Mini-Budget 2015: More restraint needed

By Arthur Kamp

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In tandem, the slowdown in economic growth and a higher than expected increase in government's wage bill (even though the number employed on government's payroll have declined in recent years) continue to make it difficult for the National Treasury to balance the books.

Although the revised projection for the consolidated budget deficit of -3.8% of GDP for 2015/16 (-3.6% in 2014/15) is in line with the initial budget deficit for the year of -3.9% of GDP this, in part, reflects cancellation of the UIF-contribution holiday proposed in February 2015, which is expected to add around R15bn back to government's revenue projections for 2015/16.

Overall, weaker growth projections have lowered expected revenue collection by a cumulative R35 billion over the next three fiscal years. Accordingly, the Minister continues to pave the way to introduce higher tax rates or new taxes at some point, including carbon tax, a higher VAT rate, changes to estate duty and possibly the introduction of wealth taxes, along with a focus on reducing revenue loss through profit shifting and "misuse of transfer pricing". One hopes any tax changes will focus on indirect taxes rather than direct taxes. The latter discourage work, savings and investment.

Meanwhile, special appropriations for Eskom (R23 billion) and the New Development Bank (R2 billion) have been added to spending in the current fiscal year, although this is funded through the sale of state assets. As a result total spending is now projected at R1 379 billion in 2015/16, compared with the initial budget of R1 351 billion. Importantly, though, the National Treasury has kept support for the State Owned Enterprise and the Development Bank "deficit neutral".

In recent years the Treasury built up a soundtrack record by sticking closely to its expenditure ceiling. According to the Medium Term Expenditure Framework, the Treasury continues to stick closely to its previous expenditure projections in absolute terms (while using its contingency reserve to absorb the additional wage costs, which increase by 10.1% in the current fiscal year and by 2% in real terms per year in the following two fiscal years).

However, the disappointment in this Medium Term Budget Policy Statement (MTBPS) is the significant slippage evident in spending relative to GDP. Consolidated spending is projected to fall from 33.6% of GDP in 2015/16 (inflated by the special appropriations) to 32.5% in 2017/18 and 32.4% in 2018/19. This compares with the previous projection of 31.7% of GDP in 2017/18 published the February 2015 Budget Review. Of course, this reflects lower income growth in the economy. Also, the Treasury has, importantly, proposed a long-term fiscal policy guideline which links expenditure and GDP (that is maintaining expenditure as a stable share of national income). Even so, a spending level of 32.5% of GDP is disappointingly high.

All in all, the consolidated budget deficit narrows to -3.2% of GDP in 2017/18 (compared with the previous projection of just -2.5% of GDP), before easing further to 3.0% of GDP in 2016/17.

Following on from this, the Treasury's projections show the gross debt ratio stabilising at 49.4% of GDP in 2018/19 as the Main Budget primary budget deficit declines to 0.2% of GDP in that year. Net loan debt continues to edge higher over the three years from 43.5% of GDP at end 2015/16 to 45.4% of GDP at end 2018/19. This may not be especially high, but it leaves no fiscal space in the event of a sustained downturn in the economy.

Other than the poor performance of the economy, risks to the fiscal outlook include a lack of clarity over the funding of National Health Insurance and the performance of the State Owned Enterprises. As regards the latter, though, the Treasury has begun to address risks evident in State Owned Enterprises where it "intends to cost the developmental mandates undertaken by companies separately from their commercial activities, with the financial implications being more clearly set out in shareholder compacts". The Medium Term Budget Policy Statement indicates pilot projects are under way at a number of entities.

By budgeting for continued narrowing of the primary budget deficit to almost 0% of GDP by 2018/19, following the recorded improvement from -2.3% of GDP in 2012/13 to an expected -1.2% in 2015/16, the National Treasury has clearly signalled its intent to stabilise the debt ratio. This is underscored by its willingness to raise taxes if needed. Further, its track record on maintaining its expenditure ceiling in recent years is commendable. Also, revenue collection continues to perform well considering the state of real economic activity (although strong personal income tax collection reflects a marked increase in the level of tax collected relative to individuals' income levels).

However, while all of this is encouraging, it is also evident South Africa's lower potential growth rate demands a renewed focus on expenditure restraint. Indeed, it seems fair to argue the current depressed level of growth cannot support the intended level of government spending. The Treasury's proposed long-term fiscal policy guideline is an appropriate response. Now it needs to implement it. Until then, the jury is out on long-term fiscal sustainability.

ABOUT ARTHUR KAMP

Arthur Kamp is an economist at Sanlam Investments (SI).