transactions[2]	22.4	3.0	4.9	3.9	3.6	3.3	0.3
Contingency reserve	–	–	–	–	3.0	6.0	18.0
Budget balance	**-117.1**	**-110.8**	**-135.9**	**-138.8**	**-153.1**	**-150.3**	**-126.9**
Percentage of GDP	*-4.3%*	*-3.7%*	*-4.3%*	*-4.0%*	*-4.0%*	*-3.6%*	*-2.8%*

1. Includes payments for capital assets, receipts from the sale of capital assets and capital transfers
2. Transactions in financial assets and liabilities

Managing risks: 1 – containing the wage bill

Growth in government employment

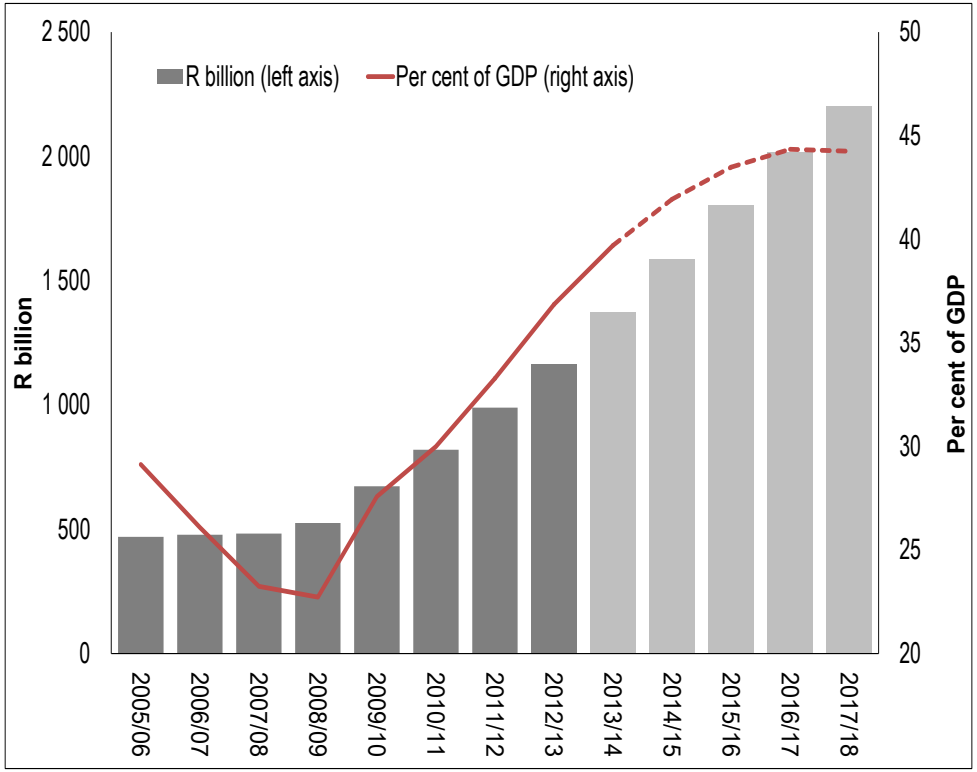
CPI and growth in average government earnings



- Ensure that employment and earnings growth does not threaten the expenditure ceiling.
- Specific attention paid to restraining growth in administrative posts.
- NT and DPSA are working to improve the monitoring of wage-bill trends and to enforce discipline in hiring of new personnel.
- Commitment to reach a sustainable public-sector wage agreement.

Managing risks: 2 – managing government's debt portfolio

Net government debt, 2005/06 – 2017/18



- The weaker rand exchange rate has pushed up the rand value of foreign-denominated debt
- Inflation has increased the revaluation value of inflation-linked debt
- Deterioration in the economic growth outlook has increased the debt-to-GDP ratio
- While debt-service costs are the fastest growing area of expenditure, debt levels stabilise by 2017/18

Managing risks: 3 – balance sheets of public entities and state-owned companies

- State-owned companies are at the centre of South Africa's infrastructure expansion
- State corporations are expected to borrow on the strength of their balance sheets, rather than being funded from the fiscus
- Where capitalisation of core public assets may be required, other measures, such as upfront disposal of non-core assets, will be considered
- State-owned companies facing persistent difficulties will require operational restructuring to become financially sustainable and to fulfil their mandates

Summary

- The 2015 Budget will not provide additional funding to the 2014 MTEF spending trajectory
- Resources on current baselines should be reallocated from activities that are no longer policy priorities, towards the more urgent priorities defined in the NDP and the MTSF
- Institutions should assess the possibilities for closing down programmes and projects that are no longer key priorities of government or which are not achieving desired outputs
- Emphasis should also be placed on improvements to spending efficiency and effectiveness
- Political decisions will need to be taken about the overall resource envelop and the allocation between competing priorities.

Thank you