The budget framework in South Africa

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Overview

- The link between the revenue envelope and ceilings
- Expenditure ceilings
- Medium Term Budget Policy Statement document
- Contingency reserve

The link between the revenue envelope and ceilings

- Revenue needs to be considered at the same time as expenditure in order to determine a consolidated picture of government operations
- Spending will need to respond to revenue projections
- Government revenue is typically directed to a common revenue pool before it is distributed (the NRF in the case of South Africa)
- The practice of resource earmarking is discouraged

Deciding the revenue envelope: the South African context

Determining the macroeconomic forecast

Table 2.2 Macroeconomic performance and projections, 2011 – 2017

Calendar year	2011	2012	2013	2014	2015	2016	2017
Percentage change		**Actual**		**Estimate**		**Forecast**	
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)	**3,025.0**	**3,262.5**	**3,534.3**	**3,801.7**	**4,112.8**	**4,443.2**	**4,829.9**
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

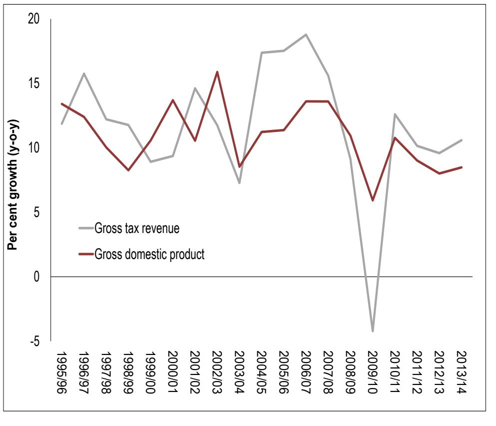
Deciding the revenue envelope: the South African context (continued)

- Work out how much money comes into the National Revenue Fund
  - Tax revenue
  - Non-tax revenue (Provinces, entities, SSF's, RDP)
- The revenue analysis working committee meets regularly to determine revenue projections for the Medium Term Expenditure Framework
- The committee is comprised of representatives from:
  - National Treasury
  - SARS
  - SARB
- The committee discusses and debates trends in tax revenue and form a consensus view on the revenue outlook for the new MTEF

The South African context (continued)

- Tax revenue is highly sensitive to economic performance
- During 1995/96 to 1999/00, nominal gross tax revenues grew at annual average of 12.1 per cent.
- From 2001, revenue performance accelerated, buoyed by strong commodity prices and improved tax administration, with growth rates in excess of 17 per cent after 2004
- Revenue declined by 4.2 per cent in 2009/10 as a result of the global financial crisis
- Since then growth in tax revenue has stabilised, but weakening economic performance has resulted in slowing revenue growth

Nominal growth in gross tax revenue and GDP, 1995/96 - 2013/14



Deciding the revenue envelope: the South African context Budget revenue, 2011/12 – 2017/18

R million	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
	Outcome			Revised	Medium-term estimates		
Taxes on income and profits[1]	426 584	457 314	507 759	556 700	620 890	678 652	744 473
of w hich:							
Personal income tax	*250 400*	*275 822*	*309 834*	*350 000*	*393 890*	*433 842*	*479 189*
Corporate income tax	*151 627*	*159 259*	*177 324*	*183 000*	*202 032*	*218 211*	*236 691*
Taxes on payroll and w orkforce	10 173	11 378	12 476	13 200	14 690	16 140	17 800
Taxes on property	7 817	8 645	10 487	12 603	13 692	14 823	16 089
Domestic taxes on goods	263 950	296 921	324 548	355 718	389 427	422 378	458 883
of w hich:							
VAT	*191 020*	*215 023*	*237 667*	*260 600*	*283 794*	*313 690*	*346 711*
Taxes on international trade	34 121	39 549	44 732	40 779	42 576	47 207	52 466
Tax revenue	**742 650**	**813 826**	**900 013**	**979 000**	**1 081 275**	**1 179 199**	**1 289 711**
Non-tax revenue[2]	24 402	28 468	30 626	27 006	19 038	23 302	21 143
of w hich:							
Mineral and petroleum	*5 612*	*5 015*	*6 439*	*5 636*	*6 221*	*6 730*	*7 301*
less: SACU[3] payments	-21 760	-42 151	-43 374	-51 738	-51 022	-36 513	-45 444
Main budget revenue	**745 291**	**800 142**	**887 265**	**954 269**	**1 049 291**	**1 165 988**	**1 265 409**
Provinces, social security funds and selected public entities	96 873	108 594	120 838	136 722	139 564	165 526	174 122
Consolidated budget revenu	**842 165**	**908 737**	**1 008 103**	**1 090 991**	**1 188 855**	**1 331 514**	**1 439 531**
As percentage of GDP							
Tax revenue	*24.1%*	*24.5%*	*24.9%*	*25.2%*	*25.8%*	*26.0%*	*26.2%*
Budget revenue	*24.2%*	*24.0%*	*24.6%*	*24.6%*	*25.0%*	*25.7%*	*25.7%*
GDP (R billion)	*3,080.9*	*3,327.6*	*3,609.8*	*3,879.9*	*4,191.8*	*4,538.8*	*4,926.1*
Tax/GDP multiplier	*1.13*	*1.20*	*1.25*	*1.17*	*1.30*	*1.09*	*1.10*

1. Includes secondary tax on companies/dividends tax, interest on overdue income tax and small business tax amnesty levy
2. Includes mineral royalties, mining leases, departmental revenue and sales of capital assets
3. Southern African Customs Union. Amounts made up of payments and other adjustments
Source: National Treasury and South African Revenue Service

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What is an expenditure ceiling?

- An expenditure ceiling refers to an overall restriction on the outcome of all or most government expenditure and is well established well in advance of the start of a budget preparation period
- It is an independent decision on the maximum level of government expenditure, and is used as an instrument to enforce aggregate expenditure discipline
- The process of setting the ceiling before the negotiations guides the preparation and execution of the budget

national treasury
Department: National Treasury
REPUBLIC OF SOUTH AFRICA

Why expenditure ceilings matter?

- To avoid the tendency to expand the size of government sector without a corresponding increase in revenue
- Cases of fiscal deterioration in many countries due to imprudent government spending
- Foster fiscal discipline
- Formalised restrictions on aggregate expenditure can be a valuable component of a framework intended to fiscal sustainability

Some considerations regarding an expenditure ceiling?

- Balance has to be struck between the ambition to enforce expenditure discipline and allowing for justified variations in expenditures including:
  - The impact of inflation
  - Unexpected expenditure
- Setting of ceilings is not a homogenous process, as it is largely dependent on the context of fiscal, economic and political conditions
- Principles for establishing the expenditure ceilings need to be explicitly linked with other fiscal objectives
- Is the ceiling going to be a unilateral government commitment or is there scope for it to be translated into legislation

Expenditure ceilings: the South African context

- The expenditure path in South Africa is driven by:
  - Revenue developments
  - The expected path of government debt
  - Current and expected economic growth
  - Social needs
- Fiscal policy responds differently to different crises:
- 1989-1993
  - Most severe recession experienced by South Africa
  - Fiscal policy very expansionary resulting in large deficits
    - Global slowdown
    - Politically motivated expenditure
    - Limited political legitimacy to increase tax revenue further
  - Fiscal responses (1993-1996)
    - Reconstruction and Development Programme (RDP)

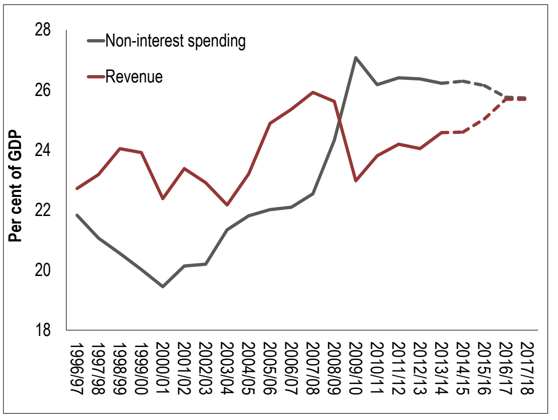
Expenditure ceilings: the South African context

  - The deficit remained stubbornly high because
    - Driven by need to begin addressing historical inequalities
    - Effort to meet basic needs
    - Higher public spending seen as important element of growth
    - Wage bill accelerated strongly
- 1997-2004
  - Growth, Employment and Redistribution (GEAR) – informed by the need to stabilise the macro economy
    - Expenditure cuts in education, economic services and health in 1997/98
    - Prudent fiscal management
    - Revenue efforts
- 2005-2008
  - Strong economic base leads to exceptional revenue performance, resulting in room to increase expenditure

Expenditure ceilings: the South African context

- First fiscal surplus
- 2009-2010
  - Sharp fall in tax revenue by R60 billion
  - Countercyclical fiscal stance maintained, turning a budget surplus to a deficit
  - Chose to maintain expenditure through additional borrowings

Main budget revenue and non-interest expenditure,1996/97– 2017/18



Maintaining the expenditure ceilings: the South African context

- Risks to the fiscus began to materialise towards the end of 2012
- Decision was made to stick to the expenditure ceilings proposed in the Budget 2012
- 2013/14 was an exception, as the breach of the ceiling was due to the recapitalisation of the DBSA
- Government is on track to achieve the spending target set in the 2014 MTBPS for 2014/15

Table 3.2 Main budget non-interest expenditure, 2011/12 – 2017/18

R million	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
2013 Budget Review	812,063	878,642	955,333	1,029,262	1,107,564	–	–
2013 MTBPS	–	877,443	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	–
2014 MTBPS	–	–	–	1,021,855	1,095,761	1,168,940	1,267,025
2015 Budget Review	–	–	–	1,020,105	1,095,904	1,168,973	1,267,486

The Medium Term Budget Policy Statement

- Medium-term expenditure framework
  - In 1997, South Africa adopted a multi-year budgeting system and the MTBPS
  - We budget for three years, but revise this annually
  - We use the concept of a rolling three-year framework
- The MTBPS policy statement that informs the Budget and it sets out:
  - Key priorities
  - Size of the spending envelope
  - Division between 3 spheres
  - Allocations to major conditional grants
- It provides indicative allocations and forecasts for the MTEF to be published in the Budget Review and ENE
- The MTBPS is a part of South Africa's institutional framework
- The MTBPS is presented to Parliament and for public debate to ensure transparency

Purpose

The MTBPS:

- Outlines the economic context in which the forthcoming government budget is being formulated
- Explains fiscal policy in the context of the economic outlook
- Presents the division of revenue amongst the three spheres of government
- Proposes government's spending framework for the next three years

Key aspects covered in the MTBPS

- Chapter 1: Overview and policy themes
- Chapter 2: Economic outlook
  - Including macroeconomic forecasts
- Chapter 3: Fiscal policy
  - Includes the fiscal policy stance for the MTEF
  - Broad discussion of revenue, expenditure, the budget balance, and government debt
- Chapter 4: Medium-term expenditure priorities and division of revenue
- Annexures

The importance of publishing such a document annually

- The MTBPS provides a multi-year macroeconomic forecast
- The provision of a multi-year fiscal forecast enables:
  - fiscal discipline & multi-year planning
  - a degree of certainty for budget managers for expenditure commitments and budget allocations over the medium-term
- Enables fiscal risk analysis:
  - Signals the direction of the fiscal trajectory and the medium-term fiscal target

Formulation

Formulation of the fiscal framework includes the following:

- Macroeconomic forecasts
- Revenue projections
- Non-interest expenditure decisions
- Expenditure-changes to interest spending
- Budget balance considerations
- Maintaining credibility of fiscal aggregates

Macroeconomic forecasts

- 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 and nominal GDP
    - GDP and CPI inflation

Revenue projections

- Revenue projections are decided by the RAWC (two meetings are held before the finalisation of the MTBPS)
- Revenue needs to be considered at the same time as expenditure in order to determine a consolidated picture of government operations
- Revenue projections for the new outer year is provided

Non-interest expenditure decisions

Determining the baseline for non-interest expenditure:

- Use the framework presented in the Budget as a starting point for the current year's MTBPS
  - -e.g. framework in Budget 2015 will be used as a starting point for MTBPS 2015
- 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

Non-interest expenditure decisions (continued)

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 aside
- 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

Determining expenditure-changes to interest spending

Estimates of interest on debt are determined using:

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

Budget balance

- The budget balance is guided by:
  - sustainability
  - intergenerational equity

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

Maintaining credibility of fiscal aggregates

- 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

Contingency reserve-the case for South Africa

- **The role of the contingency reserve is to:**
  - ➢ accommodate changes to the economic environment
  - ➢ meet unforeseen and unavoidable spending pressures
- The amount is set aside in advance but not allocated
- The reserve is relatively small in the first year of the MTEF, but increases in the outer years
- In the first year, the reserve is allocated in the adjustment budget (MTBPS in October)
- This allocation usually cover the balance of revenue shortfalls or spending overruns

Size of the contingency reserve

- **The dilemma in determining the size of the contingency reserve**
  - ➢ Ensuring sufficient buffer to absorb justified uncertainty
  - ➢ Maintain disciplining restriction in the budget
- **Factors affecting the appropriate size:**
  - ➢ Time frame
  - ➢ Policy composition
  - ➢ Indexation schemes
  - ➢ Extent of contingent liabilities
- **Common practice is 1-3 per cent of total expenditure**

Size of the contingency reserve in South Africa

Contingency reserve, Budgets 1998 - 2015

	1998	2002	2006	2010	2014	2015
Year 1	1 000	3 300	2 500	6 000	3 000	5 000
Year 2	3 000	5 000	5 000	12 000	6 000	15 000
Year 3	7 000	9 000	8 000	24 000	18 000	45 000
Total	**11 000**	**17 300**	**15 500**	**42 000**	**27 000**	**65 000**

- Indicative allocations in 2017/18 have also been restrained, and there are substantial unallocated resources
- These resources will be available to build a buffer against economic and fiscal shocks in the years ahead
- In the 2015 Budget, unallocated reserves are provided for as follows:
  - R5 billion in year 1 of the MTEF
  - R15 billion in year 2
  - R45 billion in year 3

The consolidated operating and capital accounts

Table 3.4 Consolidated operating and capital accounts, 2011/12 – 2017/18

R billion	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
		Outcome		Revised estimate	Medium-term estimates		
OPERATING ACCOUNT							
Current revenue	**830.7**	**893.4**	**993.1**	**1,079.3**	**1,184.5**	**1,323.7**	**1,434.5**
Current payments	**838.6**	**921.1**	**1,010.9**	**1,095.6**	**1,181.4**	**1,261.9**	**1,334.1**
Compensation	347.4	376.6	409.5	445.3	479.5	509.6	539.6
Goods and services	150.8	162.7	174.6	180.3	187.7	200.3	209.4
Interest payments	81.7	93.3	109.3	120.8	132.4	146.8	158.3
Current transfers and subsidies	258.6	288.5	317.5	349.2	381.8	405.2	426.9
Current balance	**-7.8**	**-27.7**	**-17.8**	**-16.3**	**3.0**	**61.8**	**100.4**
Percentage of GDP	*-0.3%*	*-0.8%*	*-0.5%*	*-0.4%*	*0.1%*	*1.4%*	*2.0%*
CAPITAL ACCOUNT							
Capital receipts	0.2	0.3	0.3	0.4	0.5	0.5	0.5
Capital payments	62.3	66.3	74.5	86.3	97.5	103.7	111.4
Capital transfers	48.4	52.3	55.8	57.7	63.6	67.9	70.9
Capital financing requirement	**-110.5**	**-118.2**	**-130.1**	**-143.6**	**-160.6**	**-171.1**	**-181.8**
Percentage of GDP	*-3.6%*	*-3.6%*	*-3.6%*	*-3.7%*	*-3.8%*	*-3.8%*	*-3.7%*
Financial transactions[1]	8.2	10.1	10.6	7.5	0.4	7.0	4.2
Unallocated reserves	–	–	–	–	5.0	15.0	45.0
Budget balance	**-110.1**	**-135.8**	**-137.2**	**-152.4**	**-162.2**	**-117.3**	**-122.2**
Percentage of GDP	*-3.6%*	*-4.1%*	*-3.8%*	*-3.9%*	*-3.9%*	*-2.6%*	*-2.5%*

1. Transactions in financial assets and liabilities
Source: National Treasury

Principles of fiscal policy and the consolidated fiscal framework

- **Principles of countercyclicality, debt sustainability and intergenerational fairness continue to guide fiscal policy**
- **The 2015 Budget implements government's commitments to narrow the budget deficit, stabilise debt and begin to rebuild fiscal space.**
- Since 2012, government has pointed out that a deterioration of the economic environment would warrant a reconsideration of expenditure and revenue plans
- Economic growth has been revised down for the fifth consecutive year and is likely to remain below 3 per cent over the next two years
- Despite the implementation of a spending ceiling, weak economic growth has produced a persistently large budget deficit
- While fiscal policy has supported the economy for the past seven years, this countercyclical approach has reached its limits. The budget deficit is largely structural and cannot be reduced through a cyclical upturn in revenues
- Accordingly, the fiscal policy package is proposed in the 2014 MTBPS and Budget 2015

Principles of fiscal policy and the fiscal policy package

- Elements of the fiscal policy package:
  - Reduce the expenditure ceiling by R25 billion over the next two years, compared with the 2014 Budget baseline.
  - Increase personal income tax rates and the general fuel levy, raising an additional R16.8 billion 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.
  - Ensure that the financing of state-owned companies does not increase national government's budget deficit.

THANK YOU