COMMISSION SUBMISSION ON THE 2012 FISCAL FRAMEWORK AND REVENUE PROPOSALS

"For an Equitable Sharing of National Revenue."

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CONTENTS

LIST OF TABLES AND FIGURES

LIST OF ACRONYMS

EDD	Economic Development Department
FFC	Financial and Fiscal Commission
GDP	Gross Domestic Product
GEA	Government Expenditure Assessment
GFIP	Gauteng Freeway Improvement Project
IMF	International Monetary Fund
IPAP	Industrial Policy Action Plan
MBPARMA	Money Bills Amendment Procedure and Related Matters Act
MDG	Millennium Development Goal
MFMA	Municipal Finance Management Act
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
NERSA	National Energy Regulator of South Africa
NGP	New Growth Path
NHI	National Health Insurance
NPC	National Planning Commission
PES	Provincial Equitable Share
PFMA	Public Finance Management Act
SANRAL	South African National Roads Agency Limited
SARB	South African Reserve Bank
TCTA	Trans-Caledon Tunnel Authority

1. BACKGROUND

1.1 This submission is made in terms of Section 4 (4c) of the Money Bills Amendment Procedure and Related Matters Act (MBPARMA) (Act 9 of 2009) which requires Parliamentary Committees to consider any recommendations of the Financial and Fiscal Commission (FFC) (hereafter the Commission) during their deliberations on Money Bills. It is also made in terms of the FFC Act of 1997 which requires that the Commission respond to any requests for recommendations by any organ of state on any financial and fiscal matters relevant to its mandate.

1.2 The submission consists of seven sections. The second section gives a brief description of the fiscal framework for 2012. The third section looks at the macroeconomic outlook and long-term fiscal risks. Section 4 discusses tax revenue estimates and 2012 tax proposals, while section 5 considers the expenditure estimates and proposals for 2012. Section 6 highlights what the Commission considers as important issues in relation to future fiscal frameworks, and the final section is the conclusion.

2. A BRIEF REVIEW OF 2012 FISCAL FRAMEWORK

2.1 Government tabled a total national budget of R1.1-trillion to be spent amongst the three spheres for 2012 financial year, growing to R1.3-trillion in 2014/2015. A significant portion of this allocation is spent at national level (47.1%) and provincial level (44.5%), while the local government receives 8.4% of this allocation.

2.2 This year's fiscal framework sees expenditure rise by R55.9-billion relative to baseline over the medium term expenditure framework (MTEF). A total of R844.5-billion has been allocated to infrastructure investment, while some R6.2-billion has been added to spending plans for job creation over the next three years.

2.3 The allocations to provinces have been revised upwards with an additional R15-billion to the Provincial Equitable Share (PES) and R4.4-billion to conditional grants over the MTEF period. The local government sphere receives an additional R2.2-billion to its equitable share and R3.1-billion to conditional grants.

2.4 In the 2011 Medium Term Budget Policy Statement (MTBPS), government had reiterated its commitment to promoting faster and more inclusive growth through shifting the composition of spending towards infrastructure spending. A precondition for this is a moderation of increases in the public sector wage bill and recurrent expenditure generally. The budget for 2012 reflects this resolve, through a considerable portion of the budget allocated to infrastructure, as well as through moderate planned[1] increases in the public sector wage bill (budgeted at 5% for 2012, below the projected inflation figures) and moderate decreases in state debt costs over the medium term.

(a) In terms of the differences between the 2011 MTBPS and the 2012 Budget:

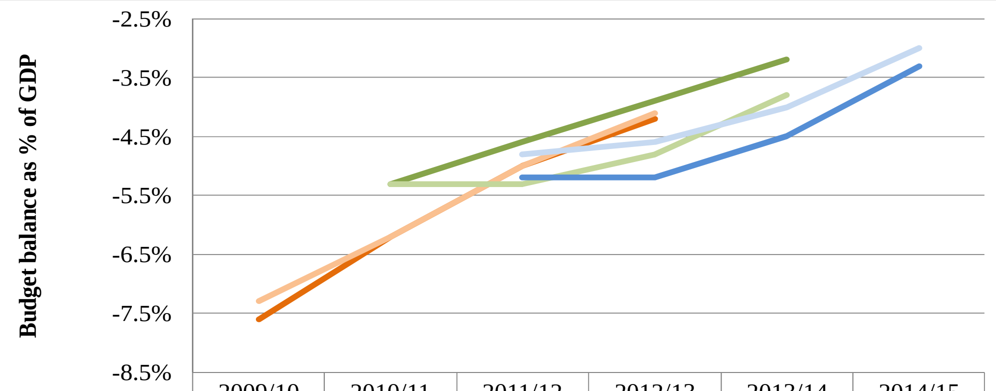
i. Revenue estimates are slightly higher in the budget;

ii. The budget reports slightly lower non-interest expenditure and state debt cost figures;

iii. So that the combination of (i) and (ii) leads to a faster decrease in the budget deficit over the medium term.

(b) Twice yearly, at the MTBPS and the budget itself, government's expected fiscal stance (including the anticipated deficits over the next three years) is published based on the latest economic data available. Comparison of the budget deficit forecasts from 2010, 2011 and 2012 MTBPS reports and budgets yields the following:

Figure 1. Medium-Term Budget Deficit Projections



	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
2009 MTBPS	-7.6%	-6.2%	-5.0%	-4.2%		
2010 Budget	-7.3%	-6.2%	-5.0%	-4.1%		
2010 MTBPS		-5.3%	-4.6%	-3.9%	-3.2%	
2011 Budget		-5.3%	-5.3%	-4.8%	-3.8%	
2011 MTBPS			-5.2%	-5.2%	-4.5%	-3.3%
2012 Budget			-4.8%	-4.6%	-4.0%	-3.0%

Source: MTBPS (2009, 2010, 2011); Budget Review (2010, 2011, 2012).

[1] It should be noted that government's planned wage increases may or may not translate into moderated actual personnel increases, depending on how wage negotiations are handled. At present there seems to be no social compact that such moderation is desirable by the unions.

Compared to the 2010 budget (light orange line) which indicated a fast pace in closing the budget deficit, 2011 and 2012 budgets (light green and light blue lines, respectively) indicate more gradual decreases in the deficit in the first year of the medium term framework, with a more aggressive pace in the latter part of the medium term framework. Clearly, government's strategy surrounding fiscal consolidation has changed towards more of a back-loading strategy – possible reasons for this include the global economic recession as well as the need for government to continue to play a supportive role in the economic recovery process. What is also evident from the figure above is that with the exception of 2009 (where the MTBPS and the budget projections were consistent – light and dark orange lines), MTBPS has since either overestimated (in 2010 – light and dark green lines) or underestimated (in 2011 – light and dark blue lines) the budget projections. This is probably because forecasting tax revenue tends to be largely influenced by the third quarter outcome while capital expenditure (which is a driver of variation between the MTBPS and budget figures) is not available at that time.

3. Macroeconomic Outlook and Long-Term Fiscal Risks Confronting South Africa

3.1 Economic Growth

(a) South African economy has been negatively affected by the uncertain global economic climate, and particularly due to its exposure to Eurozone economies through trade and financial markets. Economic growth (in real terms) has increased from 2.8% in 2010 to 3.1% in 2011 which much like for 2010 remains reflective of the ongoing economic recovery from the 2008 downturn. However, current as well as projected economic growth is sluggish and poses a real threat to the targets outlined in the New Growth Path (NGP) as well as the National Planning Commission's (NPC) Vision for 2030[2]. In addition,

[2] As noted in the Commission's response to the 2011 MTBPS, given the revision in the economic growth figure for 2011 as well as the estimates for economic growth over the medium term, it is apparent that South Africa will need a much higher economic growth than the 7% set out in the NGP document. This is further borne out by the current slow, positive growth rates not producing significant job increases. If National Treasury's estimates for 2012/13-2014/15 materialise, South Africa will need an average growth rate of 8-9% in the period

international as well as domestic organisations have recently revised South Africa's economic growth forecasts for 2011 downwards[3]. The Commission's own forecasts place the economic growth for 2011 at between 2.9% and 3%.

i. Given that infrastructure has been identified as the key driver for economic growth and job creation in South Africa, it is somewhat paradoxical that public sector infrastructure spending has been revised downwards since 2011 MTBPS for the categories of economic services as well as justice and protection services (see Table 1 below). However, with the investment for the category of financial services remaining largely unchanged over the medium term, it seems that all of the cuts in infrastructure investment have been directed towards investment in social services which are important for crowding in private investment.

Table 1.Changes in Public Sector Infrastructure Expenditure by Sector Between 2012 Budget and 2011 MTBPS (Real Figures, %)

	2011/12	2012/13	2013/14	2014/15
Economic services	-6.7%	-2.8%	0.0%	3.0%
Social services	31.2%	43.7%	48.9%	50.9%
Justice and protection services	-22.0%	-22.7%	-31.4%	-36.2%
Central government and administrative services	-9.5%	-1.2%	0.0%	12.0%
Financial services	0.0%	0.0%	0.0%	12.5%

Source: MTBPS (2011); Budget Review (2012); Commission's calculations.

3.2 JOB CREATION

(a) This year's budget (much like last year's budget) is unmistakably aimed at growth and job creation, with the expenditure and revenue proposals reflecting government's pursuit of progressive developmental policies. However, economic aspects of development focus not only on promoting job creation, economic growth and structural change, but also on improving the potential of the population. This entails creating policies and practices aimed at

2015/16-2020/21 (Commission's estimates). This figure is highly unlikely considering that emerging market economies are expected to grow at some 5-6% over the same period.

[3] For example, International Monetary Fund (IMF) lowered its economic growth forecast for South Africa for 2011 from 3.4% to 3.1% (in line with its downward revisions for global economic growth; this is also well below 6.2% expected for developing countries in 2011). South African Reserve Bank's (SARB) economic growth forecast for 2011 is also 3.1%. IMF economic growth forecast for 2012 is even lower at 2.5%. Similarly, SARB has adjusted its growth forecast for 2012 downwards to 2.8%.

development, as well as leadership at national, subnational and departmental levels, that is willing to cooperate, is committed to attaining developmental objectives and that has a good understanding of incentives (such as tax incentives and incentives for influencing management behaviour), both in the public and private sector spheres[4]. These ideas are to a large extent embodied in the NGP and NPC documents[5]. While in principle, policies like NGP (and its predecessors) are welcome developments, history has shown that capacity to bring these plans to fruition poses enormous challenges. This year's budget also addresses capacity concerns through developing capacity-building models for public sector financial management as well as investment in large-scale public sector infrastructure aimed at expanding the capacity of the economy to grow more rapidly.

(b) Public sector employment growth (as reported in the 2011 Medium Term Budget Policy Statement (MTBPS)) is not a robust way to sustainably create job, particularly when considering that the public sector wage bill is already more than a third of all government spending[6]. In this year's budget, government has announced its intention to shift the composition of spending from consumption towards capital investment, and moderating growth in the public sector wage bill forms part of this strategy. These are developments that are welcomed by the Commission. However, plans to curtail public sector expansion need to form part of the public sector restructuring in government's efforts to establish a more efficient and less costly public service. This issue needs to be nuanced rather than rules driven. The point is that government needs periodic Government Expenditure Assessment (GEA) exercises that will provide important additional flexibility for the proposed expenditure framework. The GEA is the proposed means of evaluating the relative priorities (for example, employment of public servants that contribute to developmental state necessary for economic growth) in terms of the resources

[4] The Commission notes that NPC's 2030 Vision addresses this point quite comprehensively.
[5]Both policies are aimed at elimination of poverty and reduction of inequality. The specific targets for job creation and economic growth set in the two strategies are: NPC: 11 million jobs by 2030, which requires an annual growth rate of 5.4%; NGP: 5 million jobs by 2020, which requires an annual growth rate of about 7%. Naturally, because the horizons of the two strategies are different (and because these strategies were developed a year apart), final targets and the economic growth rates necessary to achieve them are different.
[6] As reported in the 2012 budget, public sector wage bill is the largest component of current expenditure and has grown considerably over the last decade.

allocated, and would involve assessing the relative contribution of expenditure areas towards meeting the programme for government commitments.

(c) The key to realising sustained and inclusive economic growth is for government to create high quality education systems that will teach its citizens the necessary skills for them to be able to obtain jobs[7]. As noted in the Commission's response to the 2011 MTBPS, education expenditure should be directed towards the hiring of quality teachers, subsidies for transport, supplies for teaching aids, building of new and safer schools, and prioritisation of learners with special needs. Such increase in government spending will have an impact on the rest of the economy as well as on the realisation of millennium development goals (MDGs).

3.3 NATIONAL HEALTH INSURANCE (NHI)

(a) With regard to National Health Insurance (NHI), as expected to be the case, government reiterated that steps will be taken over the MTEF period ahead to improve public health administration, accelerate the hospital revitalisation programme and pilot district-based primary health services as part of the preparation for national health insurance. A new specific purpose (schedule 5) grant, the National Health Insurance Grant was introduced to cover NHI pilot projects in ten districts focused on comprehensive primary health care to test the feasibility of policy proposals in the NHI Green Paper and models of delivery. The Commission is of the view that the pilot route taken by government is a sensible way of going about such a reform with far reaching consequences for sustainability of fiscal frameworks. The advantage of such a strategy is that key shortcomings will start to emerge in the pilots and can be addressed before full scale launch of the scheme.

(b) While the NHI scheme would not affect the rate of taxation to any material extent in the short term, government indicated that there will be a shortfall in the medium term. In addition, government reiterated the three options available for raising taxes to finance the NHI – namely, a payroll tax, a higher value-added tax and/or a surcharge on taxable income. The Commission has already provided inputs on the green paper process as well as commented on the NHI proposals in its response to the 2011 MTBPS. The Commission now

[7] Currently, there is an increased emphasis on learner and graduate throughput with less emphasis on employability.

looks forward to a further and in-depth consultation process as promised by Government when a discussion paper on funding proposals is released in April 2012.

3.4 Commodity Prices

(a) Given that commodities account for over 60% of South Africa's total exports, fluctuations in commodity prices have a significant impact on South African exchange rate. Dampening international demand for risky assets, particularly in Eurozone countries, has recently resulted in declining commodity prices, which in turn had a weakening effect on the South African exchange rate.

(b) However, domestically, the impact of strikes over wage-related issues has also had an effect on commodity prices. The Rustenburg platinum plant is responsible for a tenth of the world's platinum output, so that the recent strikes have resulted in an increase in the price of platinum. Thus, taking this and the previous point into consideration, the uncertainty as well as the volatility of commodity prices pose a risk for the South African economy, particularly for the trade sector and the exchange rate.

(c) The oil price has traditionally played an important role in the South African economy, often offsetting the positive benefits of rising commodity prices and posing a risk to the fiscal framework. Currently, the threat to South African economy comes in the form of oil supply shortages and what these imply for the price of oil. Developments in Iran and the Eurozone economies have implications for other countries that are relying on Iran for their supply of crude oil. Iranian oil makes up about a third of South Africa's oil imports and South Africa is Iran's ninth largest export market. Clearly, there is a need for the South African government to explore alternative strategies and contingency financing to cater for possible oil supply shortages. This is further borne out by the Department of Energy stating that even if alternative sources of oil could be located, it would still pose a considerable cost to South African refineries due to necessary alterations that will need to be made for these refineries to be able to process other grades of oil. These costs will likely be passed on to the consumer and may result in inflationary pressures. This may also have broader effects given that transport is a big contributor to government strategy for rural development, so that higher fuel costs may impact negatively on rural development and undo poverty reduction efforts.

3.5 PUBLIC DEBT

(a) In its response to the 2011 MTBPS, the Commission reiterated the importance of fiscal consolidation in South Africa. Given the uncertainty surrounding global recovery, South African government should exercise caution by conserving fiscal space which can then be used to deal with future shocks (this strategy was very successful in averting more serious effects of 2009 crisis). A particular concern of the Commission is the projected increase in gross government debt which rises to 40% of GDP in 2011/12 (or 40% of GDP by 2014/15 in net terms) after which it is expected to gradually increase over the medium term (the projections beyond the medium term are not made available).

(b) Recent downgrading of South African sovereign debt by international agencies was driven by the belief that government's ability to finance debt and deficit levels is deteriorating. Major banks as well as state enterprises such as Eskom are all linked to the fiscus through bonds. Hence, in the instance of possible systemic risk (i.e. possibility of a collapse of one of the banks or a financial system), the existing high debt and deficit levels will decrease the ability of government to bail out these banks. In South Africa's case, the review has also been triggered by the recently assigned negative outlook on South Africa's A3 government bond rating, which reflects constrained public finances and signals that government financial flexibility may be weakening. However, the Commission is of the view that this downgrading is a combination of what is happening globally (i.e. challenging global economic environment) with South Africa's fiscal position and sluggish economic growth. From the Commission's analysis of the economic outlook, government's own commitment to fiscal prudence as articulated in the 2012 budget and the innovatively regulated financial sector relative to the rest of the world, the Commission does not necessarily believe that the downgrading is warranted[8]. However, although these factors do not pose immediate threat to

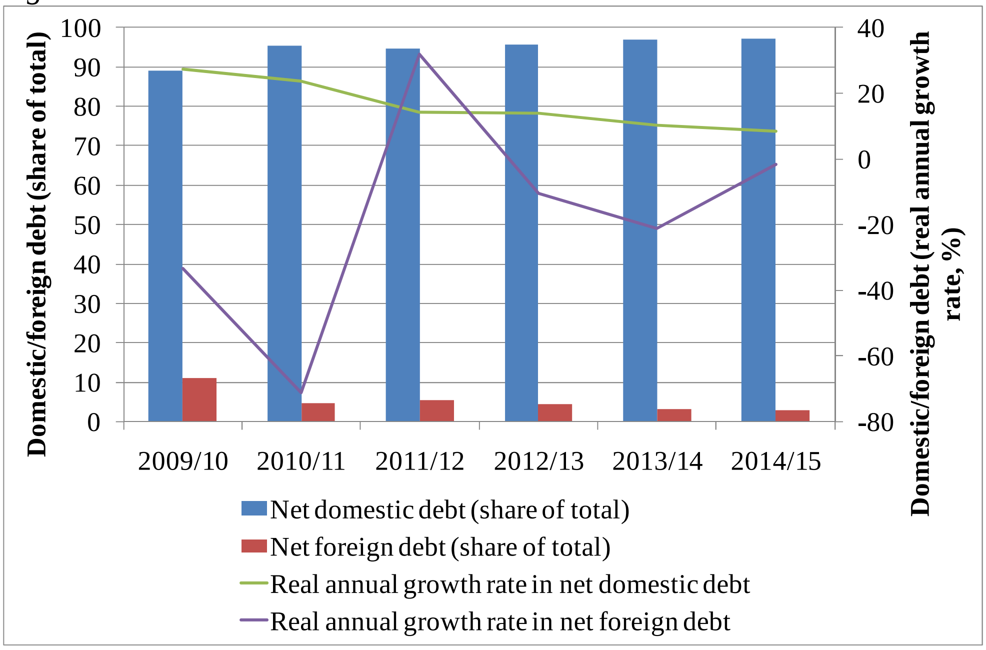
[8] Factors that are in South Africa's favour include:

- The rest of the world's sovereigns are worsening, while South Africa's sovereign debt remains in a healthy position.
- The debt and deficit levels that South Africa has at the moment are a consequence of the 2008/09 recession.
- The 2012 Budget Review and 2011 MTBPS made a commitment to countercyclical policy and will try as best as possible to keep the targets set.

fiscal sustainability, they could turn out to be a significant constraint on the fiscal space in the event of shocks. Also, the importance of confidence in, and the perception of, South African economy are factors that should not be underestimated.

(c) When looking at the share of total debt over the medium term (see Figure 2 below), domestic debt increases while foreign debt decreases. However, in real terms, the annual growth rate of domestic debt is steadily declining whereas the annual growth rate of foreign debt is more volatile, increasing dramatically in 2011/12 and then dipping in the first part of the medium term only to increase again at the end of the medium term.

Figure 2. State Debt Shares and Growth Rates



Source: Budget Review (2012); Commission's calculations.

State debt service costs are decreasing across all categories over the medium run (see Table 2 below), and apart from a sharp increase in domestic short-term loans in 2013/14, there does not seem to be a worrying trend.

- Government has very little exposure to foreign debt (which is about 6% of total debt), and hence foreign risk.
- Average maturity of South Africa's debt is relatively high (some 7-8 years).

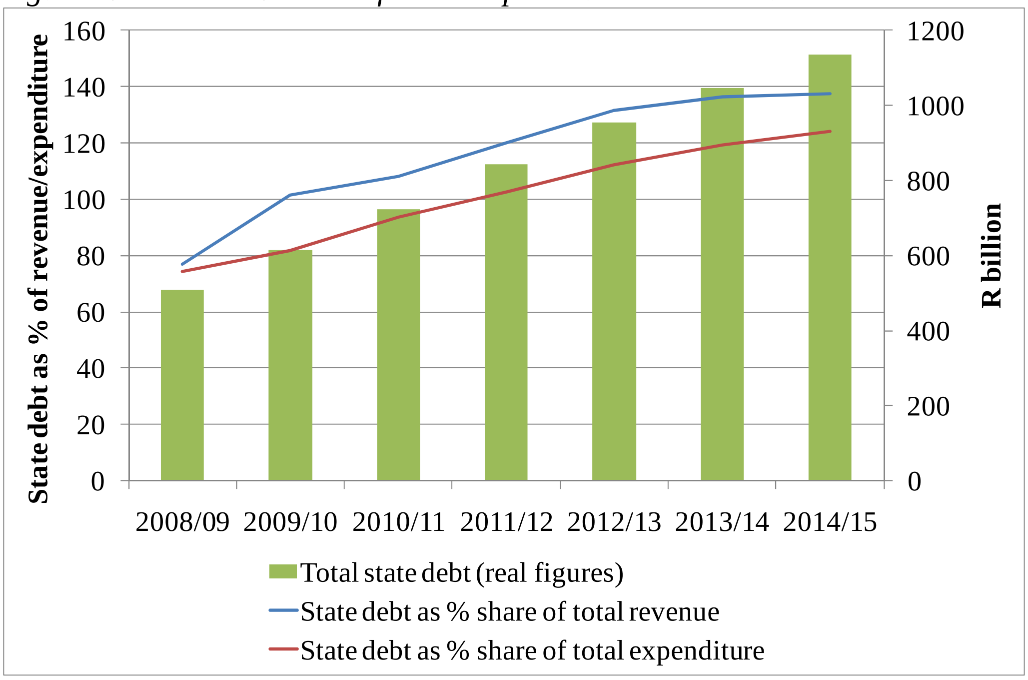
Table 2. State Debt According to Category (Real Annual Growth Rates, %)

	Domestic	Short-term loans (domestic)	Long-term loans (domestic)	Foreign
2011/12	10.2	7.2	10.7	7.2
2012/13	10.7	5.1	11.6	6.3
2013/14	8.5	20.2	6.6	-14.2
2014/15	5.2	7.3	4.8	-8.2

Source: Budget Review (2012); Commission's calculations.

However, looking at state debt as a percentage of total expenditure and total revenue, there seems to be an increasing trend (see Figure 3 below). Increasing state debt burden (state debt as percentage of total revenue; loosely interpreted as debt service ratio) implies that expenditure increases are being financed by debt. This in itself is not necessarily a problem if debt is financing productive expenditure, such as expenditure on infrastructure.

Figure 3. State Debt: Share of Total Expenditure and Revenue



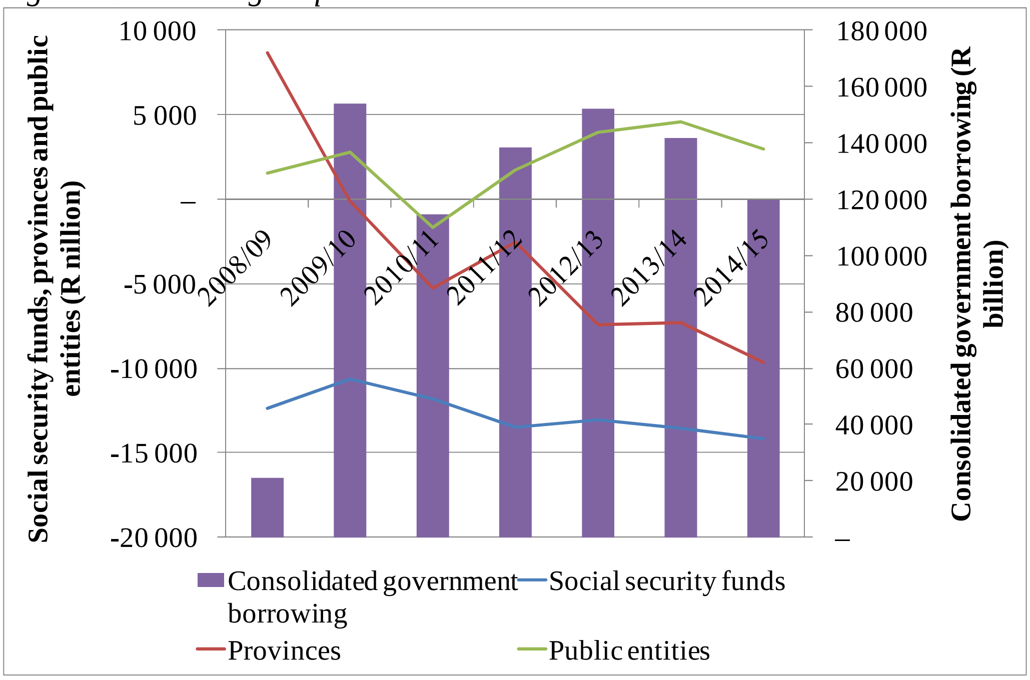
Source: Budget Review (2012); Commission's calculations.

(c) Looking at the public sector borrowing requirement, there is a clear decrease in the borrowing requirement for provinces and social security funds over the medium term (Figure 4 below). However, there is an increase in the borrowing requirement for public entities over the medium term (stabilising towards the end of the medium term). In addition, consolidated government borrowing which includes borrowing for South African National Agency

Limited (SANRAL) and Trans-Caledon Tunnel Authority (TCTA) also increases over the medium term and follows a similar path to that of the borrowing requirement for public entities over the medium term.

(d) A special appropriation of R5.75-billion for 2011/12 for SANRAL's Gauteng Freeway Improvement Project (GFIP) is included in the borrowing requirement of national government. The Commission is of the view that while this was a necessary step taken by government in light of the negative effects expressed by the public in general, it will be important going forward that more rigorous scrutiny has to be applied before such large infrastructure projects are implemented. The measures should include thorough consultation processes with possibly affected parties. The Commission welcomes government intervention to avoid potentially negative impacts of GFIP on the South African economy. However, the Commission is also of the view that government should strengthen the accountability framework relating to decisions taken by public entities to ensure that negative impacts are minimised.

Figure 4. Borrowing Requirement



Source: Budget Review (2012); Commission's calculations.

3.6 ADMINISTERED PRICES

(a) Administered prices such as electricity, medical aid, education and municipal services (especially water) continue to impact on resource allocation with important implications for fiscal frameworks that can pose fiscal risk associated with these. The issue relating to the electricity situation in particular with specific reference to the potential decisions on electricity tariff increases beyond the expiry of the current three-year agreement in April next year is a case in point. South African electricity price changes are based on negotiations between Eskom and National Energy Regulator of South Africa (NERSA). This does not result in prices that respond to market conditions. It appears that while the regulator can consider cost-side issues, it cannot consider those on the demand-side; price increases can be permitted because costs have risen, but not because there is a need to reduce demand. Problems inherent are exacerbated by the fact that electricity pricing issue is a complex one, encapsulating also municipalities that are trying to generate a profit from adding margins to the cost set by Eskom. Thus electricity pricing also spills into the political sphere, impacting on the relationship between central and local government.

(b) Issues to consider include whether or not to target specific sectors of the economy with subsidies as opposed to operating with a unified tariff across all sectors as part of economic transformation agenda. Similarly, the impact of sharp increases as opposed to gradual increases has differential macroeconomic repercussions that can disturb macroeconomic balance. To safeguard stability of fiscal frameworks, it is important to introduce as soon as possible certainty about the outlook for electricity tariffs for a significant period of time, certainly beyond a three year horizon in order to reduce uncertainty surrounding what the tariff increases will be. A clear path for tariff increases beyond a three-year time horizon would add much needed stability to fiscal frameworks.

3.7 "SURPRISE" FACTORS

(a) Finally, there are also "inevitable surprise" factors, that is, shocks that are difficult to predict for which fiscal leeway is required. The contingency reserve "top slice" amount that South Africa routinely sets aside should be commended and further strengthened.

(b) There are many issues that pose fiscal risks for South Africa. These issues range from explicit, legislated and commitment-related risks, to implicit fiscal commitments flowing from perceived role of government (e.g. dealing with effects of sea level rise, sectoral adjustments in agriculture, flooding, etc.). The question remains whether or not South Africa should tighten the fiscal policy framework further to take account of these long-term issues[9].

4. Revenue Estimates and Tax Proposals

4.1 Revenue Estimates and Specific Tax Proposals

(a) Table 3 below presents the changes between the 2011 MTBPS and 2012 budget:

Table 3. Revenue Source Revisions

R billion	2011 MTBPS	2012 Budget	% change
Taxes on income and profits	418.345	423.805	1.3%
Persons and individuals	252.75	249.7	-1.2%
Companies	144.165	152	5.4%
Secondary tax on companies	18.1	19.5	7.7%
Tax on retirement funds	0	0	
Other taxes on income and profits	3.33	2.605	-21.8%
Taxes on payroll and workforce	9.15	10.1	10.4%
Taxes on property	9.59	7.87	-17.9%
Domestic taxes on goods and services	274.21	264.65	-3.5%
Value-added tax	200.88	190.815	-5.0%
Specific excise duties	25.085	25.88	3.2%
Ad valorem excise duties	2.23	1.815	-18.6%
General fuel levy	36.9	37.18	0.8%
Other domestic taxes on goods and services	9.115	8.96	-1.7%
Taxes on international trade and transactions	30.325	32.31	6.5%
Customs duties	29.86	32.26	8.0%
Miscellaneous customs and excise receipts	0.41	0.005	-98.8%
Diamond export levy	0.056	0.045	-19.6%

Source: MTBPS (2011); Budget Review (2012); Commission's calculations.

[9] National Treasury's long-term modelling exercises would raise issues such as these.

A welcome revision comes in the form of a modest personal income tax relief amounting to some R9.5-billion. The tax burden on companies has been revised upwards since the 2011 MTBPS. In addition, taxes on international trade and transactions have been revised downwards possibly in a bid to bolster trade (i.e. carbon tax, through additional relief for trade-exposed sectors).

4.2 Consistency of Revenue Estimates

(a) Table 4 compares the forecasts and outcomes for total revenue as documented in the past three issues of the MTBPS as well as the past three issues of the budget. The idea is to provide some indication as to whether or not total revenue estimates are consistent. What the table below illustrates is, with the exception of 2010 MTBPS, the tendency of government to underestimate total revenue, as indicated by the differences between the outcome and MTBPS/budget (i.e. 1-year forecast horizon). When the forecast horizon is increased to 2 years, the differences are even larger, still indicating the tendency of government to underestimate total revenue. However, the forecasts are consistent in the sense that differences between outcomes and the MTBPS/budget become smaller as the forecast horizon decreases (also, differences between the outcome and the budget are smaller than the differences between the outcome and the MTBPS, in absolute terms).

Table 4. Total Revenue Estimates and Outcomes

Total Revenue	2009/10	2010/11	2011/12
2009 MTBPS	657.5	743.5	833.4
2010 MTBPS	-	761	843
2011 MTBPS	-	-	814.2
2010 Budget	657.6	738.4	827.7
2011 Budget	-	755	824.5
2012 Budget	-	-	830.2
Outcome	666.9	758.4	-
Difference between outcome and MTBPS			
1-year forecast horizon	9.4	-2.6	-
2-year forecast horizon	-	14.9	-
Difference between outcome and budget			
1-year forecast horizon	9.3	3.4	-
2-year forecast horizon	-	20	-

Source: MTBPS (2009, 2010, 2011); Budget Review (2010, 2011, 2012); Commission's calculations.

5. EXPENDITURE ESTIMATES AND PROPOSALS

5.1 EXPENDITURE ESTIMATES: FUNCTIONAL CLASSIFICATION

(a) Table 5 reports the changes between the 2011 MTBPS and 2012 budget:

Table 5. Expenditure Component Revisions (Functional Classification)

Figures for 2011/12 (R billion)	2012 Budget	2011 MTBPS	% Change
General public services	52.068	53	-1.8%
Defence	38.367	38.3	0.2%
Public order and safety	90.544	90.6	-0.1%
Economic infrastructure	81.494	77.4	5.3%
Economic services and environmental protection	53.077	52.4	1.3%
Local government, housing and community amenities	107.482	121.5	-11.5%
Health	113.796	113.2	0.5%
Recreation and culture	9.043	9.6	-5.8%
Education	195.483	190.8	2.5%
Social protection	144.693	147.8	-2.1%
Science and technology	9.856	7.3	35.0%

Source: MTBPS (2011); Budget Review (2012); Commission's calculations.

The following expenditure categories were revised downwards: general public service, public order and safety, local government, housing and community amenities, recreation and culture, as well as social protection. The Commission notes the downward revision of housing, a government spending component that can contribute to economic growth. Although this is possibly due to factors such as underspending and plans to support a more focused approach to delivery, such a revision could possibly compromise Government's outcome on human settlement in the face of growing backlogs. While government has indicated that continuing on a subsidy trajectory is not sustainable, any reform may require a budgetary injection. Welcome developments include the significant upward revisions for economic infrastructure as well as science and technology, as investment in these activities is important to economic growth. Investment in science and technology is an important element for the creation of a knowledge economy. In this regard, South Africa needs to put proper planning, economic and fiscal mechanisms in place and the role of innovation in this process should continue to be enhanced. With regard to infrastructure, even though it seems that government is being consistent, over the medium term, figures provided in the MTBPS have all been adjusted downwards in the 2012 budget, in contrast with government's commitment to investment in infrastructure. However, as noted earlier, this could be an indication of the shift in infrastructure investment towards social services (which is perhaps captured in the increases in spending on education over the medium term).

5.2 CONSISTENCY OF EXPENDITURE ESTIMATES

(a) Table 6 below compares the forecasts and outcomes for total expenditure as documented in the past three issues of the MTBPS as well as the past three issues of the budget. The idea is to provide some indication as to whether or not total expenditure estimates are consistent. What the table illustrates is the progressive tendency of government to overestimate total expenditure, as indicated by the differences between the outcome and the MTBPS/budget (i.e. 1-year forecast horizon). When the forecast horizon is increased to 2 years, the differences are even bigger, still indicating the tendency of government to overestimate total expenditure. However, similar to revenue forecasts, expenditure forecasts are consistent in the sense that differences between outcomes and the MTBPS/budget become smaller as the forecast horizon decreases (also, differences between the outcome and the budget are smaller than the differences between the outcome and the MTBPS, in absolute terms).

Table 6. Total Expenditure Estimates and Outcomes

Total Expenditure	**2009/10**	**2010/11**	**2011/12**
2009 MTBPS	841.4	905.6	975.6
2010 MTBPS	-	904.1	977.2
2011 MTBPS	-	-	978.8
2010 Budget	835.3	906.7	977.4
2011 Budget	-	897.4	979.3
2012 Budget	-	-	972.5
Outcome	832.5	885.8	-
Difference between outcome and MTBPS			
1-year forecast horizon	-8.9	-18.3	-
2-year forecast horizon	-	-19.8	-
Difference between outcome and budget			
1 year forecast horizon	-2.8	-11.6	-
2 year forecast horizon	-	-20.9	-

Source: MTBPS (2009, 2010, 2011); Budget Review (2010, 2011, 2012); Commission's calculations.

6. HOW CAN SOUTH AFRICA'S FISCAL FRAMEWORK BE IMPROVED?

6.1 FISCAL GUIDELINES

(a) The Commission notes that the principles of countercyclicality, long-term debt sustainability and intergenerational equity emphasised in the 2012 budget are a form of fiscal guidelines. Considering the criteria for a good fiscal rule (guideline) that are presented in international literature, the principles cited above broadly satisfy some of those, though not all (and they are not expected to satisfy all), criteria (i.e. well-defined; highly transparent; simple in the eyes of the public; flexible enough to accommodate cyclical fluctuations and exogenous shocks; consistent with other macroeconomic policies; adequate with respect to specific goals; enforceable in the given environment and supported by efficient policies). Though the principles pursued by government are broad and essentially flexible, continued commitment by government to consolidate the budget while adhering to the three principles in the MTBPS and the budget each year can enhance government's credibility. Long-term fiscal reporting can in principle reinforce these commitments as well as further enhance the quality and transparency of the public sector reporting and strengthening public confidence in public sector financial management.

(b) A related and important issue for consideration in strengthening fiscal frameworks concerns whether there should be legislative requirements for government to run balanced budget or whether this is implied in the PFMA/MFMA. Looking at section 230 of the constitution on provincial borrowing and section 230A, it is clear that both provinces and municipalities are permitted to run deficits only on their capital account (financed by borrowing). All current borrowing can be for bridging purposes only, within a fiscal year. Therefore the current budgets for both provincial governments and municipalities should be balanced. The PFMA and Borrowing Powers of Provincial Governments Act of 1996 regulate section 230, but the Borrowing Powers of Provincial Government's Act is outdated because it was drafted in terms of the interim constitution. The MFMA regulates section 230A of the constitution, mainly by providing a disclosure framework and processes for municipal bankruptcy. There are no legislative balance budget restrictions in respect of national government budget balances. The MBPARMA only looks at procedural checks and balances and full disclosure rather than substantive rules.

6.2 LONG-TERM FISCAL REPORTING

(a) In 2010 and 2011, the Commission proposed the following:

i. A "multi-pronged" strategy to take long-term fiscal concerns into account in the short- to medium-term planning. The tenets of this include a budget process and framework that recognises more clearly the long-term fiscal risks and builds on existing work, strengthened analytic approaches and a blend of aggregate fiscal rules.

ii. The political economy challenge of dealing with long-term fiscal policy issues requires provocation of public debate on long-term fiscal challenges – implied intergenerational tradeoffs, degree of risk aversion, etc.

iii. Pertaining to fairness, Government should be required to publish analysis of the distributional impact of new policies. Requiring such analysis as a rule on all new policy would be welcome, as would a requirement to publish assessments of the inter-generational or long-term impact of policies whose effects vary over time and/or generations.

(b) Hence, the Commission is in favour of long-term fiscal reporting as it is likely to further enhance the quality and transparency of public sector reporting and strengthen public confidence in public sector financial management. However, the real question pertains to the degree of influence that long-term fiscal reporting will exert over the policy debate and implementation (for example, in the instance that policymakers suggest the introduction of a programme that is threatening to compromise fiscal sustainability).

7. Recommendations

As a way of concluding, the Commission commends the Government for a well-crafted budget.

7.1 There is a firm commitment to fiscal consolidation and implementation of the countercyclical measures that were announced in 2009. The Commission's empirical assessment of the framework has shown that Government forecasts are consistent in the sense that differences between outcomes and the MTBPS/budget become smaller as the forecast horizon decreases (also, differences between the outcome and the budget are smaller than the differences between the outcome and the MTBPS, in absolute terms). This is welcome because the credibility of a medium-term framework is supported by projections that are realistic and reliable. This is a central part of budget preparation and in-year monitoring that is necessary to formulate appropriate policies, and to ensure realistic and reliable forecasts for revenue and expenditure. In order to ensure sustainability, it is necessary to maintain and enhance the capacity to make realistic and reliable forecasts for macroeconomic parameters and revenue and expenditure development beyond the Ministry of Finance to include other departments as well as subnational spheres of government. In order for the government and Parliament to allow the medium-term development to affect decisions on public finances, it is vital that all forecasts are and continue to be of the highest quality.

7.2 The Commission is of the view that the rising price of oil and administered prices could dampen an otherwise positive economic outlook for South Africa. From a policy perspective, such developments could have negative implications particularly for rural development objective of government. The Commission has done a substantial amount of work on these issues and would welcome an opportunity to brief the Committee on these if requested.

7.3 The efficiency and effectiveness of resource use must receive more attention. Performance based budgeting systems have a role to play here but the highest priority needs to be given to the incentives on officials to perform, particularly through better matching of authority and responsibility (through implementation of infrastructure strategy, reduce under-spending and eliminated bloated public sector).

7.4 The Commission supports the strategic phase of budget making with a document such as a long term fiscal plan tabled with MTBPS which contains a discussion of both long-term fiscal policy and sectoral priorities and policies. The Commission suggests that this document should be tabled in Parliament, preferably in advance of the preparation of detailed estimates.

For and on behalf of the Financial and Fiscal Commission

Bongani Khumalo (Mr.)
Acting Chairperson/CE