Report of the Standing Committee on Finance on the 2014 Medium Term Budget Policy Statement (MTBPS), dated 30 October 2014

The Standing Committee on Finance, having considered the 2014 Medium Term Budget Policy Statement (MTBPS), reports as follows:

1. Introduction

Section 12(3) of the Money Bills Amendment Procedure and Related Matters Act, Act No. 9 of 2009 (the Money Bills Act) requires that the Minister of Finance tables a revised fiscal framework with the national adjustments budget if the adjustments budget effects changes to the fiscal framework. Section 12(5) of the Money Bills Act requires that the revised fiscal framework be referred to a joint sitting of the Committees on Finance for consideration and report.

The 2014 revised fiscal framework, as part of the 2014 Medium Term Budget Policy Statement (MTBPS), was tabled in the National Assembly by the Minister of Finance on 22 October 2014. The Financial and Fiscal Commission (FFC), South African Reserve Bank (SARB), and Parliamentary Budget Office (PBO) made submissions at the oral hearings on the MTBPS.

2. Economic outlook

There is general consensus amongst the analysts that global economic growth will continue to be moderate and that growth will pick up momentum in the second half of 2014 and in 2015. The International Monetary Fund (IMF) has revised downwards the 2014 and 2015 Gross Domestic Product (GDP) growth forecasts to 3.3 per cent and 3.8 per cent in 2015, respectively. Growth in emerging markets is expected to expand by 4.4 per cent in 2014 and 5 per cent in 2015.

The revised growth projections envisage a rebound in growth from both the advanced and emerging economies in the remainder of 2014 and in 2015. The IMF further assumed that geopolitical tensions would decline; that activity in the United States and the Euro area would pick up and that the emerging market economies would gradually lift structural impediments to growth.

Major risks to the global economic outlook include geopolitical tensions; monetary policy normalisation in the US; deflation; low growth turning into stagnation in advanced economies as well as a decline in potential growth in emerging economies.

Sub-Saharan Africa (SSA) is forecast to remain one of the fastest growing regions. Economic activity in SSA remains robust, with growth projected to average above 5 per cent over the medium term. The SSA outlook is subject to risks such as a widespread contagion of Ebola in affected countries; heightened fiscal vulnerabilities; volatility in the global financial markets and lower growth in emerging market economies.

The South African economy is growing at a moderate pace and continues to perform below its potential. In line with the IMF, the South African Reserve Bank (SARB) and the Bureau of Economic Research (BER), the National Treasury has revised down its growth forecasts to 1.4 per cent in 2014, from 3.6 per cent in 2011. Similar to other analysts, the National Treasury attributed the economic slowdown to structural constraints in the economy. These include electricity supply and transport constraints, labour tensions and skills shortages. The Fiscal and Financial Commission (FFC) identified further constraints to growth as education and health outcomes while the Parliamentary Budget Office (PBO) identified the ability of spheres to implement cost-stabilising measures as a further risk.

Table 1: 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	3.5	2.6	1.9	2.3	2.8	3.0
Final government consumption	4.3	4.0	2.4	1.8	1.5	1.5	1.5
Gross fixed capital formation	4.2	4.4	4.7	2.7	3.6	4.7	5.1
Gross domestic expenditure	4.6	4.0	2.2	0.9	2.6	3.0	3.3
Exports	6.8	0.4	4.2	3.1	4.2	4.7	5.2
Imports	10.0	6.0	4.7	1.0	4.1	5.0	5.6
Real GDP growth	3.6	2.5	1.9	1.4	2.5	2.8	3.0
GDP inflation	5.9	4.5	5.8	6.1	5.8	5.7	5.6
GDP at current prices (R billion)	2932.7	3139.0	3385.4	3642.6	3952.6	4295.8	4675.6
CPI inflation	5.0	5.7	5.8	6.3	5.9	5.6	5.4
Current account balance (% of GDP)	-2.3	-5.2	-5.8	-5.6	-5.4	-5.2	-5.0

Source: National Treasury

Economic growth is expected to rise gradually over the medium term, reaching 3 per cent only in 2017. Moderate global growth; rising exports to the African Continent; the easing of transport and logistics constraints; stabilisation of electricity constraints and a recovery in private investment are expected to support economic growth over the medium term.

The electricity and transport constraints as well as labour stoppages have affected outputs in the mining and manufacturing sectors. The manufacturing sector has struggled to recover from the 2009 recession and the slowdown in Europe. Growth in manufactured exports has risen, suggesting competitiveness and efficiency gains. The share of mining as a percentage of GDP has been declining and the sector accounts for just under 50 per cent of the country's exports. The agricultural sector has grown strongly in 2014, mainly due to large increases in maize and livestock production, favourable weather conditions and higher prices.

The pace of job creation lags behind growth in the labour force, contributing to persistently high levels of joblessness. The June 2014 Quarterly Labour Force Survey (QLFS) conducted by the Stats SA showed that the official rate of unemployment measured 25.5 per cent (from 25.3 per cent in the first quarter) and increases to 35 per cent if discouraged job seekers are included. Weak employment outcomes are reflected in slowing real disposable income and household consumption growth.

Headline Consumer Price Index (CPI) remained within the 3-6 per cent target range over the past four years and rose to 6.4 per cent in August 2014 due to a spike in maize and wheat prices coupled with the impact of the weaker Rand on petrol prices. National Treasury and the SARB expects Headline CPI to average 6.2 to 6.3 per cent in 2014, return and remain within the target band over medium term. Risks to the inflation outlook include exchange rate depreciation, higher electricity prices and possible wage demands in excess of inflation.

Structural challenges, prolonged industrial action, a moderation in global demand and declining commodity prices affected SA's export performance in the second quarter of 2014. The trade deficit deteriorated from 2.1 per cent to 2.8 per cent of GDP in the second quarter of 2014. The current account deficit is estimated to measure 5.6 per cent of GDP in 2014, declining to 5 per cent of GDP in 2017. Despite increased volatility in financial and foreign exchange markets and the downgrading by international credit rating agencies in the first half of 2014, the balance of payments proved to be fairly resilient. Capital flows have been sufficient to finance investment.

The low level of domestic savings and high investment requirements, increase the economy's reliance on foreign capital flows, hence the "twin deficits" that are larger than those of its emerging market peers. The twin deficits combined with electricity shortages and low growth prospects are seen as key risks by investors.

Risks to the domestic outlook include volatility and capital outflows from the emerging markets (current account deficit); weaker Chinese growth; lower commodity prices, lack of structural reforms in emerging markets; weaker growth outlook and domestic supply side bottlenecks.

3. The 2014 Fiscal Framework

South Africa's fiscal policy is guided by the principles of counter-cyclicality, debt sustainability and intergenerational equity. Over the medium term, the focus will shift to debt sustainability, allocative efficiency and obtaining value for money in public spending.

Government's fiscal objectives aims to reduce budget deficit; stabilise debt to ensure fiscal sustainability; continue to shift spending towards government's priorities and contain expenditure on goods and services and compensation of employees.

The 2014 consolidated fiscal framework makes R1.2 trillion available for spending in 2015/16, R1.3 trillion in 2016/17 and R1.4 trillion in 2017/18 financial years. Revenue of R1.055 trillion in 2015/16, R1.169 trillion in 2016/17 and R1.272 trillion in 2016/17 financial years have been set aside. National Treasury expects a revenue shortfall of R61 billion over the Medium Term Expenditure Framework (MTEF) period, R10 billion of which will occur in 2014/15.

Government's tax revenue collection is highly dependent on the developments in economic conditions both at a global and domestic level. National Treasury proposed to increase taxes, the details of which will be informed by the recommendations of the Davies Tax Committee Review report. These increases are expected to generate R44 billion over the next three years.

The framework estimates a budget deficit of 4.1 per cent of GDP in 2014/15, 3.6 per cent in 2015/16, narrowing further to 2.5 per cent in 2017/18, as economic growth and revenue collection pick up pace.

Table 2: Consolidated fiscal framework, 2013/14 – 2017/18

R billion/percentage of GDP	2011/12	2012/13	2013/14	2014/15		2015/16	2016/17	2017/18
	Outcome			Budget	Revised	Medium-term estimates		
Main budget								
Revenue	**745.3**	**799.2**	**886.1**	**962.8**	**956.6**	**1 055.1**	**1 169.4**	**1 272.9**
Expenditure	**889.9**	**965.5**	**1 047.8**	**1 142.6**	**1 136.3**	**1 222.3**	**1 308.4**	**1 416.7**
of which								
Non-interest allocations	*813.5*	*877.4*	*946.6*	*1 024.7*	*1 021.9*	*1 090.8*	*1 153.9*	*1 222.0*
Debt-service costs	*76.5*	*88.1*	*101.2*	*114.9*	*114.5*	*126.5*	*139.4*	*149.7*
Unallocated reserves	–	–	–	*3.0*	–	*5.0*	*15.0*	*45.0*
Main budget balance	**-144.6**	**-166.3**	**-161.7**	**-179.8**	**-179.7**	**-167.2**	**-139.0**	**-143.8**
Budget deficit	*-4.9%*	*-5.2%*	*-4.7%*	*-4.7%*	*-4.8%*	*-4.1%*	*-3.2%*	*-3.0%*
Consolidated budget balance	***-110.8***	***-136.2***	***-134.7***	***-153.1***	***-153.2***	***-144.5***	***-114.1***	***-118.7***
	-3.7%	*-4.3%*	*-3.9%*	*-4.0%*	*-4.1%*	*-3.6%*	*-2.6%*	*-2.5%*

Source: National Treasury

Government’s net debt as a share of GDP continues to grow, but the fiscal package is expected to stabilise debt at R2.4 trillion (R45.9 per cent of GDP) in 2017/18, an increase of R590 billion. South Africa’s debt-to-GDP ratio increase is comparatively high among the emerging markets. Weak economic growth has entrenched a structural imbalance between revenue and expenditure.

Debt service costs for 2014/15 are expected to reach R114.5 billion, increasing to R149.7 billion in 2017/18, the fastest spending growth of 9.3 per cent. Weaker rand exchange rate pushes the value of foreign debt up; an increase in inflation increases the value of inflation linked debt and weaker economic growth impacts directly on increasing government debt.

Government has proposed a fiscal package with five elements, which are aimed at narrowing the deficit and stabilising debt over the medium term. These elements are reducing growth in spending; adjusting tax policy and administration; emphasizing long term planning and efficient resource allocation; freezing government personnel headcounts and adopting a deficit-neutral approach to the financing requirements of state owned companies over the next two years.

The main risks to the fiscal outlook are economic performance, public sector wage bill and balance sheets of state-owned companies (SOEs). A further deterioration in the GDP would require consideration of additional measures. Deviations from the CPI-linked cost of living adjustments will require either a reallocation of resources or a reduction in government employment. Capitalization for SOEs will be funded from sale of non-strategic state assets and will not be drawn from tax revenue.

4. Committee deliberations and observations

During the MTBPS briefing by the Minister of Finance and at the public hearings, the Committee:

4.1 Noted with concern that there were no submissions on the MTBPS from civil society organisations, despite extensive advertisements and overtures made by the parliamentary committee secretaries; and that the three organisations making submissions were all statutory bodies.

4.2 Appreciated the presentations made by the FFC, the SARB, and the PBO, and noted that while a good overview of the MTBPS and a macroeconomic picture are provided, these presentations do not contain any specific proposals or offer any alternatives to the proposals in the MTBPS and do not sufficiently contribute in assisting the Committee to consider the strengths and weaknesses of different options to deal with the current economic and financial challenges.

4.3 Noted that most of the FFC's proposals to NT were accepted, and that the FFC welcomes most aspects of the 2014 MTBPS, including economic forecasts; fiscal consolidation; a moderate public sector wage bill; government's intention to intensify initiatives to combat waste; inefficiency and corruption; proposals to increase taxes and a deficit reduction programme.

4.4 As also noted in the Committee's Budget Report, the Committee believes that it is not sustainable for NT to keep rescuing challenged SOEs who fail to improve their performance despite constant support. The Committee accepts that there may be a need to sell non-strategic assets, but is interested to know what criteria will be used to determine what non-strategic assets are and on what the terms they will be sold.

4.5 Agrees that while there are significant global constraints hindering South Africa's economic growth over which the country has limited control, there are also major domestic constraints that can and must be addressed, including badly managed labour disputes, energy and transport challenges, skills shortages and some policy uncertainties.

4.6 Noted that the current account and fiscal deficits combined with electricity shortages and high electricity tariffs low growth prospects are seen as key risks by investors.

4.7 Noted that National Treasury has allocated R561.1 million for Employment Creation Facilitation.

4.8 Noted the input from the PBO that reducing the public sector wage bill could serve to reduce domestic demand and lead to possible job losses and reduce the prospects of economic growth.

4.9 Welcomed the government's cost-containment proposals and stressed the need to ensure that these contribute to the country's economic growth, job-creation and developmental goals; and noted, further, that the FFC supported the NT's proposals.

4.10 Supported the NT's commitment to ensuring that fraud and corruption are more actively combatted and fruitless and wasteful expenditure are more decisively reduced.

4.11 Noted that government's anti-corruption task team has been investigating 169 criminal cases involving 945 individuals. These investigations have led to 54 convictions, with R1.8 million in assets frozen and R105 million in assets forfeited;

5. Recommendations

Most of the recommendations below need to be linked to the deliberations and observations in section 4 above.

5.1 NT needs to be very clear about the criteria it uses to define non-strategic assets and the terms of any sale of these. NT also needs to seek to ensure that the sale of these non-strategic assets do not lead to job-losses or other unintended consequences that undermine the country's economic growth and developmental goals.
5.2 The sale of non-strategic assets, however defined, could be contested and could take time. However, some SOEs need financial assistance more immediately. NT will have to speedily finalise measures to separate the commercial and developmental aspects of the SOEs and other measures to assist the SOEs in ways that contribute to improving their financial position in the interim.
5.3 The 2015-16 Budget will have to clearly set out how NT will realise the assumptions of the MTBPS and mitigate the risks to implementing it. The Committee will actively engage NT on this.
5.4 The NT needs to be clearer about how government is going to deal with the domestic constraints to growth, including badly-managed labour disputes, electricity and transport challenges, skills shortages and some policy uncertainties.
5.5 NT will have to, through a variety of ways, assist provinces and municipalities to implement cost-containment proposals. The Committee wants to be briefed on this periodically.
5.6 NT needs to more actively monitor the outcomes of the Jobs Fund allocations, and the Committee will engage with the NT on this in the first quarter of 2015. The Committee is keen to understand the number, nature and quality of the jobs being created and how they link to the country's economic growth and developmental goals.
5.7 While the Committee recognises the need for foreign direct investment, it believes that there is a need for greater focus on domestic investment, and a right balance needs to be struck between domestic and foreign investment.
5.8 NT needs to more clearly explain how government will more actively combat corruption. The Committee will engage NT on this in the first quarter of 2015. If government is more effective in reducing corruption, there will be significant savings and NT will be in a better position to more carefully decide on tax increases.
5.9 The 2015-16 budget needs to be more clearly aligned with the NDP and the Medium Term Strategic Framework, and the Committee will engage with the NT on this when reviewing the budget.
5.10 In view of the lack of investor and public confidence in the prospects of economic growth NT needs to far more actively communicate its programmes and activities through the public media and its own media and through other ways.

To better prepare to monitor and follow-up on the above recommendations, the Committee further proposes:

1. As raised in the Budget Report, the Committee needs to engage with the Public Enterprises Portfolio Committee on the performance of SOEs and other related matters. The Committee will request the PBO to undertake research on the financial aspects of SOEs and other related issues, following consultations with the Public Enterprises Portfolio Committee. A research report should be presented to the Committee in the first quarter of 2015.
2. Following the input by the PBO on the possible implications of reducing the public sector wage bill, the Committee will request the PBO to develop a research report for consideration by the Committee in the first quarter of 2015.
3. Parliament needs to look into new and more creative ways of encouraging civil society participation in MTBPS public hearings in future

The DA reserves its position on this report.

Report to be considered.