2014

Medium Term Budget Policy Statement

Speech

Minister of Finance
Nhlanhla Nene

22 October 2014

Honourable Speaker

Mister President
Deputy President

Cabinet Colleagues and Deputy Ministers
Governor and Governor-Designate of the Reserve Bank
MECs of Finance

Honourable Members
Fellow South Africans

It is my privilege to present the 2014 Medium Term Budget Policy Statement and the Adjustments Appropriation Bill, the Division of Revenue Amendment Bill, all for 2014/15, and this year's Tax Bills.

Mister President, we are calling upon Parliament to consider our budget proposals at a difficult time. In many countries, growth has slowed and the economic outlook is uncertain. Across the world, tough questions are being asked about how to generate growth, and how to reduce inequality.

Governments everywhere face difficult choices because the gap between what is required and what can be afforded is very wide. And so we have to be steadfast in our resolve to do more, together, with less.

Economic outlook

Honourable Speaker, when we tabled the 2014 Budget in February, we expected the economy to grow by 2.7 per cent this year. The revised estimate is 1.4 per cent. The Treasury projects that growth will reach 3 per cent in 2017.

This downward revision is partly because of a weak global environment, including the slowdown in Europe, China and other emerging economies. But it also reflects obstacles to our own development: energy constraints, labour market disruptions, skills shortages, administrative shortcomings and difficulties in our industrial transformation.

We have achieved much over the past twenty years: we have expanded education and health care, broadened economic participation and extended income support to the most vulnerable.

But we are not making enough progress in raising incomes or reducing poverty. Far too many people are unemployed, which deepens inequality and heightens vulnerability. We import considerably more than we export.

As a result of slow growth, tax revenue is below our budget projection. Government's debt continues to rise as a percentage of GDP.

Increased debt is not in itself a bad thing, if it finances investment in future productive capacity. But we are not investing enough. And our expenditure on public services achieves less than it should.

And so, Honourable Speaker, the budget framework we table today is focused on restoring balance to the nation's finances, bolstering investment, and achieving better value for money in public expenditure. We want to improve our export performance and shift away from consumption-led, debt-reliant expansion.

These changes are fundamental to our economic transformation, because they are the foundations on which our social progress and human development goals will be achieved.

National Development Plan

Our National Development Plan is about both growth and redistribution – expanding output and incomes and building a more inclusive and more equal society. As emphasised by President Zuma in opening the fifth Parliament, we need economic growth of around 5 per cent a year to decisively reduce unemployment and poverty, and to transform our social and economic order. There are many aspects to this transformation challenge:

- How we utilise land and our mineral resources,
- How we organise transport, energy and communication networks,
- How we manage cities and local government,
- How we improve education and health services,
- How we reform our social security and welfare services,
- How we broaden ownership and enterprise development, and
- How we engage with Africa and the rest of the world.

We cannot achieve this vision if we remain on our present economic path. We have to navigate a definite change of course, taking all South Africans with us.

Medium term strategic framework

Honourable Speaker, the budget framework we are proposing for the period ahead signals this change. But economic development is much more than a schedule of taxes and spending plans.

The success of our budget is defined by its contribution to building a more equal, prosperous society, as envisaged in the National Development Plan.

Government's actions over the next five years to achieve this vision are set out in the Medium Term Strategic Framework. It highlights the need for a compact between a capable developmental state, a thriving business sector and strong civil society. It identifies employment, education and enhancing the capacity of the state as central policy objectives.

The MTSF includes programmes aimed at improving our competitiveness, particularly in new areas such as oil and gas development, renewable energy and green technology. It recognises the need to support job creation through sector-based interventions, employment incentives, the expanded public works programme and the Jobs Fund.

The MTSF also acknowledges the importance of our social grant programmes and welfare services in combating poverty, and the role of public health services and child-focused programmes in reducing vulnerability.

Honourable Speaker, there are structural shifts underway in our economy that need to be accelerated. Allow me to highlight just a few:

- In manufacturing, we are helping companies to enhance their competitiveness and upgrade equipment through the Industrial Policy Action Plan. A new framework for special economic zones has been introduced. It allows for targeted incentives, logistics improvements and active partnerships between businesses, municipalities and development agencies.

- In agriculture, better links between emerging farmers and produce markets need to accompany an improved alignment between land reform and agricultural support programmes. We have seen strong increases in maize and livestock production this year. There has also been notable growth in exports of citrus, wine and horticulture products.

- In sub-Saharan Africa, South African firms are expanding investment and business partnerships, giving impetus both to regional development and our own export growth. Africa is the fastest growing region in our trade portfolio, and offers many opportunities for domestic producers to diversify.

- In the energy sector, we have one of the largest renewable energy programmes in the world, with over 60 wind and solar power projects underway. The independent power producer programme will be extended to include 2500 MW of coal projects and 800 MW of cogeneration projects to be connected to the national grid.

- In mining, we recognise the need for a new accord between producers, organised labour, government and local communities. Modernisation of mining is not just about new technologies. It also involves housing investments, social development and improved processes for dispute resolution.

- In transport and communications, we are in the early stages of major transformative investments. The Passenger Rail Agency of South Africa has concluded a R53 billion contract to replace over 500 commuter trains over the next ten years. Transnet is expanding and improving its infrastructure and services. New public transport systems are being constructed in our cities. Telecommunications investments are steadily improving the quality and coverage of broadband networks.

- In our financial sector, the twin peak reforms to improve consumer protection and safeguard investments are underway. These will include attention to unfair lending and debt recovery practices. We are working with our Nedlac partners to promote retirement reforms. Initiatives to encourage saving are in progress. The shift away from exchange controls to more appropriate prudential standards will continue, including simpler administrative requirements.

These are areas of structural transformation, Honourable Speaker, that involve investment and change across the economy as a whole, bringing together the public and private sectors, civil society and local initiatives.

I need to highlight the key aims of our Medium Term Strategic Framework that have substantial implications for the budget.

- The quality of our education system and our health services needs to be improved. These will remain the top priorities of government spending.

- Building capacity and strengthening accountability of the public sector is critical, particularly at local government level and in state-owned companies.

- South Africa's spatial landscape has to be re-shaped, including investment in dynamic city development, integrated housing and transport programmes and support for business activity and job creation in both urban and rural areas.

The MTSF will guide the budget decisions that contribute to making the NDP a reality. The required increases in investment and productivity will not be easily achieved. There will be difficult short-term adjustments, to achieve a sustainable long-term development path. As the NDP says, we must work together as partners to revive investment, avoid lengthy production stoppages, improve public services, strengthen local accountability and generate confidence in the economy.

The recent "Operation Phakisa" review of our oceans economy is an excellent example of the kind of cooperation we need. We had intensive engagement, over several weeks, under expert guidance. This has deepened our understanding and generated practical ideas for further development.

On Friday this week, the President will again meet business leaders to discuss measures to increase investment in our economy. On 4 November, the Deputy President will lead a consultation between social partners on challenges in the labour relations environment. Through forums of this kind, Honourable Speaker, we make progress in implementing the National Development Plan and in addressing specific challenges that confront us.

We have responded to two such challenges in recent months. Let me comment briefly on each.

African Bank

It became clear earlier this year that African Bank was in difficulty. After consideration of the implications for the wider financial system, it was resolved that African Bank should be placed under curatorship. The intervention was led by the Reserve Bank and the Treasury, and included participation by other banks, private investors and the Public Investment Corporation.

In support of the restructuring, the Treasury has provided a R7 billion assurance to the Reserve Bank. Our expectation is that the new African Bank will re-list on the stock exchange early next year, and that the curatorship will be concluded without the use of taxpayer money.

Eskom and other state-owned companies

We have also taken steps to safeguard Eskom's financial sustainability.

The support proposed for Eskom will allow its build programme to continue without an unduly steep increase in electricity prices.

- Eskom will borrow a total of R250 billion over the next five years, supported by existing guarantees from government.

- Government will provide at least R20 billion of funding, raised through the sale of non-strategic assets. This will be deficit-neutral: the capitalisation of Eskom will only occur once these funds are realised. If necessary, consideration will be given to a partial equity conversion of the R60 billion loan that has already been provided.

- Financial assistance to municipalities for free basic services will continue, ensuring that the poorest households are protected against rising electricity tariffs.

Electricity supply will remain tight until the first units of the new Medupi power station come on line and the capacity of existing plants improves. Even then, it will require several years and substantial public and private investment in power generation before a satisfactory balance between supply capacity and demand is achieved.

Stepped-up investment in distribution infrastructure is also required by municipalities, alongside investment in demand management and energy efficiency improvements by both businesses and households.

In addition to Eskom, several other state-owned companies are under Cabinet's close scrutiny. A new framework is envisaged that will distinguish commercial activities from development mandates, accompanied by more stringent financial reporting requirements.

Following the successful restructuring of the Development Bank of Southern Africa, steps to address financial risks and improve governance are being undertaken at South African Airways, South African Express, the SA Post Office and the Land Bank.

Adjustments Appropriation: 2014/15

Honourable Members, I now turn to the Adjustments Appropriation for the current financial year. Details are set out for each vote in the Adjusted Estimates.

As in past years, there are various shifts of funds and minor adjustments. I will highlight just a few.

Additional allocations for unforeseeable and unavoidable expenditure include:

- R157 million on the Cooperative Governance vote to repair infrastructure damaged by disasters, and R35 million for emergency water and sanitation interventions;

- R32.6 million for the Department of Health for Ebola control and prevention measures, including support for affected countries; and

- R350 million for International Relations and Cooperation to compensate for the depreciation of the Rand.

The Adjustments Appropriation also includes R620 million for the digital broadcast migration programme, as indicated in the February budget speech.

After taking into account the unallocated reserve, declared savings and projected underspending, total expenditure in 2014/15 will be about R6 billion less than the February estimate.

The revised revenue estimate is R956 billion, leaving a deficit on the main budget of R180 billion. Surpluses of the social security funds, provinces and public entities are estimated at R27 billion. This brings the consolidated budget deficit to R153 billion, or 4.1 per cent of GDP, which is in line with the February budget estimate.

Elements of the MTBPS

In tabling the 2014 Medium Term Budget Policy Statement, Honourable Speaker, allow me to emphasise once more that investment and initiative by both the private and the public sectors are required for our economic growth and fiscal sustainability.

The National Development Plan calls for private and public sector investment to reach 30 per cent of GDP. Progress has been made: public sector spending on infrastructure has doubled over the past five years. But there is still a long way to go if we are to achieve investment-led growth, which is the centrepiece of our development strategy.

Two years ago, we pointed out that if the economic and fiscal outlook were to deteriorate, expenditure and revenue plans would be reconsidered. In the 2013 Budget, government reduced its spending plans and cut the unallocated contingency reserve. The 2014 Budget indicated that additional measures would be required if the economic outlook were to worsen.

Members of the House, we have reached that turning point. Fiscal consolidation can no longer be postponed.

By proposing measures to reduce the budget deficit, government will stabilise public debt and ensure the sustainability of our critical social programmes. The proposals being tabled today complement reforms under way to encourage lower consumption, higher savings and increased productive investment.

Re-establishing a sustainable foundation for the public finances will lower the cost of capital across the entire economy and open the way for investment-led growth. It also means that government will play its part in moderating the wide deficit on the current account and correcting our external imbalance.

Together, these fiscal measures will complement job creation and skills development initiatives. These include government’s flagship re-industrialisation programmes, projects of the Presidential Infrastructure Coordinating Commission and support for our expansion of higher education and vocational training.

Fiscal framework

The fiscal framework set out in the MTBPS is as follows.

In order to reduce the budget deficit from 4.1 per cent this year to 2.5 per cent over the next three years, the expenditure ceiling will be lowered by R10 billion in 2015/16 and R15 billion in 2016/17. To effect the lower ceiling, national government will:

- Freeze budgets of non-essential goods and services at 2014/15 levels;

- Withdraw funding for posts that have been vacant for some time; and

- Reduce the rate of growth of transfers to public entities, particularly those with cash reserves.

Across national departments, planned expenditure on travel and subsistence, conference venues and catering has been cut. Advertising and communications budgets have been reduced. Allocations for consultant services have been capped. These steps will contribute savings of about R1.3 billion over the next two years. They supplement the cost-containment measures adopted at the start of this year, which have already achieved substantial savings.

Lower government consumption also requires prudent management of the public-sector wage bill, while maintaining the real value of public service salaries. New posts will have to be funded from existing allocations and natural attrition. Posts that remain vacant will be reviewed.

Honourable Speaker, our consolidation path thus far has relied mainly on containing expenditure growth. Revenue measures will also come into consideration in the period ahead. If we are to avoid reducing expenditure in real terms, about R15 billion a year in additional revenue will need to be raised. Details will be announced in the 2015 budget. The revenue measures will be designed to limit as far as possible any negative impact on growth and job creation.

Acting now to re-establish a sustainable foundation for public finances will enable government to rebuild fiscal space in the years ahead. Once debt has stabilised, spending growth will be aligned with long-term economic growth trends. In the final year of the MTEF period an unallocated reserve is retained, to allow for future shocks to the fiscus or allocations to new priorities.

Government will place greater emphasis on longer-term planning and efficient resource allocation. There will be a comprehensive assessment of baseline estimates for 2017/18, emphasising value for money and alignment with policy priorities.

Capital injections for state-owned companies will be allocated without impacting on the budget deficit over the next two years, and on the condition that a sound business plan is in place.

Medium term expenditure priorities

Honourable Speaker, over the past decade we have increased public spending on the main budget from 26 per cent to 31 per cent of GDP. Much of this increase has gone to programmes that contribute to the social wage, including schools, roads, hospitals, housing and municipal services.

Our medium term objective is to ensure that public spending promotes growth and creates an environment for greater private sector investment. To this end, we are targeting three priority spending areas.

- First, we will support cities to improve living conditions, modernise transport and communications infrastructure, expand the urban economy and promote trade and investment. Government will work with development finance institutions to increase investment in the urban landscape and expand the municipal debt market.

- Secondly, we will reinforce support for export competitiveness and job creation. This includes over R18 billion for manufacturing incentives, the establishment of special economic zones and the employment tax incentive.

- Thirdly, we will expand the skills base: R800 billion is proposed over the MTEF period for education and skills development. Post-school education and training has received the fastest-growing share of the budget over the past three years, and will continue to expand.

Alongside these priorities, there will be real growth in spending on local development and social infrastructure. As in the past, the largest allocations will go to education, health and social protection.

This year, one-third of allocated expenditure will go to the compensation of employees. Over the period ahead, we have budgeted for nominal wage-bill growth in line with consumer price inflation. In the present economic circumstances, it is especially important that we maintain a careful balance between personnel spending and other resources required for public service delivery.

Division of revenue

Honourable Speaker, a national appropriation of R1.2 trillion in 2015/16 is proposed, rising to R1.3 trillion in 2016/17. The proposed division of revenue allocates 48 per cent to national departments, 43 per cent to provinces and 9 percent to local government over the MTEF period.

Allocations to national departments will total R495 billion in the current year and will increase to R585 billion in 2017/18.

Provinces

Provinces will receive R469 billion next year, increasing to R527 billion in 2017/18. Efficiency improvements will be prioritised in the core areas of service delivery: basic education, health, roads and social development.

National Treasury will work with provincial departments to improve human resource management and supply chain processes. Special attention must be paid to containing personnel expenditure, which now accounts for 61 per cent of total provincial spending.

Local government

The division of revenue allocates R91 billion to local government next year. This will increase to R110 billion in 2017/18 to support the MTSF outcome of responsive, accountable, effective and efficient local government.

Support will be provided to municipalities to improve revenue collection and management of infrastructure financed from both own revenue and grants.

The local government equitable share continues to finance the provision of free basic services to poor households, but municipalities must work harder to broaden access.

Service delivery impact

What do all the proposals being announced today mean for service delivery?

Let me be absolutely clear: we will not balance the budget on the backs of the poor. This means that intensive effort has to be focused on achieving the intended savings and maximising efficiency.

- This will include a focus on procurement costs. In November, we will release a Public Procurement Review which clearly outlines reforms to be implemented over the next five years.

- Cost-containment measures will be reinforced to identify goods and services expenditure that can be eliminated without affecting service delivery.

- A culture of doing more with less is required. For example, Treasury is working with municipalities to link the disbursement of infrastructure grants more tightly to the efficient delivery of capital projects.

- We will continue to fight waste and corruption, supported by our audit institutions and stringent monitoring and reporting requirements.

More details of these measures will be provided in the 2015 Budget Review.

Honourable Speaker, South Africans rightly expect efficient and reliable delivery of basic government functions – water supply, sanitation, refuse removal, teachers in classrooms, medicines in clinics, postal delivery, visible policing. These essential services come first. Where they are in disrepair, they must be fixed.

To meet the cost of these services, taxes have to be paid and municipal bills collected. So let me again express appreciation to the many South Africans who pay their taxes and bills, on time. Our thanks also to the officials whose duties are to enforce the laws.

Conclusion

In concluding, Honourable Speaker, allow me to acknowledge the guidance and support of President Zuma and Deputy President Ramaphosa in these difficult times.

Cabinet collectively owns this medium term budget policy statement. Its support and understanding for tough measures is highly appreciated.

My appreciation also goes to colleagues in the Ministers' Committee on the Budget for their continuous and vigorous engagement with the challenges before us.

A heartfelt thank you to Deputy Minister Jonas for his sound advice.

My thanks to the MECs of Finance, who play a critical role as guardians of 43 per cent of our spending.

Our appreciation also goes to:

- The outgoing Governor of The South African Reserve Bank, Gill Marcus, who has so wisely steered the Reserve Bank during stormy financial times, Governor-designate Lesetja Kganyago and the Deputy Governors,

- Auditor-General Mr Kimi Makwetu and the audit teams who keep us under scrutiny,

- Commissioner Tom Moyane and the staff of the South African Revenue Service,

- The executive heads of the Development Bank of Southern Africa, the Land Bank, the Public Investment Corporation, the Financial and Fiscal Commission, the Financial Services Board, the Financial Intelligence Centre and the Government Pension Administration Agency,

- The managing director of NEDLAC and its constituency representatives,

- The chairs of the Standing and Select Committees on Finance and Appropriations, Honourable Yunus Carrim, Charel de Beer, Paul Mashatile and Seiso Mohai, who ensure that Parliament remains a vibrant forum for accountability and public participation,

- Director-General Lungisa Fuzile and the management and staff of the National Treasury and the Ministry, and

- My very supportive family.

And finally, I must express sincere gratitude to all South Africans who offer words of encouragement – as well as criticism and concerns. This is what keeps us accountable and drives us constantly to improve.

I hereby table for consideration by the House the Medium Term Budget Policy Statement, the Adjusted Estimates of National Expenditure, the Adjustments Appropriation Bill, the Division of Revenue Amendment Bill, the Rates and Monetary Amounts and Amendment of Revenue Laws Bill, the Taxation Laws Amendment Bill, and the Tax Administration Laws Amendment Bill.

Honourable Speaker, Nelson Mandela set the tone for us in November 1994 when he said: “Our primary objective is to address the basic needs of especially the poor. We have to reconcile this with South Africa's resource constraints. We must consequently shift our priorities, accept financial discipline and create a climate conducive to sustained economic growth.”

I table this budget framework at a watershed moment in our country’s history. This year, we have been able to celebrate our collective achievements of the past 20 years – creating a more prosperous and inclusive nation, and the maturing of our institutions of democracy and accountability.

Surely, we also share a determination to protect these gains, to deepen our capacity to meet the needs of our people and to place our future on firm foundations. We, Mister President, together with all South Africans, are joint trustees of this compact.

I thank you.