



Western Cape  
Government

Provincial Treasury

# Fiscal Policy Seminar

A strengthened approach  
toward a budget for  
growth

**2016**

28 October 2016

**Compiled by:** Public Policy Services - Provincial Government Budget Office and  
Fiscal Policy Unit

## 2016 FISCAL POLICY SEMINAR

*“A strengthened fiscal approach towards a budget for growth”*

### 1. BACKGROUND

The current environment is one of constrained economic conditions, linked to the weakened global environment and structural challenges in the domestic economy. Pressure on tax revenue and government services as well as rising debt-service costs has collectively aggravated the constrained fiscal context in South Africa. Political and policy uncertainty as well as pressure by credit rating agencies has called for a firm approach to addressing the current economic climate and fiscal constraints.

This year marked the second iteration of the Western Cape Provincial Treasury's Fiscal Policy Seminar. The seminar builds on the premise of shared fiscal and economic ideas and was attended by representatives from various Provincial Treasuries, academic institutions, district and municipal representatives, private sector organisations, Western Cape Government provincial departments and other independent institutions. Economists and Fiscal Policy experts from various institutions presented and shared their views with the Western Cape Minister of Finance – Dr IH Meyer and participants at the Fiscal Policy Seminar. Presenters at the Fiscal Policy seminar included:

- Dr IH Meyer – Western Cape Minister of Finance
- Ms Marcia Korsten – Western Cape Provincial Treasury
- Ms Busisiwe Radebe – Nedbank Economist
- Mr Michael Sachs – National Treasury
- Prof Jannie Rossouw – University of Witwatersrand
- Prof Lieb Loots – Economist
- Dr Ramos Mabugu – Financial and Fiscal Commission

Being a responsive Government means that while the economic and fiscal outlook is pessimistic, the Western Cape Government (WCG) will continue to explore mechanisms that address some of these challenges with the aim to maintain this Province's commitment toward developing a fiscal framework which gives effect to *inclusive, smart and sustainable growth*. This report provides a summary of the key presentations and discussions of the Fiscal Policy Seminar which feeds into the 2017 – 2020 Provincial Medium Term Budget Policy Statement (MTBPS) and the 2017 Budget address.

*The views, comments and discussions expressed in this report are that of participants at the 2<sup>nd</sup> Annual Fiscal Policy Seminar and does not reflect the views of the Western Cape Government, unless otherwise stated.*

## 2. THE PROVINCIAL TREASURY: REFOCUSING THE WESTERN CAPE GOVERNMENT FOR A CONSTRAINED FISCAL ENVIRONMENT

### Dr IH Meyer

- The Fiscal Policy Seminar serves as an economic and fiscal policy think tank which will assist to inform the Provincial Medium Term Budget Policy Statement and the 2017 Budget in March 2017.
- The WCG has been engaging with Minister Gordhan on the fiscal environment and the proposed budget reductions and its implications for the Province.
- Dr IH Meyer recommended the use of a Good Financial Governance Incentive Grant to incentivise positive service delivery trends and impact/gains made.
- Risks related to state guarantees, a bloated government and corruption was highlighted as well as the unsustainable bloated civil service and wage bill that needs to be addressed.
- South Africa's national debt levels places the country under severe pressure.
- **The national democratic revolution is currently taking the path of fiscal expansion. Fiscal expansion without fiscal discipline will subsequently lead to fiscal erosion.**
- The WCG has aligned itself to the National Development Plan and focuses on fiscal consolidation, fiscal discipline and fiscal sustainability.
- Policy principles underpinning the WCG's budget process: constitutionalism, evidence- based, public value, rule of law, partnerships, whole-of-society and citizen-centric.

### Ms M Korsten

- **A key focus of the WCG is enabling inclusive growth**, which does not only focus on increasing economic growth but economic growth which empowers people through employment opportunities and increased welfare.
- The Western Cape economic outlook indicates that the provincial economy is slowing in line with the national economy and is vulnerable to any further international and domestic shocks.
- The fiscal outlook is constrained while fiscal consolidation has resulted in potential reductions in baseline allocations to the Province.
- However, economic opportunities for the Western Cape include value chains in agri-processing and tourism and Africa as a destination for exports.
- Challenges include drought, the current water crisis and recent economic developments in the UK and Euro area impacting on trade.
- **Considering the constrained economic conditions, government needs to adopt more innovative and entrepreneurial approaches.**

- The fiscal framework of the WCG is underpinned by fiscal and budget policy principles tabled in the 2016 Budget, and built on in the 2017 planning and budgeting process: allocative efficiency, fiscal sustainability, fiscal consolidation and fiscal discipline.
- The WCG's budget policy priorities are aligned to and support the National Development Plan and Inclusive Growth.
- **The 2017 Budget theme: "Integrated Management and Partnering to deliver a Budget for Growth"**- focuses on integration, responsiveness to the economic and fiscal context, giving effect to policy priorities and social and economic objectives and promoting innovation.
- **Integrating local, provincial and national budgets in the Western Cape to create service delivery impact is important.**
- A budget for growth looks at three areas: inclusive, sustainable and smart growth.
- **Fiscal Rules in support of National and Provincial Fiscal policy:**
  - *Budget balance rules* - a budgeting approach and adjustment budget process towards fiscal stabilisation, sustainability and a risk adjusted budget.
  - *Expenditure rules* - managing expenditure growth, placing expenditure ceilings on Cost of Employees.
  - *Revenue rules* - enhance provincial own revenue, through Domestic Resource Mobilisation to optimise collection potential and generating own revenue - focusing on using revenue to maximise impact.
- **The Western Cape has already made progress to identify and implement initiatives which are aligned to the key themes of the National MTBPS:**
  - Containment of personnel expenditure - upper limits on Cost of Employees.
  - Enhance revenue collection: Provincial Domestic Resource Mobilisation Strategy.
  - Underperforming programmes and entities - Review of Public entities.
  - Cost-containment measures applied and extended to municipalities.
  - Improvements in Infrastructure spend: Strengthening of the Infrastructure Delivery Management System and the Ministerial Infrastructure Committee.
- **Procurement** efficiencies and effectiveness **linked to economic development** as well as **Infrastructure being key to boosting the economy.**
- The budget is no longer just about the numbers, but about limited resources and hard trade-offs and a focus on the more effective use of resources.
- The focus is on integrating planning and budgeting for service delivery impact and public value and **INCLUSIVE GROWTH.**

### 3. NEDBANK: STATUS: IT'S COMPLICATED: AN OVERVIEW OF THE SOUTH AFRICAN ECONOMY

#### Ms Busisiwe Radebe

- On average South Africa slower GDP growth since 2010.
- Factors influencing SA's slow growth includes: Subdued global demand and the slump in global commodity prices impacting on SA exports and China growing slower and differently.
- South Africa's challenges: production costs and labour (expensive to productivity), compliance costs and red tape, inefficient government services & corruption, costs of electricity - electricity production has declined since 2011 - low growth reason for no load shedding.
- Nedbank growth forecasts: 0.2 per cent in 2016, 1 per cent in 2017, 1.5 per cent to make a difference SA needs to grow at 6 per cent.
- Current realities and recent developments do not match up with what the NDP intended to achieve.
- **South Africa is scoring "own goals".**
- Increasing trend in public sector jobs are insufficient to compensate fully for stagnant to falling private sector employment - **the private sector and the public sector each have their roles to play in this economy.**
- High unemployment and the slowdown in consumer spending are likely to intensify which impacts on the economy.
- **South Africa's high debt burden places the fiscus under pressure.**
- South Africa can still be downgraded at the end of this year or throughout next year – although it is unlikely this year.
- Options to stimulate the economy:
  - Fiscal policy (however given the period of fiscal consolidation fiscal policy cannot be expansionary anymore);
  - Monetary policy (inflation above 6 per cent will not lead to drop in interest rates); and
  - Structural reform (**there is a need for structural reform to turn the economy around-economic transformation**).

### Discussion:

- We need a **clear agenda articulating the framework to change South Africa's current low-growth path and reduce unemployment.**
- The right policies are in place but implementation requires focus.
- The fiscal rules should be reviewed in light of the constitutional mandate of the WCG also noting the opportunities of own revenue streams and the functions of municipalities and how it relates to domestic resource mobilisation.
- We need to look at what government should stop doing: Maintenance, Innovation, Termination and Succession methodology as well as monitoring and evaluation of budgets.
- Government should not be an interventionist but should create an enabling environment through levers such as red tape reduction, energy security, skills development, etc.
- The importance of enhancing partnerships and integrating with the private sector to further enhance economic development.
- It will get better – a threat of a downgrade is effective as it places the necessary pressure on decision makers– competition also drives the implementation of our policies.

## 4. NATIONAL TREASURY: OVERVIEW OF THE 2016 NATIONAL MEDIUM TERM BUDGET POLICY STATEMENT

### Mr M Sachs

- South Africa is currently going through a difficult economic transition where the world economy is less robust and more uncertain than before.
- To grow faster and generate enough revenue the economy needs higher levels of private investment - **low confidence remains the largest obstacle to growth.**
- Government is committed to partnerships to aide in inclusive growth.
- Over the medium term, government intends sustaining real growth in the budget albeit minimally so - public finances will face trade-offs in the coming years.
- **The National MTBPS proposes fiscal consolidation, reducing the expenditure ceiling by R10 billion in 2017/18 and adding R13 billion in revenue measures – combined measures bring total tax increase for 2017/18 to R28 billion.**
- Provincial budget reductions are on the cards.
- **Infrastructure investment will be prioritised.**
- Some African countries are however still growing at more than 5 per cent, so we may want to look at **greater regional economic integration.**

- The NDP goals and targets were premised on a 4 per cent growth environment; however 2 per cent growth is the new normal.
- Private sector balance sheets are healthy (low debt), but no investment because of lack of confidence (political risk/policy uncertainty) resulting in little investment in the domestic economy.
- There is a platform for economic recovery, however if confidence is not restored then South Africa will struggle to reach their goals.
- Emerging factors for recovery:
  - Real exchange rate depreciation
  - Moderate rebound in commodity prices
  - Consumer spending improves on lower inflation, wage growth
  - Easing of drought conditions
  - Improvement in electricity supply
  - Investment recovery on lower borrowing costs and higher capacity utilisation
  - Sustained public investment
- **To create the conditions for more rapid growth, fiscal policy aims to deliver a measured consolidation that avoids a sharp contraction in expenditure, and stabilises national debt as a share of GDP.**
- 2 Fiscal Challenges:
  - **Low Growth Trap** (short to medium) with decisive action required to restore confidence. In this regard it was suggested that the political risk must be taken away and articulate a clear vision.
  - **Realising the aspirations of the constitution (long term) will require trade-offs.**
- **A package of actions to restore confidence include:**
  - Finalising a regulatory framework for private-public participation in infrastructure projects.
  - Addressing legislative and regulatory uncertainty that holds back investment.
  - Rationalising, closing or selling off public assets that are no longer relevant or central to achieving NDP objectives.
  - Concluding labour market reforms.
- There is an inherent tension between fiscal consolidation and growth.
- Need to **interrogate the quality of expenditure.**
- Efficiencies may equate to savings but that does not mean you spend less, those funds are re-directed into other areas and in so having better spending.
- Need to articulate the vision for the country to turn the economy around.

### Discussion:

- On the credibility of fiscal targets: the 49 per cent debt to GDP is merely where the National Treasury would like to stabilise the debt to GDP ratio over the 2016 MTEF.
- The Nuclear build initiative: guiding principle for NT is to ensure what is in South Africa's interests and not that of Eskom.
- Political and economic issues within a municipal space relates to a breakdown of trust between leaders and their communities: the importance of leadership, trust - citizens must be able to trust the political leadership that serve them.

## 5. UNIVERSITY OF WITWATERSRAND: ECONOMIC AND FISCAL HEAD WINDS FACING SOUTH AFRICA

### Prof Jannie Rossouw

- **The danger of a fiscal cliff requires fiscal consolidation**, however, it must be measured - balance the requirements between fiscal consolidation and structural reform.
- Strong point that South Africa and the Western Cape is a services economy given its size and structure.
- **The 'pain' of fiscal consolidation should be accepted as it is needed.**
- Social grant expenditure and civil service remuneration is absorbing government revenue.
- The interest burden of government debt is a specific concern.
- Government debt is becoming a burden and there are an excessive number of hidden structural costs which have been identified as an issue - Bureaucratic oversupply/ bloated public service.
- Since the introduction of the concept of the fiscal cliff, it has become part of South Africa's lexicon. However the current thinking is around the **fiscal cliff is now been seen as a fiscal plateau** (stabilisation of public debt). Significant steps have been taken by National Treasury to avert the fiscal cliff.
- It is important as the biggest economy in Africa to defend this position, strengthening the notion of South Africa as the gateway into Africa from an investor perspective.
- Specific challenges relate to the population growth of 1 per cent, whilst economic growth at 0.5 per cent. Hampering the implementation of the NDP is the growing unemployment.
- Limited additional tax revenue sources and personal income tax carrying a heavy burden (and is not sustainable).
- SACU partner transfer payments becoming an issue- we need to rethink transfers.
- Restoring confidence in South Africa's leaders is important (state capture report presents risks).

- Concluding remarks include:
  - Picture of continued tight fiscal position emerges
  - Limited additional tax revenue sources
  - Implication is that we should rethink current policies

#### **Discussion:**

- Speaker recommends an increase in marginal tax rate for higher income earners and increasing income tax - however the speaker is against the wealth tax.
- Need to improve revenue numbers through growing the economy, whilst remaining on a sustainable path.
- Labour unions and the wage agreement: very volatile world yet we engage in 3 year wage contracts therefore reducing flexibility.

## **6. FISCAL CLIFF OR FISCAL RIDGE: THE ROLE OF THE PROVINCE AS AN ENTREPRENEURIAL STATE**

### **Prof Lieb Loots**

- Lessons from Europe:
  - Countries with low investment in Research and Development (R&D) will have lower GDP growth and are also fiscally more vulnerable to shocks.
- Countries that failed to invest (for decades) in areas that increase economic growth were the hardest hit by the financial crisis (2007).
- Innovation can be the only real driver of growth through increases in productivity and competitiveness.
- No country has ever grown without major investments in key areas such as education, research and human capital formation.
- These investments along with institutional 'systems' of innovation which promote horizontal linkages between areas like science and industry are core to a country's competitiveness.
- Short- term fiscal discipline cannot avoid long- term fiscal vulnerability without investment in innovation.
- **SA needs policies that are aimed at smart, innovation led growth that's also inclusive.**
- Entrepreneurship of the state is important to help create new markets and sectors. Also the state has a role to play in creating innovation where the private sector may not be prepared to invest in.
- Therefore, the **State should not sit back and allow market forces to dictate but rather lead the way through partnerships, investment in innovation, and development of new markets and sectors to foster more economic growth.**

- Policy options for the government include:
  - Facilitate industrial structure in the secondary and tertiary sectors. However, a lack of skills in the labour force and high labour unit cost may limit growth in these sectors.
  - The solution is to have innovation that increases productivity and competitiveness in an inclusive manner.
  - Government should think big by identifying and creating new opportunities; making the initial large necessary investments; enabling a decentralised network of actors and allow development and the commercialisation process to occur in a dynamic way.
  - Smart, inclusive and sustainable growth is growth by innovation, supported by an entrepreneurial state.

### Discussion:

- What does the entrepreneurial state/role for provinces mean?
  - There are certain investments that the private sector cannot and will not make, either due to the upfront costs required or the length of time taken for a return on investment.
  - Capital returns can take 10 – 20 years whereas venture capital requires a return over 3 year period.
  - **Government has a role to play in fostering entrepreneurship through procurement to support development of new technologies.**
  - Military/public investments are often a key driver of innovation which spill over into the private sector, e.g. Apple.
- Institutional culture needs to be innovative and there is a need to learn from failure.
- Government is driven by compliance and the dominance of a risk avoidance culture, and there is a **Need to foster the space for innovation and a prototype culture.**
- Where do you locate the economic function/LED within municipalities, there is a need to influence, persuade and convince, rather than only focus on operationalising.

## 7. FINANCIAL AND FISCAL COMMISSION: IMPACT OF AGGREGATE REVENUE AND EXPENDITURE ASSIGNMENTS ON ECONOMIC GROWTH IN SOUTH AFRICA

### Dr Ramos Mabugu

- The objective is to analyse and evaluate the effect of subnational fiscal policies (revenue and expenditure) on economic activity, more specifically:
  - To empirically implement a framework that puts an increased role for provinces through fiscal policy in economic growth in a national growth context.
  - To compare different components of provincial social expenditure in terms of their effects on economic activity.
  - To compare provincial social expenditure components to other types of public expenditure in terms of their effects on economic activity.
  - To consider the crowding in (or crowding out) effects of social spending on consumption and investment.
- There are not many growth levers at the provincial level; however, **labour and capital contributes positively to provincial economic growth** therefore if provinces perform the basics of **Education, Health and Infrastructure** properly the **economy will benefit**.
- Results at the provincial level show that the **revenue lever can stimulate economic growth**; this is because provincial revenue collectors are able to take advantage of their superior knowledge concerning local affairs, which contributes towards a healthier fiscal position and has a positive effect on economic growth.
- Provinces have inflexibility in managing their budgets due to their dependence on national transfers.
- Identifying the appropriate level of fiscal decentralisation is an important area for future research.
- The present low economic growth environment may be an opportune time for presenting arguments to National Treasury for greater own revenue assignment in order to reduce the reliance on transfers.
- There is a need for municipalities to improve existing revenue collection efforts as this can contribute positively towards economic growth.
- Statistical evidence of a long run relationship between social spending and economic growth is not robust, in the short run, expenditure in social development, other (non- social sector) expenditure and private capital contribute to economic growth.
- Recommendation is that it is time to argue for a costed norms approach to measuring provincial expenditure needs to foster adequacy and accountability.

### Discussion:

- Municipalities should investigate options to provide shared services through shared services agreements, piggy backing on property rates, resorts.
- Possibility of introducing innovative levy's e.g. a District Municipality has introduced a fire levy.

## 8. DR IH MEYER'S CLOSING REMARKS

- The seminar is designed to think on three levels:
  - First level of thinking is on a **conceptual level**; presenters provided for conceptual thinking around the concept of the fiscal cliff and fiscal ridge that the National and Provisional economy is currently facing.
  - Second level of thinking is on a **factual level**; presenters also provided insight on the GDP growth rates of the country; debt service costs; the wage bill; current budget deficit, etc.
  - Third level of thinking is on a **value level**; the seminar is designed to assist in passing value judgement and the points raised include the effectiveness of government processes; value propositions; political economy issues.
- There has been a general consensus that the way forward to grow the economy is through instruments in fiscal policy, monetary policy, but most importantly, through structural reform.
- There is a need to focus more specifically on innovation in government in order to grow the economy.
- However, government should not invest in wasteful entrepreneurial ventures.
- There is a dire need for a capable state, rule of law, ethical and effective leadership in the country.
- Investment in health, education and infrastructure is key for economic growth.
- WCG focuses on asymmetrical economic development and invests in the growth potential of a town/municipality.
- WCG believes that economic development can be reached through the implementation of the National Development Plan.

08:15 – 09:00	<b>ARRIVAL AND REGISTRATION</b>
09:00 – 09:10	<b>Opening</b> Mr Harry Malila, Programme Director
09:10 – 09:30	<b>Refocusing the Western Cape Government for a constrained fiscal environment</b> Dr Ivan Meyer, Western Cape Minister of Finance
09:30 – 09:50	<b>It's complicated: An overview of South Africa's Economy (Fiscal implications)</b> Ms Busisiwe Radebe, Nedbank Economist
09:50 – 10:10	<b>Questions and Discussion</b>
10:10 – 10:30	<b>Overview of the 2016 National Medium Term Budget Policy Statement</b> Mr Michael Sachs, National Treasury Budget Office
10:30 – 10:50	<b>Economic and fiscal headwinds facing South Africa</b> Prof Jannie Rossouw – University of Witwatersrand
10:50 – 11:10	<b>Questions and Discussion</b>
11:10 – 11:30	<b>TEA/COFFEE</b> Ms Marcia Korsten, Programme Director
11:30 – 11:50	<b>Fiscal cliff or fiscal sharp ridge – The role of the Province as an Entrepreneurial State</b> Prof Lieb Loots - Economist
11:50 – 12:10	<b>The Impact of Aggregate Revenue and Expenditure Assignments on Economic Growth: The Case of Provinces and Municipalities in SA Intergovernmental Relations</b> Dr Ramos Mabugu – Financial and Fiscal Commission
12:10 – 12:30	<b>Questions and Discussion</b>
12:30 – 12:45	<b>Summary of Key Points</b> Ms Marcia Korsten, Programme Director
12:45 – 13:00	<b>Closing Remarks</b> Dr Ivan Meyer, Western Cape Minister of Finance
13:00 – 14:00	<b>LUNCH</b>



BETTER TOGETHER.

## FISCAL POLICY SEMINAR PROGRAMME – A strengthened fiscal approach towards a budget for growth

Friday, 28 OCTOBER 2016

VENUE: FIRE AND ICE, PROTEA HOTEL, CAPE TOWN

