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BRIEFING TO THE FINANCE COMMITTEES ON THE 2014 FISCAL FRAMEWORK AND REVENUE PROPOSALS

04 March 2014

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

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Outline of the Submission

1. Overview of Economy and Public Finance
2. Global Developments and Risks
3. Domestic Developments and Risks
4. Fiscal Frameworks and Revenue Proposals
5. Longer Term Debt Challenge
6. Developing South Africa's Infrastructure
7. Conclusion

Overview of Economy and Public Finance

- SA still some way from restoring strong and sustainable economic growth rates as required by the NDP
  - Full effects of international crisis hit in 2009 with negative growth rate of 1.5%
  - Economy was able to recover to growth rates slightly above 3% in 2010/2011
  - With continuation of poor developed economy growth and slower growth in large developing economies, SA economy struggled to achieve growth rates above 2% in 2012/2013. Growth for 2012 came in at 2.5% before slowing to 1.9% for 2013
  - Throughout this period of uncertainty, Government's countercyclical policy has protected the economy and helped drive the current modest economic recovery

OVERVIEW OF ECONOMY AND PUBLIC FINANCE [CONT.]

- Budget 2014 is formulated against backdrop of global signs of recovery from effects of 2008 financial crisis
  - Economic growth is at 2.7% with Government relying on targeted investment in transport and electricity to promote higher growth
  - Relatively more aggressive approach being taken to ↓ deficit towards the end of 2014 MTEF but plans are heavily based on containing expenditure thus bringing into sharp focus efforts at more efficient/effective spending

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Global Developments and Risks

- Against opportunities presented by the NDP, Budget 2014 faces 3 key global risks (1) Euro area sovereign debt crisis, (2) USA 'fiscal cliff' and tapering in USA Federal Reserve quantitative easing (3) Slowing Chinese/emerging markets growth
- Complex global picture has emerged over 2014, with an easing of some risks, particularly in the euro area
  - Advanced economies are expected to ↑ growth in 2014 and 2015, but political and economic risks remain
  - Concerns that slowdown in growth of Chinese economy and switch towards more consumption-oriented economy will cause demand for commodities from emerging markets to diminish.
  - Oil prices in 2013 peaked in August at $117 per barrel in response to instability in the Middle East. Prices have since fallen back and at $108 per barrel, the 2013 average has been slightly down compared with recent years. Risks remain and a significant commodity price shock has potential to destabilise SA recovery

Domestic Developments and Risks

- Key domestic risks = labour unrest, inadequate education and skills base, insufficient infrastructural investment and service delivery, perceptions of rising corruption and stress on consumers to cope with increased inflationary pressures
  - Impact of strikes continues to cause damage to economic growth - Government should consider greater level of intervention and review of labour laws and other elements pertaining to effective operation of the collective bargaining system
  - Growth prospects for 2014 MTEF will continue to be plagued by structural factors such as inadequate education and skills base.
  - Reluctance of private sector to invest in infrastructure is contributing towards lower than anticipated capital investment and overall economic growth
  - Growth of household consumption expenditure has been slowing down markedly, with continuing sharp depreciation in the value of the Rand over the last 2½ years resulting in upward pressure on inflation

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FISCAL FRAMEWORKS AND REVENUE PROPOSALS

FISCAL FRAMEWORK

- Government tabled a total national budget of R3.3 trillion over the 2014 MTEF period
  - A significant portion of this allocation is spent at national (47.6 percent) and provincial level (43.4 percent), while the local government receives 9 percent of this allocation
- Budget 2014 deficit reduction forecasts, reflects a much more aggressive approach relative to what was projected in 2013 MTBPS. Hopefully this will be enough to stave off any downgrades to the sovereign credit rating

Table 2. Budget Deficit as a % of GDP, 2013-2016

	2013	**2014**	**2015**	**2016**
Budget 2013	-4.6%	-3.9%	-3.1%	
MTBPS 2013	-4.2%	-4.1%	-3.8%	-3.0%
Budget 2014	-4.0%	-4.0%	-3.6%	-2.8%

FISCAL FRAMEWORKS AND REVENUE PROPOSALS [CONT.]

REVENUE ESTIMATES AND TAX PROPOSALS

- On aggregate, tax revenue estimates presented in Budget 2013 have been revised ↑ by R1 billion, thus increasing total tax revenue for 2013/14 to R899 billion
  - Government was able to accommodate personal tax relief to compensate for the effects of bracket creep arising in an inflationary environment - R9.25 billion was allocated for such purposes. The increases in other forms of taxation are less in line with inflation
- An interesting and welcoming trend in Budget 2014 relative to Budget 2013 is better performance of direct taxes notably corporate tax. However, VAT is expected to slow down, possibly indicating lower consumption in the economy
- Commission supports establishment of the Davis Tax Committee to review SA's tax system. In this regard, the Commission did not expect major changes to the current tax structure before the Committee tables its full recommendations

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FISCAL FRAMEWORKS AND REVENUE PROPOSALS [CONT.]

EXPENDITURE REDUCTION AND PRIORITISATION

- Important question = how much from a tax point of view could be afforded in the context of relatively low economic growth
  - To cater for ↑ spending pressures over 2014 MTEF period Government has ↓ contingency reserve and reprioritised funding away from underperforming items, specifically conditional grants
- Welcome developments include ↑ revisions to science and technology, economic services, education and related functions, LG housing and community amenities and health
- Revised ↓: economic infrastructure, employment and social security, social protection and general public services. Given the emphasis on electricity and transport as drivers of growth, ↓ revisions to these allocations are surprising. Expenditure in respect of social protection and employment and social security provide an important buffer for the poor, making the marked ↓ revision to employment and social security a concern

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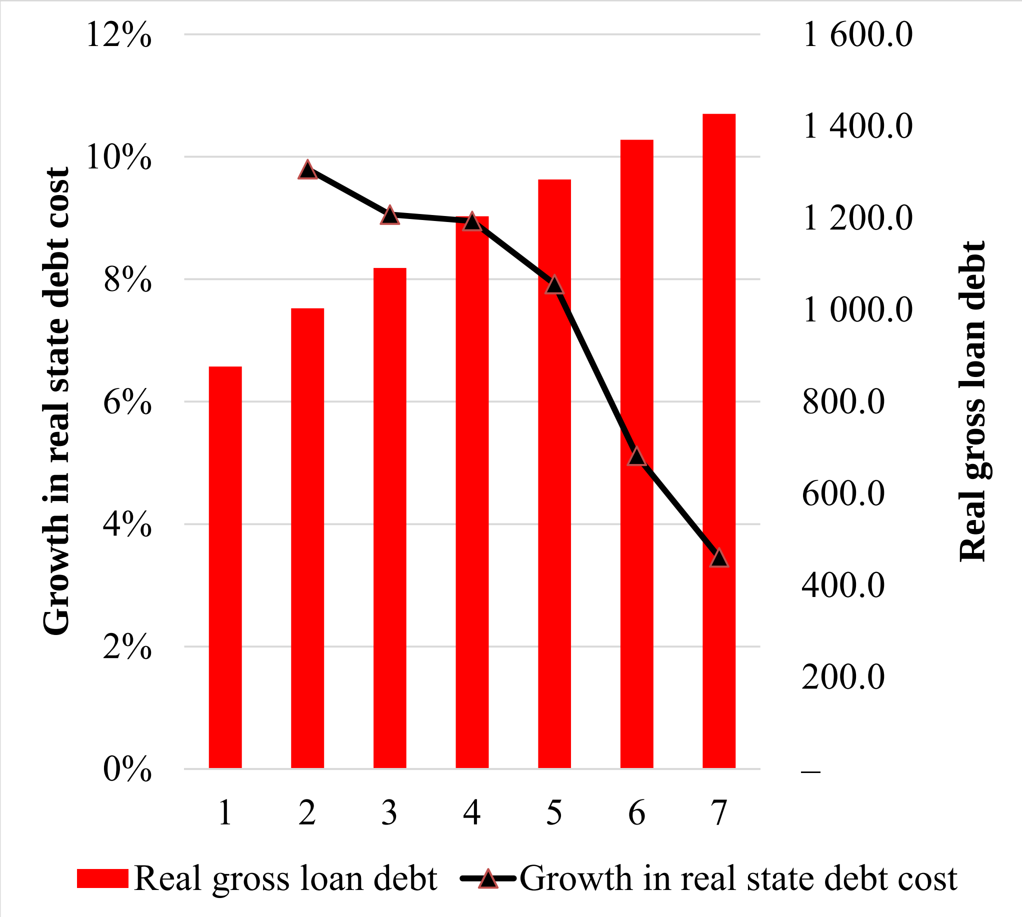
Longer Term Debt Challenge

- Prior to global economic crisis public debt to GDP ratio ↓ from close to 50% of GDP in 1994 down to 45% from 1995
- Percentage to GDP inevitably ↑ as deficits were incurred in light of the international crisis and local economic consequences
- Debt level exceeded 36 percent of GDP in 2012 and will continue to ↑ over the next few years as deficits continue, though the ↑ is moderate
- Proportion of foreign debt especially foreign bonds has been far higher in recent years than it was in 1995-1998 at which point it comprised only around 5% of total government debt
  - It has expanded by a multiple of 8.6 times in Rand value since then, giving an indication of the need for careful consideration around the extent and manner of raising new public debt

LONGER TERM DEBT CHALLENGE [CONT.]

Gross Loan Debt and Growth in Real State Debt Cost



- Real gross debt is ↑over MTEF whilst growth in real state debt costs, while still ↑, is slowing
  - ↑debt levels coupled with slowing growth in debt costs reflects continued debt restructuring efforts through the switch programme
- High levels of public debt risk undermining growth and economic stability
- South Africa therefore faces a long-term challenge in reducing debt levels. Ongoing work at the Commission shows an illustrative scenario for debt reduction from 2019-20 onwards

DEVELOPING SOUTH AFRICA'S INFRASTRUCTURE

- As part of Budget 2014 Government set out long-term programme of capital investment amounting to over R847 billion over the MTEF
- A significant proportion of the investment in infrastructure takes place within municipalities
  - Historically, municipalities have not been able to spend infrastructure budgets effectively - performance has been characterized by delays, poor planning, lack of project management capacity and poor oversight on the part of provincial and national government
  - Continues to be financial and capacity challenges within certain SOCs and municipalities in general, bringing into question the ability to support infrastructure investment plans

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DEVELOPING SOUTH AFRICA'S INFRASTRUCTURE [CONT.]

- Alongside investment in new infrastructure, there is a pressing need to maintain and renew existing infrastructure adequately
  - Municipalities underfund and underspend on maintenance and renewals, thus putting at risk potential benefits that could be reaped as a result of Government's large investment in infrastructure
- Ongoing research at the Commission is exploring the Infrastructure Development Bill with a view to finding ways of strengthening its key implementation pillars, particularly with respect to how integration with subnational government processes could be strengthened

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CONCLUSION

- Budget 2014 places a strong emphasis on resource allocation in relation to implementation of NDP – the Commission welcomes these ongoing efforts to attain the targets that will take SA closer to attaining Vision 2030
- On the whole, the 2014 Budget is very much in line with the Commission's expectations when it made its submission on 2013 MTBPS
  - Government has succeeded in pursuing fiscal discipline, whilst balancing priorities and investment in constitutionally mandated basic services like education, health and water
- Growth in revenue, specifically between 2015/16 and 2016/17, runs contrary to growth in GDP raising concerns around buoyancy of SA tax revenues, which, according to Commission calculations, have been ↓ since the 1990's

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CONCLUSION [CONT.]

- To address the perceived negative sentiments of rating agencies, Government needs to ensure that the 2.7 percent and 3.2 percent economic growth rates used in the budgetary parameters in the 2014 Budget for domestic economic growth translate to reality
- It is essential for Government to ensure that the rising trend of public debt to GDP is staved off
- The Commission welcomes Government efforts at setting an expenditure ceiling. Government should proceed to:
  - Give guidelines on scope of the ceilings and then an assessment of performance of the ceiling against progressive realisation of constitutional mandates
  - Put the ceiling approach in legislation such as the PFMA to avoid confusion between the output and outcomes based PFMA and the input controlling thrust of expenditure ceilings

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THANK YOU.

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