Budget 2010: Still a Rocky Road Ahead

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Budget 2010: Still a Rocky Road Ahead

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2010
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1. **Introduction**

It was already clear in Pravin Gordhan’s first medium-term budget policy statement (MTBPS) in October 2009 that a substantial adjustment needed to be made to public finances over the next few years. Though the South African economy has formally moved out of recession, and though some indicators, such as household consumption expenditure, are improving, economic recovery will be slow. This means, of course, that the recovery of tax revenue will also be slow. Doing more with less, and how to actually achieve this, should therefore be a key aspect of budget debates in the next weeks and months.

Though the 2010 Budget does stress the scarcity of recourses and presents a muted increase in government sending, it also introduces a number of potentially significant interventions aimed especially at the problem of unemployment in South Africa. The wage subsidy for first-time workers and the commitment of real resources to the proposed Industrial Policy Action Plan are two such interventions on which more detail will be provided in the coming months. The Budget Speech also provided welcome certainty on a number of questions that have generated speculation over recent months, such as changes to the monetary policy framework.

As the discussion that follows explores in more detail, Budget 2010 assumes that the worst of the recession is over, that recovery will be slow but consistent, and that finding solutions to the problems of unemployment and inequality in particular cannot be postponed until a more favourable context arrives. By 2014 South African public debt will have risen from the current 23% of GDP to over 40% of GDP as a result of the proposed deficits of 6.2%, 5% and 4.1% over the coming three years. Though such a debt position remains sustainable, much will depend on the social and economic return from spending over the next three years. The Budget Speech was therefore quite right to emphasise issues of efficiency and performance against agreed output and outcome measures.

2. **Fiscal Policy in Budget 2010**

From about 2002 to 2007 the South African economy grew at a fairly healthy rate as a result mainly of a global commodity boom. Higher growth meant more tax revenue, and the period saw real increases in the resources available to government to fulfil its objectives. At the peak of
these ‘boom years’, the fiscal authorities were in the enviable position of being able to increase government spending at a faster rate than GDP growth and significantly increase public gross fixed capital formation, yet simultaneously run budget surpluses, that is contribute to aggregate savings in the economy.

Though household poverty almost certainly declined over this period and a significant number of jobs were created, the unemployment rate remained quite high and new entrants to the labour market found it particularly hard to find employment. At the same time, as the latest development indicators confirm, inequality probably increased over the period and a number of indicators of wellbeing, such as life expectancy and maternal, infant and child mortality rates have not improved much, and have deteriorated in some instances.

The 2009 MTBPS clearly reflected the changed economic and fiscal circumstances. Growth expectations were revised downward significantly, and it was tax revenue expectations especially that required adjustment. As a result, simply to maintain spending commitments over the medium term, the Minister of Finance adjusted the deficit estimate for 2009/2010 from the 3.8% proposed in February 2009 to 7.8%.

Budget 2010 suggests that the 2009 MTBPS adjustments were realistic and accurate. Tax receipts up to the end of December 2009 are fairly well aligned with MTBPS estimates, and in fact may exceed those estimates in the fourth quarter if consumption demand in particular improves further. In light of these revenue trends, and a fairly stable expenditure pattern, Budget 2010 is probably correct in anticipating a 2009/2010 deficit of about 7.3%, which is slightly less than the 7.6% estimated in the MTBPS. The deficits of 6.2%, 5% and 4.1%, which are proposed for the next three fiscal years, are certainly still larger than the pre-crisis ones, but are required in order to maintain public spending along its current trajectory.

Risk assessments of the sustainability of debt in 2014 and onward make it clear that much will depend on the growth rate of the economy over the next three years: if growth remains muted for longer than anticipated, then spending cuts, further high deficits, or increased tax rates will be required in future. However, if the South African economy grows at about 2.5% or higher in the 2010/11 fiscal year, and higher than 3% after that, then debt levels should not lead to a significant fiscal impasse. Such growth rates are, in fact, well aligned with consensus views for the next few years.
3. **Spending Priorities and Resource Constraints in Budget 2010**

Budget 2010 retains the broad prioritisation of recent budgets and introduces some new initiatives. Figure 1 below represents proposed allocations of consolidated government by function for the current medium term.

**Figure 1: Trends in Real Consolidated Spending by Function**

![Bar chart showing trends in real consolidated spending by function from 2009/2010 to 2012/2013.]

The nominal values provided in the *Budget Review* have been adjusted for inflation\(^8\) in order to gauge to what extent, and for which functions, the medium-term allocations do in fact provide more real resources. Small real increases from 2009/2010 to 2010/11, reflecting some of the stated budget priorities, can be seen for Health, Education and Social Protection as well as for Housing and Community Amenities and Public Order and Safety. The real increases in allocations to Social Protection reflect increases in eligible beneficiaries as a result of more poverty stemming from recent job losses, the extension of age-eligibility to 18 over the next two years, and improvements in take-up as newly eligible beneficiaries begin to claim their transfers.
On the other hand, allocations to General Public Services decline in real terms over the entire medium-term period, as do allocations to Defence and Economic Affairs. In the latter case this decline results from the substantial reduction in allocations to Fuel and Energy, from some R38.8 billion in 2009/2010 to R9.5 billion by 2012/13, as government begins to downscale fiscal transfers to infrastructural development in the sector.

What even a cursory glance at Figure 1 makes apparent is that, at this stage, very little if any real increase in spending is anticipated in the 2011/12 Budget. Virtually all allocations for the 2010 Budget, in other words, will only stay the same or decline from April 2011 onward. This gives some further sense of the resource-scarce environment of the present. This should not surprise one, though the bleakness of the 2011/12 context in particular is to some extent disguised by the small real increases in Budget 2010 and the increases anticipated in 2012/13. To give a further sense of this situation, it is worth pointing out that it is possible that allocated expenditure in the consolidated government spending classification (that is to say, excluding debt costs and the contingency reserve) may well decline in real terms from 2010/11 to 2011/12. The nominal percentage change in total allocated expenditure between these two years is 5.7%, which is, in all likelihood, less than the rate of inflation will be. If one adds the 2011/12 contingency reserve to allocated expenditure, then the nominal increase is approximately 7.1%, slightly larger than the anticipated inflation rate.

The exception to this slowdown in real spending increase is of course debt servicing, stemming from the 2009/10 deficit (estimated now at 7.3%) and the proposed deficits over the medium term. As the Budget Review states, debt service costs increase by a nominal annual average of almost 22%, or about 16% in real terms. Some crowding out of other spending as a result of debt commitments will of course occur in the period ahead and is an unavoidable result of the deficit-financed response to the global crisis and its impact on the South African economy. South Africa’s response could not, however, have been significantly different and the South African economy as well as public finances have weathered the storm better than many. Furthermore, the medium-term proposals in Budget 2010 that entail real spending decreases or maintenance of the status quo come after a number of years of a cash-flush fiscus following the commodity boom and other factors. In a more austere environment, departments may learn valuable lessons about how to maximise the impact of what they do, lessons that are more difficult to learn in a period of plenty because the pressure to do so is less.
4. Service Delivery, Value for Money and Oversight

Value for money, then, is the crucial dimension of public finances in the coming resource-scarce period. The period of comparative resource scarcity will extend not only over this medium term – that is to the end of fiscal year 2013 – but substantially further than that. Even a strong growth and tax recovery by, say, 2012 would, from a fiscal perspective, be muted because of the need to prioritise reducing the debt stock before opening up further space for additional spending.

The consequent emphasis in the Budget Speech on cutting out the ‘bells and whistles’ in departments, and in reducing corruption, as well as on enhancing efficiency and service delivery, are a welcome shift in emphasis away from allocations only. It is regrettably the case that, although South Africa did experience an economic as well as fiscal ‘boom’ up to 2008, many indicators of wellbeing and of human capacity development did not shift much over this period. Life expectancy and infant, child as well as maternal mortality rates have not improved much and, in some cases, have deteriorated. Similarly, despite large resource allocations, it is now well documented and widely recognised that South African pupils perform poorly as regards educational attainment compared to similar countries. Similarly, service delivery protests in the last few years have suggested poor performance in the delivery of basic services such as electricity, water, sanitation, and housing. The most recent Auditor-General’s Report on the Audit Outcomes of National and Provincial Departments also indicates that the majority of departments still struggle to meet the requirements of the Public Finance Management Act and, perhaps even more worryingly, suggests that departments’ financial management quality may have deteriorated rather than improved recently.

Budget 2010 recognises that the challenge for South Africa now is to get more from less and to address governance challenges that impede the translation of resources into outcomes. The 2010–14 Outcome Targets presented recently by Minister Chabane, and included in the Budget Review, do have the potential to strengthen accountability and therefore also efficiency. They are, however, understandably broad. The more specific outputs, which are intended to give effect to the outcomes, are a useful means of overseeing government and assessing the success or failure of the budget in changing the lives of South Africans. However, to give real effect to such a performance-oversight framework requires robust multi-
stakeholder engagement and an ongoing conversation about what is being achieved and what is going wrong in the public sector.

It is very important that Parliament as well as civil society participate in monitoring and evaluating against the criteria established by Minster Chabane. Parliament’s authority over the budget has been substantially increased from this year onward as a result of the legislation passed in 2009 giving it extensive power to amend the budget proposed by the executive. At present Parliament is still developing the institutional capacity to utilise this authority, and it may be some time before it possesses the requisite analytical support to add value through actual amendment. However, the addition in the Budget Review of a Report by the Minister on Parliament’s MTBPS recommendations is a welcome move towards more cooperative executive-legislative relations when it comes to the budget. A legislature that is perceived as a meaningful site for budgetary engagement will also attract more and better civil society engagement, which in turn can enhance both the allocative and operational efficiency of the budget.

5. Job Creation

The Minister’s Budget Speech as well as the Budget Review placed a great deal of emphasis on the general structural unemployment problem of South Africa as well as the large numbers of jobs lost (870 000) in the course of 2009. A related dimension of the challenge is the particularly high incidence of unemployment among South African youth.

Budget 2010 correctly recognises that in the long run only economic growth and associated improvements in export performance and diversification will create the jobs that South Africa needs. A key ingredient of improved economic performance is of course an effective education and training system; as noted earlier, resources going to these functions appear to be adequate but results are often disappointing.

In addition to education and skills development, however, Budget 2010 also touches on a number of micro-measures. Not surprisingly, there is mention of the existing Phase 2 of the Expanded Public Works Programme (EPWP): the EPWP has created short-term opportunities as well as skills transmission, but it clearly cannot be the solution to South Africa’s challenge, given its reliance on government subsidisation. Budget 2010 also provides some indication, emphasised by the Minister in his Budget Speech, that a wage subsidy for first-time youth workers be made
available. The subsidy would, it is anticipated, compensate employers for the perceived risks of hiring inexperienced workers. Though the idea has merit, and its focus on the youth is welcome, more detail is needed and it is likely that such a programme will prove to be quite administratively cumbersome. In addition, it remains to be seen whether employers would in fact respond in the desired manner to the subsidy incentive.

Budget 2010 also makes it quite apparent that government is willing to reassess a number of existing policies and pieces of legislation in order to create jobs and establish a more labour-absorbing economy. Implicit in a number of sections in the chapter on Employment in the Budget Review is the suggestion that labour legislation needs to be reassessed and that closer alignment between wages and productivity needs to be established in the public sector. Thus, with reference to youth unemployment in particular, the Budget Review notes the possibility of changing minimum wage legislation so that employers are more likely to hire youthful workers. From a broader perspective, the Industrial Policy Action Plan is expected to provide more detail on the structure of incentives available to businesses to encourage labour-intensive growth and the retention of workers.

The emphasis on job creation is of course aligned with the priorities of government’s medium-strategic framework and the concerns of South Africans. Unemployment has remained the central challenge for economic policy in South Africa, and the urgency of the challenge has only increased in the wake of the recession. Innovative measures, such as the wage subsidy and an effective industrial policy, are needed. But the challenge will be in the implementation and in the way in which businesses and job seekers respond to the incentives provided by government.

6. Conclusion

The 2010 Budget is largely successful in the realism of its growth and tax revenue assumptions, in the priorities to which it allocates additional resources, in the clarity it provided on questions such as possible changes to the monetary policy framework, and in its emphasis on eliminating inefficiencies that reduce the impact of the budget. In the wake of the recession, South Africa’s challenges around unemployment, inequality and poverty are more acute than ever, with fewer resources available for addressing them. Multi-stakeholder involvement will be particularly essential going forward.
Though the focus on job creation is welcome, for many of the key initiatives – such as a potential wage subsidy as well as the Industrial Policy Action Plan – detail will be provided in the weeks and months ahead. There is some evidence of the failures of government entities to successfully administer complex programmes aimed at skills development and job creation: care needs to be taken now to attain the desired outcomes and avoid further disappointment.

It is possible that the October 2010 MTBPS will in fact provide a further upward adjustment of growth and revenue estimates. However, the likelihood is that we have entered a period of comparative austerity, which will require changes in the way government departments conceive of what they do and which require effective oversight if allocations are to achieve what they are intended for.