FINANCIAL AND FISCAL COMMISSION

# BRIEFING TO THE FINANCE COMMITTEES ON THE 2015 FISCAL FRAMEWORK AND REVENUE PROPOSALS

4 March 2015

*For an Equitable Sharing of National Revenue*

# THE CONTEXT

- 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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# FOCUS OF PRESENTATION

1. Implications of economic outlook
   – Weaker economic outlook necessitates need for fiscal consolidation
2. Key areas of risk for the fiscal framework
   – State owned companies and guarantees
   – Pending reforms to health-care and social security
   – Wage bill considerations
3. Measures to improve the fiscal framework

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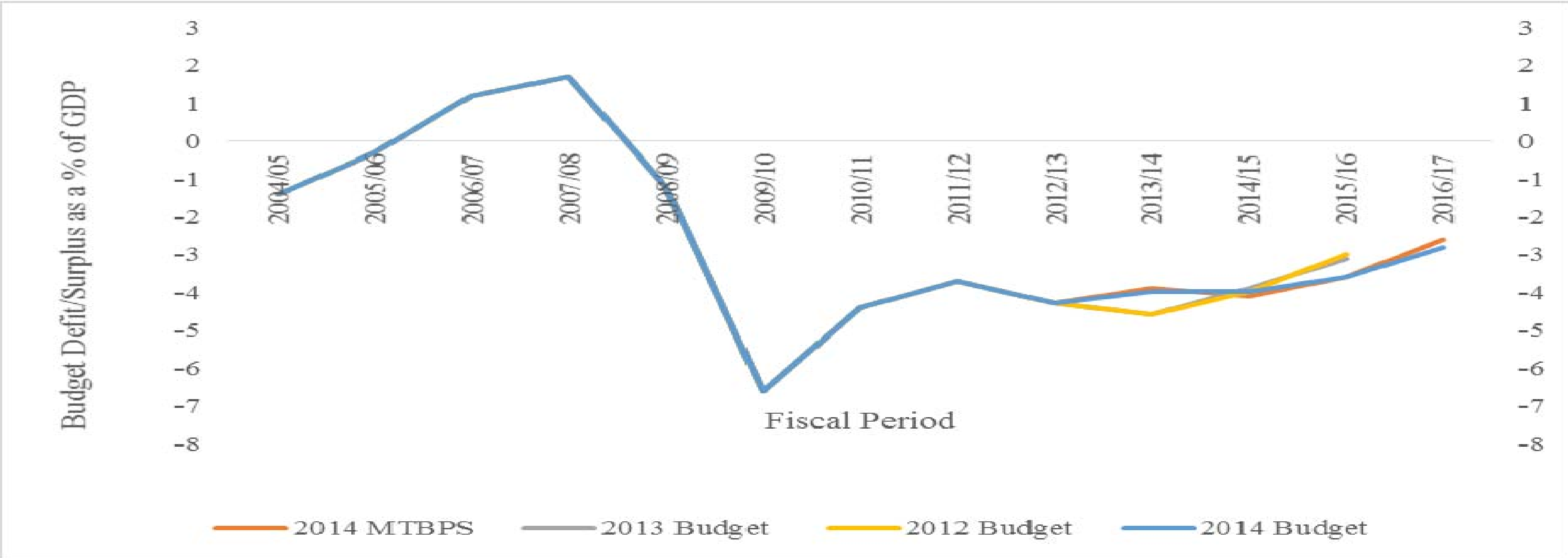
# 2015 Budget Response to Weak Economic Outlook




- Prospects of a weaker than expected economic outlook has necessitated a reconsideration of expenditure and revenue plans (fiscal consolidation)
  - Reducing growth in expenditure is to be driven by combination of cost containment measures and efforts to improve efficiency of spending.
  - Growth in revenue to be achieved through adjustments to tax policy

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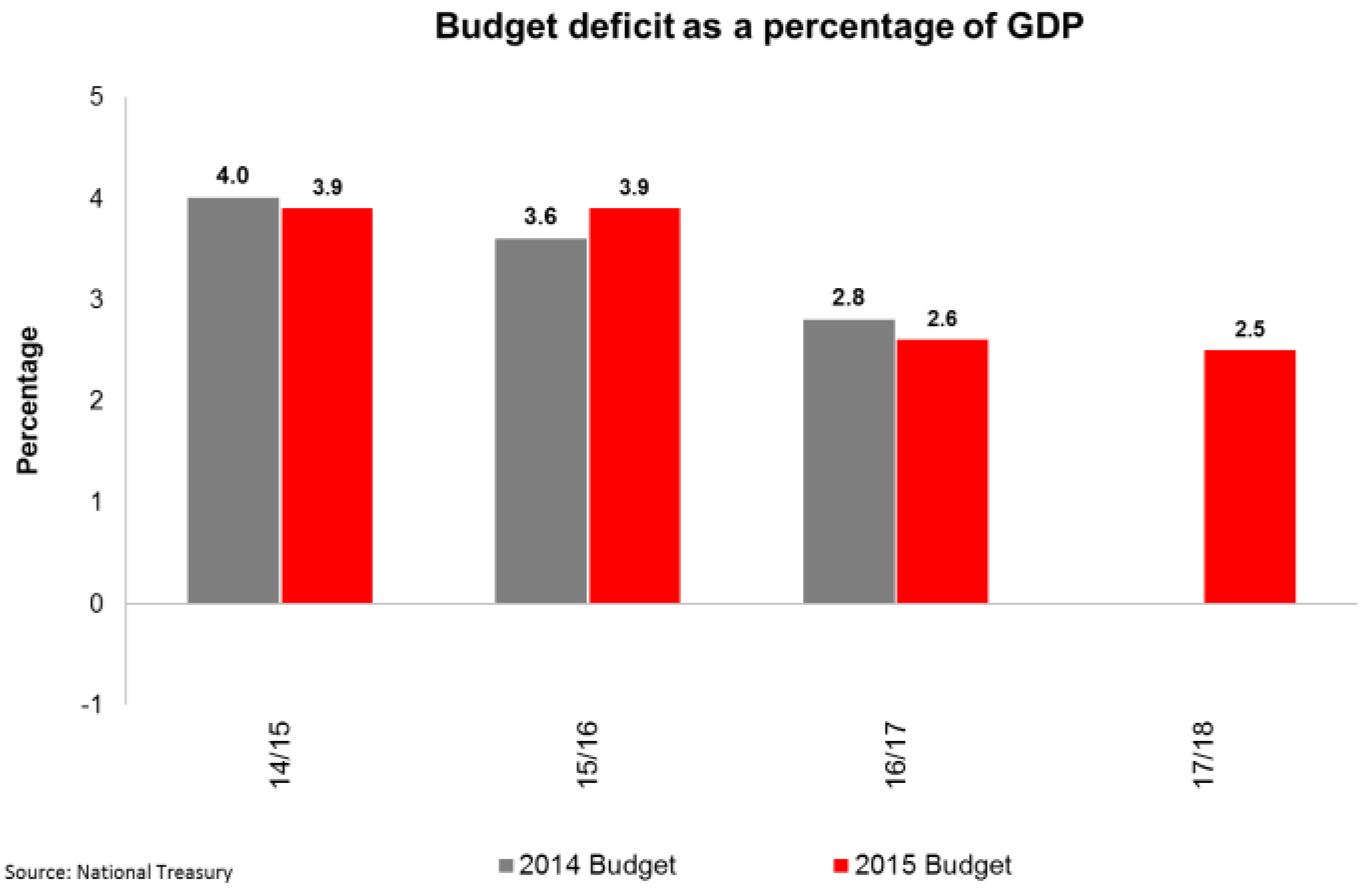
# SLIGHT INCREASE IN BUDGET DEFICIT




Source: National Treasury

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# CONSOLIDATED FISCAL FRAMEWORK

| R billion/percentage of GDP | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 |
|---|---|---|---|---|---|---|
| | Outcome | | Revised estimate | Medium-term estimates | | |
| **Revenue** | | | | | | |
| **Gross tax revenue after Proposals** | **813.8** | **900.0** | **979.0** | **1 081.3** | **1 179.2** | **1 289.7** |
| **Non-tax revenue** | **16.2** | **18.9** | **18.1** | **17.0** | **17.9** | **18.6** |
| **SACU** | **-42.2** | **-43.4** | **-51.7** | **-51.0** | **-36.5** | **-45.4** |
| **National Revenue Fund Receipts** | **12.3** | **11.7** | **8.9** | **2.0** | **5.4** | **2.5** |
| **Main budget revenue** | **800.1** | **887.3** | **954.3** | **1 049.3** | **1 166.0** | **1 265.4** |
| | | | | | | |
| **Expenditure** | | | | | | |
| National departments | 420.0 | 453.2 | 491.4 | 523.0 | 553.8 | 586.1 |
| Provinces | 380.9 | 410.6 | 439.7 | 468.2 | 496.3 | 526.4 |
| Local government | 76.4 | 82.8 | 89.1 | 99.8 | 103.9 | 110.0 |
| **Non-interest allocations** | **877.4** | **946.6** | **1 020.1** | **1 090.9** | **1 154.0** | **1 222.5** |
| **Debt-service costs** | **88.1** | **101.2** | **115.0** | **126.4** | **141.0** | **153.4** |
| **Unallocated reserves** | **–** | **–** | **–** | **5.0** | **15.0** | **45.0** |
| **Main budget expenditure** | **965.5** | **1 047.8** | **1 135.1** | **1 222.3** | **1 309.9** | **1 420.9** |
| | | | | | | |
| **Main budget balance** | **-165.4** | **-160.5** | **-180.9** | **-173.1** | **-144.0** | **-155.5** |
| | *-5.0%* | *-4.4%* | *-4.7%* | *-4.1%* | *-3.2%* | *-3.2%* |
| **Primary balance** | *-2.3%* | *-1.6%* | *-1.7%* | *-1.1%* | *-0.1%* | *0.0%* |

# TAX PROPOSALS

- Proposed tax changes
  - Fuel levy is raised by 30.5 cents per litre which represents an increase of 14% on last year
  - Road Accident Fund (RAF) levy up by 50 cents per litre, equivalent to a hike of 40%
  - 1% increase in the average tax rate of individuals
- Compared to magnitude of revenue shortfall announced in 2014 MTBPS required for successful fiscal consolidation
  - Proposals a ‘holding pattern’ rather than radical consolidation exercise
  - Research suggests probability of a successful fiscal consolidation is increased if all taxes increase, and if the wage bill is decreased
  - With NHI and Social Security reforms on the way, a need to structurally look at all revenue handles to match these entitlements

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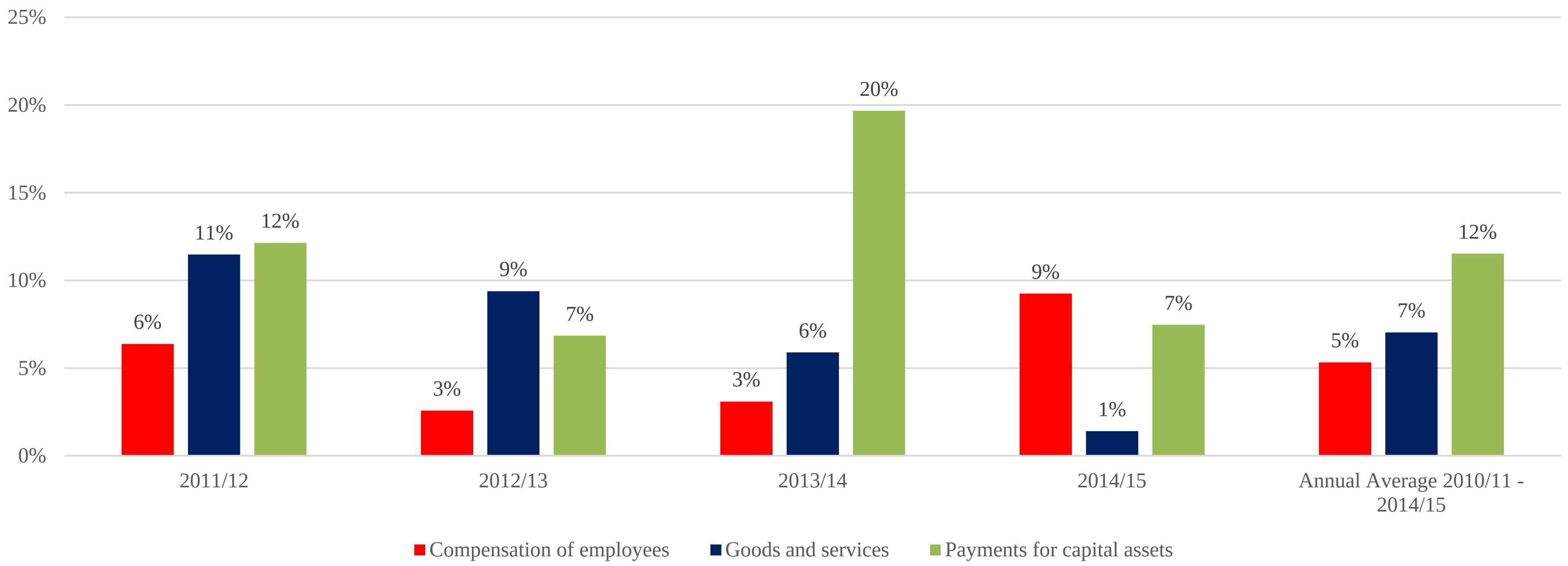
# AREAS OF RISK TO FISCAL FRAMEWORKS

- Persistent weakness in the balance sheets of certain state owned companies (SOCs) could trigger calls for additional government support
  - Continuous cash injections to assist ailing SOCs places undue stress on the fiscal framework and redirects funding away from core service delivery areas
  - Also brings into question ability of SOCs to effectively drive infrastructure-led growth
- Intentions to reform health-care and social protection pose significant areas of impact on the national and provincial fiscal frameworks
- Salary negotiations still have to be concluded – poses significant risk. While compensation of employees (CoE) slows over MTEF period, projections only credible if salary increases close to inflation
  - If this does not materialise, underlying assumptions of the fiscal framework may need to be revised

# AREAS OF RISK TO FISCAL FRAMEWORKS: WAGE BILL CHALLENGE




- Between 2010/11- 2014/15 real growth in wage bill amounted to 5% on average per annum
  - While the growth in wage bill was slower than goods and services and capital payments over the period, the size of the wage bill means the growth is significantly larger in absolute terms
  - The Commission welcomes efforts aimed at trying to find a long-term solution to the wage bill issue especially the setting up of the Presidential Public Service Remuneration to examine remuneration and conditions of service of public officials

# MEASURES TO IMPROVE THE FISCAL FRAMEWORK

- Emphasis need not only be on reductions of expenditure ceiling
  - Growth in allocations must be aligned close to inflation rate or productivity to mitigate the risk of undermining hard budget constraint
- Expand own financing of capital expenditures and economic development
  - Options include improvements in expenditure efficiencies informed by ongoing expenditure reviews, maximising debt collection, user charges
  - Long-term problem to address is that the system of revenue-raising is highly centralised, especially at the provincial level
  - Decentralising revenue-raising responsibilities can be done in a way that does not threaten the integrity of the tax system by allowing provinces some say in setting their own tax rates on the same tax base used by the national government, using user charges more effectively etc

# MEASURES TO IMPROVE THE FISCAL FRAMEWORK [CONT.]

- Commission agrees with the thrust of the adopting the user pay principle as part of a menu of options for financing economic infrastructure
- Such funding mechanisms should work in tandem with other elements of the developmental strategies to raise efficiency
- Examples include:
  - User charges which encourage people to reduce congestion or factoring social and environmental “externalities” into prices
  - Putting in place measures to improve acceptability of the user charge principle for higher levels of infrastructure services
  - Differentiation within the user charge principle and/or ensuring costs are aligned with willingness to pay
  - Based on *evidence* about people’s willingness to pay, obtained through a transparent and robust examination

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# Measures to Improve the Fiscal Framework [cont.]

- Two-pronged financing approach with respect to SOCs, specifically Eskom
- In 2013/14 and 2014/15 Government guarantees in respect of Eskom amounted to R350 billion per annum
  - Provision of guarantees give rise to contingent liabilities for Government
  - The total amount of borrowing (exposure) made against the Eskom guarantees: R125.1 billion in 2013/14 and R144.5 billion in 2014/15
  - Relative to the amount actually borrowed by Eskom, the large state guarantees should be reviewed and adjusted annually as this could create a perverse incentive to borrow more than required
  - Budget Review 2015 notes that expanded infrastructure investments have led to a steady increase in the asset base of SOCs (with Eskom and Transnet accounting for 79% of SOC's net asset value). Government should explore the possibility of a two-pronged financing approach - providing limited guarantees whilst also allowing SOCs/Eskom to leverage financing on the strengthen of their balance sheet
    - Where guarantees are considered they should be based on stringent requirements around improvements to governance and performance

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# Measures to Improve the Fiscal Framework [cont.]

- Improving expenditure efficiency and government-wide commitment to long-term planning and efficient resource utilisation
  - Long-term planning remains purview of selected infrastructure grants and an elusive goal across three sphere of government
  - No fiscal parameters to measure extent to which resources are used efficiently
  - In Submission on 2014/5 Division of Revenue, FFC recommended that interface between planning, budgeting and outcomes be improved through the newly adopted outcomes-oriented delivery approach
  - Chief procurement officer should develop spending efficiency indicators against which spending agencies can be measured

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# MEASURES TO IMPROVE THE FISCAL FRAMEWORK [CONT.]

- Efforts to improve the fiscal framework should ultimately be premised on re-igniting growth
  - Current economic growth estimates fall short of required growth rate to fulfil National Development Plan (NDP) expectations and compares unfavourably with other developing economies
  - South Africa should focus its strategy for reigniting growth on improving education expenditure outcomes in particular, increasing skills bases, maintaining strong growth on social safety net spending and increasing productivity of public infrastructure
  - Efforts should be intensified to structurally transform the economy by diversifying exports away from raw mining commodities, deconcentrate the vertical market structure of the economy and move towards a low carbon economy

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# CONCLUSION

- The Commission commends Government for tabling a stable budget with plans to put the country's public finances on a consolidation path still being maintained
  - Within the constraints of further reduced overall economic growth compared with earlier forecasts and an associated reduction in budgeted revenue growth, the 2015 Budget should just help prevent economic growth from falling too far and the country from entering into a debt trap
  - Commission's assessment indicates that whilst 2015 Budget attains a balance between contending priority areas there are various areas of risk that can unsettle the delicate balancing act
  - Presentation presented views on how the fiscal framework can be strengthened

# FFC’s Website: www.ffc.co.za