FINANCIAL AND FISCAL COMMISSION

Briefing to the Chairpersons of Finance Committees on the 2013 Fiscal Framework and Revenue Proposals

05 March 2013

For an Equitable Sharing of National Revenue

BACKGROUND

- Submission made in terms of S4(4c) of MBPARMA (Act 9 of 2009)
  - Requires Parliamentary Committees to consider any recommendations of FFC during their deliberations on Money Bills
- Also made in terms of FFC Act of 1997 a
  - Requires that FFC responds to any requests for recommendations by any organ of state on any financial and/or fiscal matter(s) relevant to its mandate

FINANCIAL AND FISCAL COMMISSION

FINANCIAL
AND FISCAL
COMMISSION

2013 Fiscal Framework: Macroeconomic Outlook and Sustainable Economic Growth

Performance of the Economy

- SA economy vulnerable to slow global recovery and domestic factors (labour unrest)
- 2.5% growth for 2012 is disappointing *but* economy managed moderately positive growth for third year following 2009 recession
- Subdued growth rate perpetuates trajectory of sub optimal growth
  - While economy not collapsing, it is also not performing well enough to make a meaningful dent to high unemployment rate
  - Despite expectations of slow recovery in medium term, economic growth forecasts still fall below 5.4% economic growth required in NDP

VIABILITY OF PROPOSED FISCAL REFORMS

- Fiscal reforms contained in 2013 budget aim to create a fiscal framework which will give SA greater ability to ↑ sustainable economic development
  - Key pillars are long-term competitiveness and responsiveness
- What is likelihood of the fiscal framework and revenue proposals contained in 2013 budget to meet these objectives? In considering this, Commission guided by two criteria:

  (a) *Enhanced efficiency* and

  (b) *Sustainability*

FINANCIAL AND FISCAL COMMISSION

Viability of Proposed Fiscal Reforms

a. Enhanced efficiency

- FFC supports main themes in 2013 Budget on how Government plans to use levers to boost SA's economic growth

Table 1: Expenditure Component Revisions (Functional Classification)

	2013/14 Figures		
R'billions	**2012 MTBPS**	**Budget 2013**	**% Change**
General public services	56.0	56.7	1.3%
Defence, public order and safety and state security	151.7	153.7	1.3%
Transport, energy and communication	91.5	88.6	-3.2%
Economic services	48.1	48.0	-0.3%
Local government, housing and community amenities	132.5	132.1	-0.3%
Health and social protection	267.8	268.5	0.3%
Education and related functions	234.0	232.5	-0.6%
Employment and social security	48.6	49.2	1.2%
Science and technology	14.5	16.3	12.4%

Source: MTBPS (2012); Budget Review (2013); Commission Calculations

FINANCIAL AND FISCAL COMMISSION

Viability of Proposed Fiscal Reforms [Cont.]

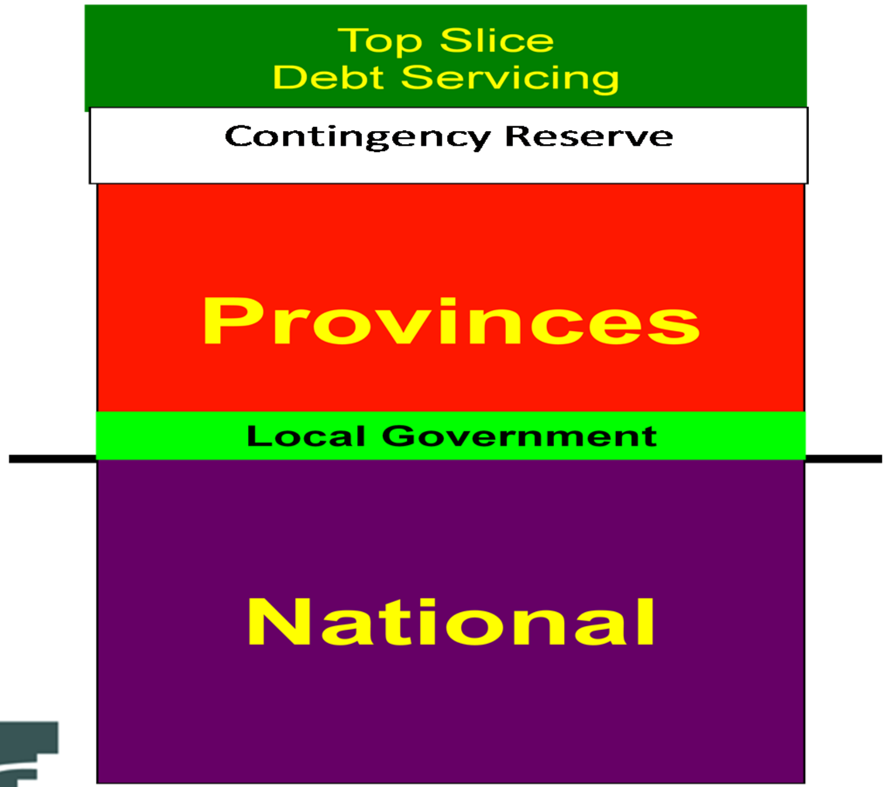
b. Sustainability: Macroeconomic stability

– Ability to respond swiftly and decisively to short-term economic pressures is vital to minimise negative shocks to growth, jobs and investment

- SA experienced first recession in 19 years in 2009. In line with FFC's recommendations, Government committed to cushion the poor by maintaining the social safety net
- Evidence suggests Government is committed to countercyclical fiscal policy and fiscal guidelines, with plans to reprioritise the budget while maintaining the social net

Viability of Proposed Fiscal Reforms [Cont.]

b. Sustainability: Budgetary stability



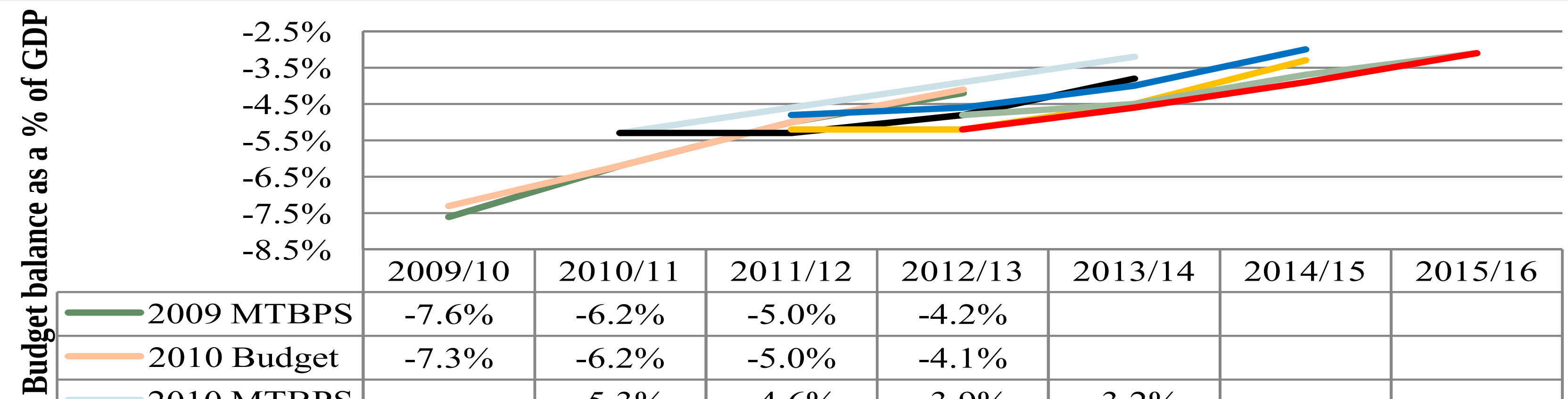
- Equitable share formulae, conditional grants, setting of 3-year spending plans provides predictability for decentralised budget
- Allocation to contingency reserve ↓ by R23.5 billion over MTEF to fund non-interest expenditure

VIABILITY OF PROPOSED FISCAL REFORMS [CONT.]

b. Sustainability: Budgetary stability

- Slower pace of fiscal consolidation raises credibility considerations

Medium-Term Budget Deficit Projections



	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
2009 MTBPS	-7.6%	-6.2%	-5.0%	-4.2%			
2010 Budget	-7.3%	-6.2%	-5.0%	-4.1%			
2010 MTBPS		-5.3%	-4.6%	-3.9%	-3.2%		
2011 Budget		-5.3%	-5.3%	-4.8%	-3.8%		
2011 MTBPS			-5.2%	-5.2%	-4.5%	-3.3%	
2012 Budget			-4.8%	-4.6%	-4.0%	-3.0%	
2012 MTBPS				-4.8%	-4.5%	-3.7%	-3.1%
2013 Budget				-5.2%	-4.6%	-3.9%	-3.1%

Source: MTBPS (2009, 2010, 2011, 2012); Budget Review (2010, 2011, 2012, 2013).

VIABILITY OF PROPOSED FISCAL REFORMS [CONT.]

b. Sustainability: Affordability

- Government economic programmes/policies aiming at dual objectives of accelerating growth and fighting poverty and unequal access to opportunities
- Ambitious social reforms to tackle poverty, growth and inequality problems are being proposed, for example:
  - **Job Creation** (Manufacturing Competitiveness Enhancement Programme, Jobs Fund, Youth Subsidy)
  - **Education (**increase in funding to cover wage settlement costs but also to improve the delivery of school infrastructure)
  - **Health** (health infrastructure, hospital revitalisation, NHI and nursing colleges)

FINANCIAL
AND FISCAL
COMMISSION

Macroeconomic Outlook and Fiscal Risks Confronting South Africa

FISCAL RISKS

- Biggest strategic risk at the moment = economic deficit
- Fiscal downturn implies prolonged period of moderate growth in public expenditure – difficult choices
  - Budget 2013 has not drastically changed composition of spending relative to 2012 MTBPS
    - Reprioritisation to ensure growth-friendly expenditure maintained
  - Widening of deficit, sees reversal of 2012 MTEF trend of moderate decreases in state debt costs – becomes fastest growing expenditure item over 2013 MTEF period
    - From sustainability perspective, this raises two critical challenges, (a) sovereign debt downgrades and (b) public debt

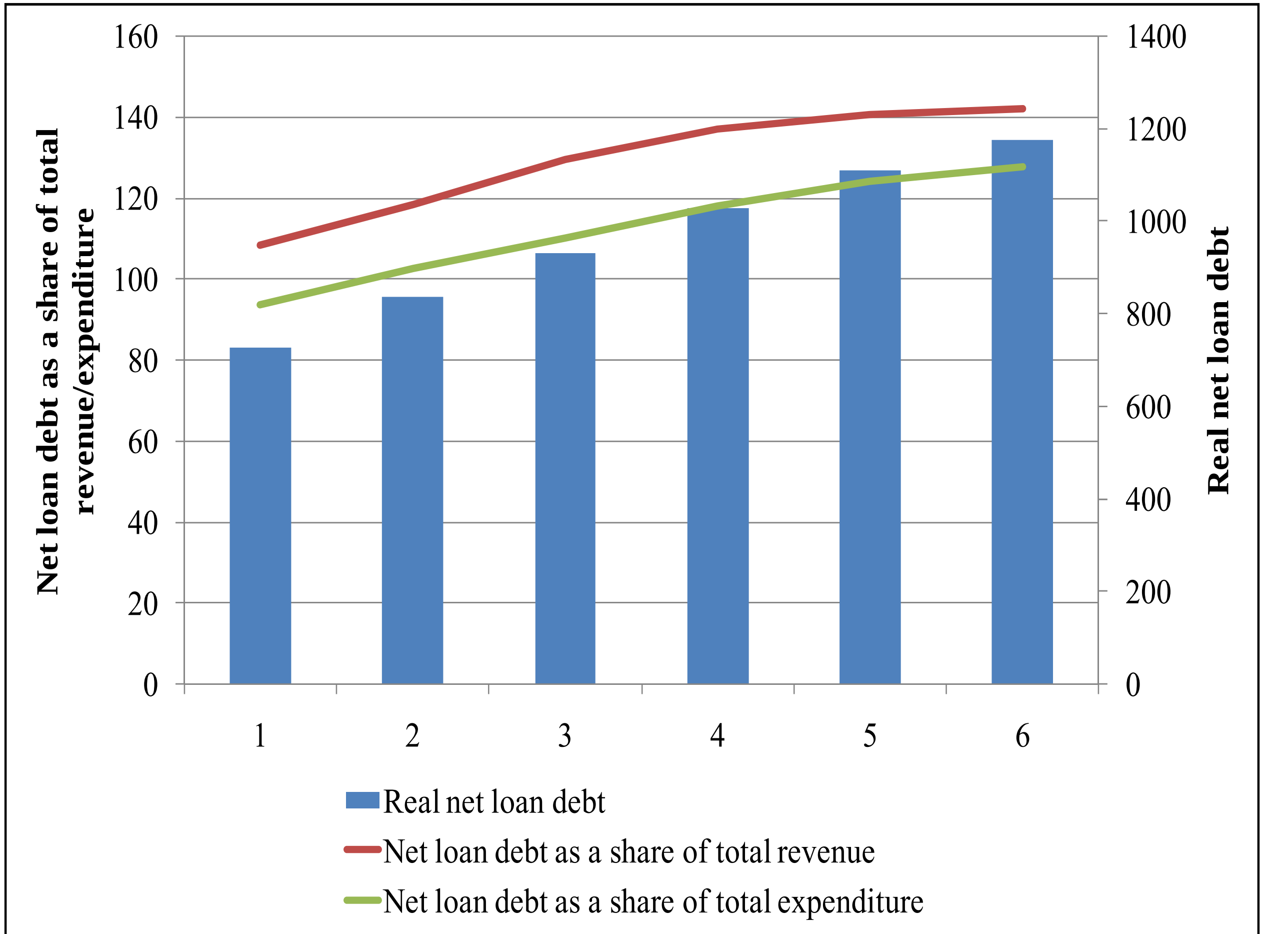
SOVEREIGN DEBT DOWNGRADES

- SA sovereign debt down-graded by three rating agencies
  - Sovereign downgrades ↑ borrowing costs and debt service costs for governments
- Reasons for down-grades: increased levels of indebtedness, socio-economic and political factors
- In 2012 response to Fiscal Frameworks and Revenue Proposals, FFC did not agree that down-grades were entirely warranted
- Need to consider Government ‘s commitment to countercyclical fiscal policy and fiscal guidelines, with plans to reprioritise the budget while maintaining the social net
  - But there is room to improve composition of expenditure, eradication of wasteful expenditure and public sector wage bill

PUBLIC DEBT

Increasing state debt burden (state debt as % of total revenue) implies that expenditure increases are being financed by debt

State Debt: Share of Total Expenditure and Revenue

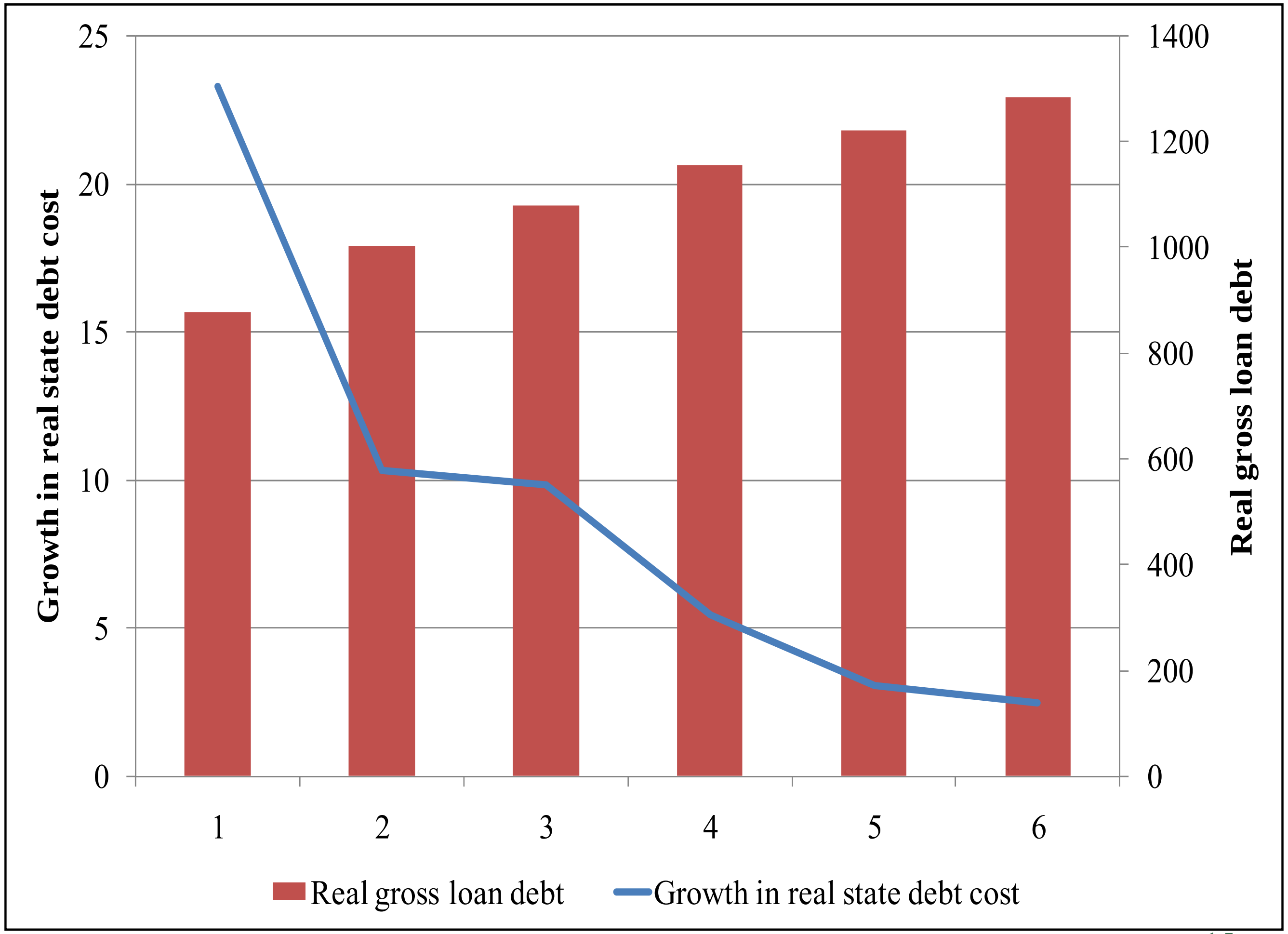


Source: Commission's calculations.

PUBLIC DEBT

Real gross loan debt is ↑ while real state debt costs are ↓ , reflecting Government's debt restructuring efforts through the switch programme

Gross Loan Debt and Growth in Real State Debt Cost



Source: Commission's calculations.

Revenue Estimates and Tax Proposals

TAX ESTIMATES

- Revenues revised ↓ from 2012 Budget and MTBPS
  - Weaker economic growth
  - VAT revenue growth
- FFC welcomes government's aim of fiscal consolidation through expenditure efficiencies and control as opposed to tax increases
  - Supports economy in short term
  - Welcomes major tax reform given long term concerns around tax revenues

Proposed Tax Structure

<table>
<tr><th>Direct Taxes</th><th>Indirect Taxes</th></tr>
<tr><td>

Welcomes tax relief to individuals of R7 billion in tight fiscal environment
Notes that tax breaks to business supports growth and promotes job creation
Supports tax incentives to promote youth employment

</td><td>

Comprehensive carbon tax proposed for 2015/16
Commission supports this but notes that it should be ring fenced to be a true instrument of behavioural change
Propose review of sharing of fuel levy with metros
Concerns around implementation
Fuel levy revenues not as buoyant in current economic circumstances
Welcome efforts to broaden VAT tax base

</td></tr>
</table>

FINANCIAL AND FISCAL COMMISSION

How Can SA's Fiscal Framework Be Improved?

Proposals

- Improving long term fiscal reporting
  - Budget process to take into account long term risks
  - Public debate on long term fiscal challenges
  - Distributional impact of new policies (particularly gender and children)
- Consolidation of fiscal reporting
  - Taking into account LG contribution to infrastructure development

FINANCIAL AND FISCAL COMMISSION

PROPOSALS [CONT.]

- Integration of the NDP into budget process
  - MTEF to evolve from simple macro-fiscal framework into comprehensive processes that are driven and give effect to NDP
- Tax and debt reform
  - Proposed tax review initiative should be widened to include other non tax revenue (borrowing policy and optimal debt)

FINANCIAL AND FISCAL COMMISSION

FINANCIAL
AND FISCAL
COMMISSION

CONCLUSION

CONCLUDING REMARKS

- Submission explored options for reform in 2013 Budget and reviewed them against criteria to assess effectiveness. The Commission is of the view that:
  - A credible commitment to fiscal consolidation is necessary to ease frequency of sovereign debt downgrades
  - Plans to intensify efforts to carry out expenditure reviews supported
  - Government's plans to intensify efforts to combat waste, inefficiency and corruption supported
  - Plans to evaluate the tax system supported
    - Recommend that evaluation include all potential sources of Government finance including optimal level of debt and borrowing policies
  - For completeness, LT fiscal report should attempt to integrate consolidated gender analysis

THANK YOU.

Financial and Fiscal Commission
Montrose Place (2nd Floor), Bekker Street,
Waterfall Park, Vorna Valley, Midrand,
Private Bag X69, Halfway House 1685
www.ffc.co.za
Tel: +27 11 207 2300
Fax: +27 86 589 1038