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BUDGET 2015

NHLANHLA NENE

Minister of Finance

FEBRUARY 2015

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Summary

- South Africa faces a difficult period ahead as a result of a weak global outlook and domestic constraints to economic growth. In the short term electricity is the most important constraint.

- Since 2008, expenditure has been sustained at high levels in the face of revenue shortfalls. Cushioning the economy by borrowing to spend has raised debt from below R500 billion in 2008 to more than R1.6 trillion today.

- Since 2012, expenditure growth has been constrained and cost containment, efficiency enhancing measures taken. The 2015 Budget builds on these measures, reducing expenditure growth by R25 billion in the next two years. Despite this, non-interest spending continues to grow in real terms by 2.1 per cent over the medium term.

- It is now necessary to introduce moderate increases in tax revenue. Changes to personal income tax and the fuel levy will raise an additional R16.8 billion in 2015/16

- Government continues to prioritise infrastructure investment for economic development and social programmes that support those citizens most in need. Capital is the fastest growing element of non-interest expenditure, and the real value of the social wage is protected.

- To create work, and reduce poverty and inequality, South Africa requires higher rates of growth. This can be achieve through the implementation of structural reforms identified in the National Development Plan. Working together, government, business, labour and civil society can speed up these reforms over the period ahead.

Global growth has been revised downwards

- Weaker global growth prospects and slower growth in key emerging markets
- Growth is picking up in the US, but remains weak in Europe and Japan. China's GDP is projected to slow further and place pressure on commodity prices
- Lower oil prices over the short term should boost global growth, trade and consumption
- The growth outlook for sub-Saharan Africa remains robust. Stronger regional growth will support South Africa's export performance
- Risks to the outlook include lower commodity prices, uncertainty about the future of oil prices, weaker EU and Chinese growth and capital market volatility

Region/country	2013	2014	2015	2016
Percentage		GDP projections[1]		
World	**3.3**	**3.3**	**3.5**	**3.7**
Advanced economies	**1.3**	**1.8**	**2.4**	**2.4**
United States	2.2	2.4	3.6	3.3
Euro area	-0.5	0.8	1.2	1.4
United Kingdom	1.7	2.6	2.7	2.4
Japan	1.6	0.1	0.6	0.8
Emerging markets and developing economies	**4.7**	**4.4**	**4.3**	**4.7**
Brazil	2.5	0.1	0.3	1.5
Russia	1.3	0.6	-3.0	-1.0
India	5.0	5.8	6.3	6.5
China	7.8	7.4	6.8	6.3
Sub-Saharan Africa	**5.2**	**4.8**	**4.9**	**5.2**
South Africa[3]	2.2	1.4	2.0	2.4

1. IMF World Economic Outlook, January 2015
2. IMF World Economic Outlook Update, October 2014
3. National Treasury forecasts

Electricity supply is the most important domestic constraint

- Net effect on the economy is difficult to gauge. Forecast assumes GDP growth remains below 2.5 per cent for the next two years
- Government is working to limit the impact:
  - Ensure outages are predicable and consumers are informed
  - Additional capacity sought from co-generation, gas and coal
  - Improving operations and maintenance at Eskom
- Over the medium term, solutions will include:
  - Stabilizing Eskom finances, including through R23 billion to be raised
  - Shifting towards cost-reflective electricity tariffs
  - Ensuring adequate investment in production
  - Incentives to conserve energy and limit consumption
- South Africa must use current challenges as an opportunity to shift towards a less energy intensive growth path

Revised National Treasury forecast

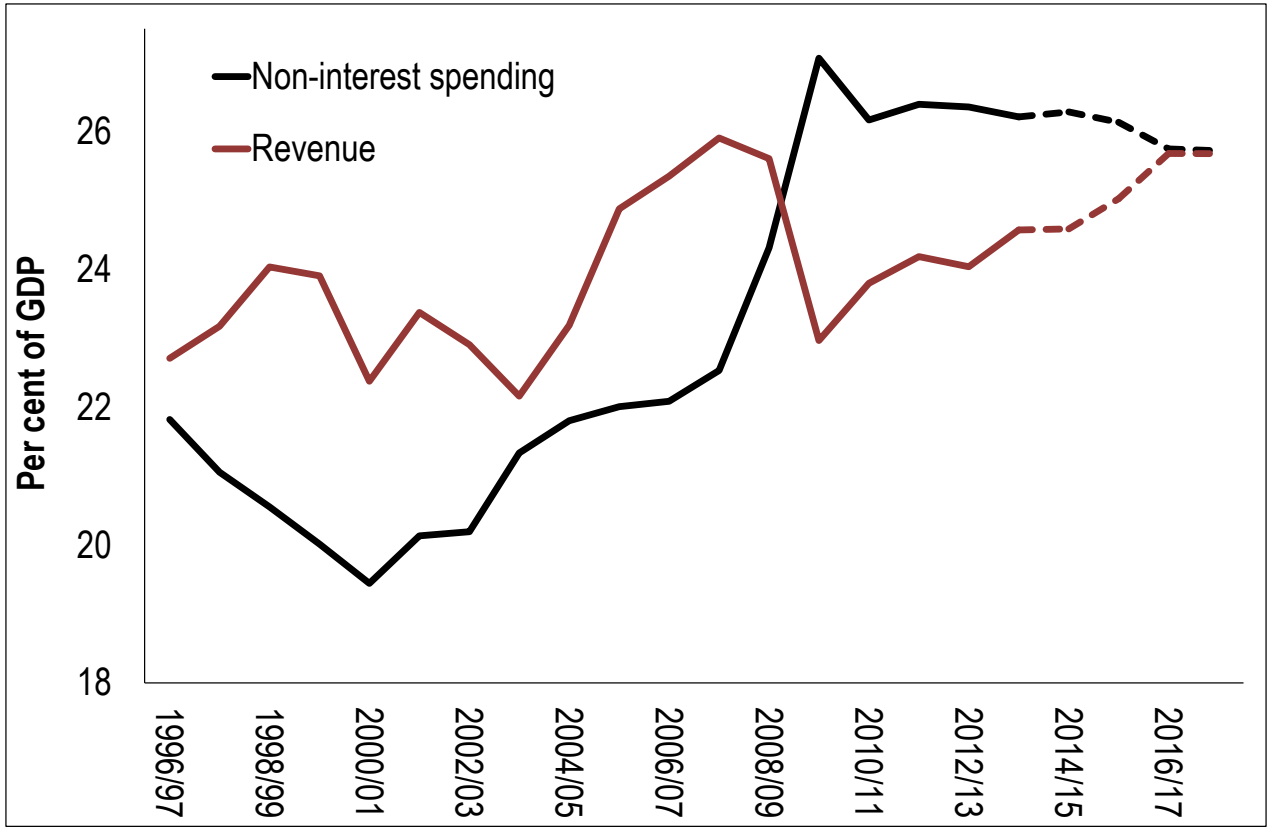
Calendar year	2011	2012	2013	2014	2015	2016	2017
		Actual		Estimate		Forecast	
Percentage change							
Final household consumption	4.9	3.4	2.9	1.2	2.0	2.6	3.0
Final government consumption	1.7	3.4	3.3	1.9	1.6	0.7	0.7
Gross fixed-capital formation	5.7	3.6	7.6	-0.6	2.2	3.4	3.8
Gross domestic expenditure	4.9	3.9	1.4	1.1	2.4	2.7	3.1
Exports	4.3	0.1	4.6	0.9	3.3	4.6	5.0
Imports	10.5	6.0	1.8	-0.3	4.6	5.3	5.5
Real GDP growth	**3.2**	**2.2**	**2.2**	**1.4**	**2.0**	**2.4**	**3.0**
GDP inflation	6.7	5.5	6.0	6.1	6.1	5.5	5.5
GDP at current prices (R billion)	**3025**	**3263**	**3534**	**3802**	**4113**	**4443**	**4830**
CPI inflation	5.0	5.7	5.8	6.1	4.3	5.9	5.7
Current account balance (% of GDP)	-2.2	-5.0	-5.8	-5.8	-4.5	-4.9	-5.2

Source: Reserve Bank and National Treasury

Balancing revenue and expenditure

- Debt is growing too fast:
  - We now owe R1.6 trillion, rising to R2.2 trillion in 2017.
  - Interest payments are the fastest growing element of spending, and now take up 12% of revenue
- Budget 2015 proposes to share the burden of fiscal consolidation:
  - Continued restraint in expenditure growth
  - More emphasis on cost-containment and efficiency gains, to protect key government programmes
  - Moderate tax increases
  - Reasonable growth in public servant's salaries
- The budget closes the gap between revenue and non-interest spending in 2016/17

Main budget revenue and non-interest spending



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Consolidated fiscal framework

R billion/percentage of GDP	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
		Outcome		Revised estimate	Medium-term estimates		
Revenue	**842.2**	**908.7**	**1 008.1**	**1 091.0**	**1 188.9**	**1 331.5**	**1 439.5**
	27.3%	*27.3%*	*27.9%*	*28.1%*	*28.4%*	*29.3%*	*29.2%*
Non-interest expenditure	870.6	951.3	1 036.1	1 122.6	1 218.6	1 302.0	1 403.5
	28.3%	*28.6%*	*28.7%*	*28.9%*	*29.1%*	*28.7%*	*28.5%*
Interest payments	81.7	93.3	109.3	120.8	132.4	146.8	158.3
	2.7%	*2.8%*	*3.0%*	*3.1%*	*3.2%*	*3.2%*	*3.2%*
Expenditure	**952.3**	**1 044.6**	**1 145.3**	**1 243.4**	**1 351.0**	**1 448.8**	**1 561.7**
	30.9%	*31.4%*	*31.7%*	*32.0%*	*32.2%*	*31.9%*	*31.7%*
Budget balance	**-110.1**	**-135.8**	**-137.2**	**-152.4**	**-162.2**	**-117.3**	**-122.2**
	-3.6%	*-4.1%*	*-3.8%*	*-3.9%*	*-3.9%*	*-2.6%*	*-2.5%*

Source: National Treasury

Key measures to restore fiscal sustainability

- Reduce the expenditure ceiling by R25bn over the next two years, compared with the 2014 Budget baseline
- Increase personal income tax rates and the general fuel levy, raising an additional R16.8bn in 2015/16
- Strengthen budget preparation and expenditure controls to improve efficiency of resource allocation and the composition of spending
- Withhold additional resources for changes to personnel numbers
- Finance urgent needs of state-owned companies without increasing the budget deficit

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Reduced expenditure on non-core items

- Expenditure limits have been reduced by R10 billion in 2015/16 and R15 billion in 2017/18.
- Reductions have mainly affected non-core goods and services budgets surpluses of public entities and reductions to bloated compensation budgets. Growth in slow spending conditional grants have also been trimmed.
- Expenditure continues to grow by 2.1 per cent faster than inflation over the next three years.

Selected goods and services budgets, national and provincial government

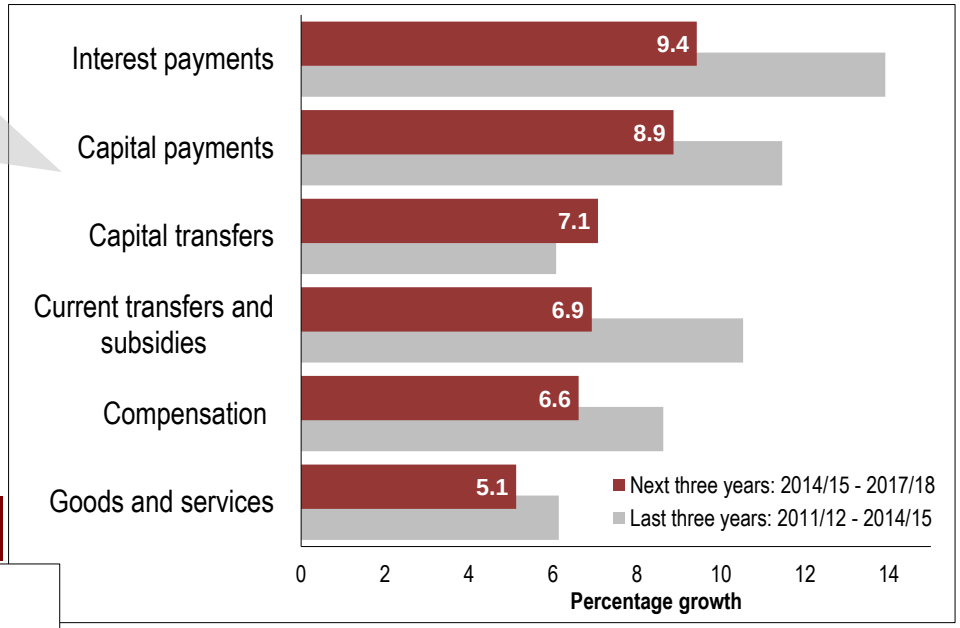
Share of total goods and services	2011/12 Outcome	2014/15 Estimated outcome	2017/18 Estimated budget	Average annual real growth 2011/12 – 2014/15	Average annual real growth 2014/15 – 2017/18
Travel and subsistence	7.8%	6.3%	5.7%	-5.4%	-4.4%
Catering, entertainment and venue rental	1.8%	1.5%	1.2%	-4.9%	-8.1%
Consultants	10.1%	9.0%	8.9%	-2.1%	-1.4%
Stationery and printing	2.2%	2.2%	1.9%	1.8%	-5.3%
Administrative and operational payments	12.8%	13.9%	13.9%	4.7%	-1.0%
Medicine and medical supplies	11.2%	12.0%	13.5%	4.2%	2.9%
Learner and teacher support material	2.5%	2.9%	3.5%	6.3%	5.1%
Fuel, oil and gas (police vehicles)	2.7%	2.4%	2.7%	-2.8%	3.6%
Total goods and services				**1.7%**	**-1.0%**

Source: National Treasury

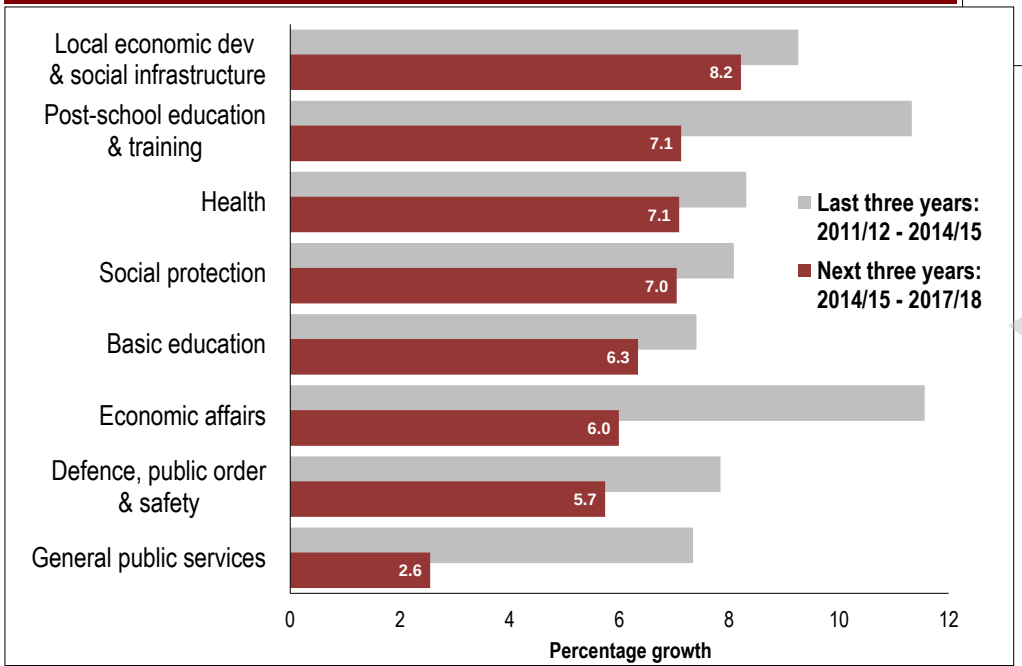
Improving the composition of expenditure

- Capital is the fastest-growing area of non-interest expenditure over the medium-term
- Compensation stabilises as a share of total expenditure, goods and services decline in real terms

Spending growth: economic classification



Spending growth: functional classification



- The fastest growing spending allocations are:
  - Local development and social infrastructure
  - Post-school education and training
  - Health
- General public services decline in real terms

Strengthening cost containment measures

- National price-referencing system
- More transversal, centralized procurements in the pipeline:
  - From January 2016, school textbook delivery will be managed through a centrally negotiated contract
  - Standardized school construction and decentralized maintenance
- Centralized supplier database and on-line tender system to improve transparency and access for small businesses
- Additional controls on personnel budgets in design to be introduced from 2016/17
- Revised treasury instructions to extend the scope of cost containment, including coverage of conferences and overseas delegations.
- Revisions to conditional grant system will incentivize performance

Revenue and tax measures

- **Personal income tax** rates, except for the lowest bracket, increase by 1%, generating R9.4bn in 2015/16
- **Fuel levies** increase by 80.5 c/litre:
  - A 30.5 cent increase in the general fuel levy raises an additional R6.5 billion in 2015/16.
  - A 50 cent increase in the earmarked Road Accident Fund (RAF) fuel levy generates an additional R9 billion to help close the RAF's cash deficit.
- Government also proposes a temporary reduction in the monthly **UIF contributions** threshold from the current R14 872 to R1 000, reducing the UIF's surplus by about R15 billion in 2015/16.
- Tax measures to increase energy efficiency to be discussed with industry and other stakeholders
- Improvements to reporting and revised rules to address transfer pricing and base erosion.
- Changes to transfer duties on the sale of property give relief to middle-income households

Taxable income brackets (after adjustment for inflation)	**Old rate**	**New rate**
Tax threshold: 0 – R73 650	*0%*	*0%*
1: R73 651 – R181 900	18%	18%
2: R181 901 – R284 100	25%	26%
3: R284 101 – R393 200	30%	31%
4: R393 201 – R550 100	35%	36%
5: R550 101 – R701 300	38%	39%
6: R701 301 +	40%	41%

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Supporting SOEs without raising government debt

- Government is taking several short-term measures to address immediate requirements.
  - Eskom will receive allocations of R23 billion, to be raised through the sale of non-core government assets.
  - South African Airways has been granted a R6.5 billion going-concern guarantee to finalise its 2013/14 annual report, in addition to the R7.9 billion in guarantees already extended to the airline.
  - The South African Post Office has been provided with a R270 million overdraft guarantee and a R1.7 billion going-concern guarantee.
- Government is establishing an inter-ministerial committee to work with State Owned Companies to improve alignment to national objectives, governance, operational inefficiencies, regulatory uncertainty
- Government will also acquire and dispose of public assets based on strategic requirements
- Exploring options for private investment to strengthen balance sheets of state owned companies

A new fiscal package for cities

- The infrastructure investments needed to change the shape of our cities will come from national government and cities' own revenues.
- Measures to support cities to increase their contribution to infrastructure development include:
  - Modifying the infrastructure grant system by reducing the number of grants, introducing more flexible grant conditions and increasing the certainty of transfers over a longer time period
  - Reforming the system of development charges to improve fairness and transparency, and reduce delays in infrastructure provision for private land developments
  - Expanding opportunities for private investment in municipal infrastructure through the Development Bank of Southern Africa increasing its origination of longer-term loans
  - Reviewing the sustainability of existing own-revenue sources for metropolitan municipalities
  - Project preparation facility, with the DBSA
  - Infrastructure delivery management system is being expanded

Public sector infrastructure spend: R813bn over the MTEF

Provinces and municipalities continue to be significant drivers of infrastructure spending due to capacity expansion in transport, housing, water & sanitation, hospital revitalisation and social infrastructure

State owned companies to spend R362.2 billion (45% of total spend)

Proportional expenditure of total by level of government between 2015/16 and 2017/18

Percentage	
National departments	6%
Provincial departments	17%
Local government	22%
Public entities	10%
Public private partnerships	1%
State owned companies	45%
Total	**100%**

Total infrastructure by functional classification between 2015/16 and 2017/18

R million	MTEF Total	% of Total
Economic services	668 494	82%
Social services	106 687	13%
Justice and protection services	15 191	2%
Central government and administrative services	19 749	2%
Financial	2 995	0%
Grand Total	**813 116**	**100%**

The bulk of expenditure is directed towards economic services

Risks and uncertainties

- Public-sector salary negotiations: a significant departure from inflation will require adjustments to other elements of expenditure
- Financing needs of state-owned companies, beyond current plans
- Economic growth could be lower than projected, with negative consequences for revenue.

Conclusion

- Need to adjust to a difficult period ahead.
- Cushioning the economy by borrowing to spend has raised debt from below R500 billion in 2008 to more than R1.6 trillion today.
- The 2015 Budget reduces expenditure growth by R25 billion in the next two years but non-interest spending continues to grow in real terms by 2.1 per cent over the medium term.
- Changes to personal income tax and the fuel levy will raise an additional R16.8 billion in 2015/16
- Government continues to prioritise infrastructure investment for economic development and social programmes that support those citizens most in need.
- To create work, and reduce poverty and inequality, South Africa requires higher rates of growth.