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BUDGET SPEECH 1996 BY THE MINISTER OF FINANCE, MR CF LIEBENBERG, 13 March 1996

INTRODUCTION

The many outstanding achievements by South Africans in team and individual sport events stand out among the highlights of the past year. In celebrating these accomplishments, one sometimes forgets the prerequisites for success. These include self discipline, sacrifice, fitness, skills, training, playing to the rules of the game and good strategic planning. A successful budget outcome and the effectiveness of government as a participant in the economy depend on a broadly similar approach. But, unlike in sport where the rules of the game, the referee and the playing field are predetermined, government not only participates or competes in the economy by supplying and purchasing goods and services; it also lays down many of the rules through legislation and regulations and it acts as a referee. Often government also acts as a groundsman levelling the playing field for all participants, making sure that spectators can see the game and also policing the behaviour of the crowd. Being a good government requires practice.

The majority of government actions have financial effects and are reflected in the government's budget, which in turn reflects government's involvement in the economy and in society in general. Accordingly, the budget must show how all the activities of government fit together in a sustainable and affordable way.

In achieving a successful transition to an economically sound, open, democratic dispensation each budget of the Government of National Unity will have to achieve certain objectives. These objectives are concerned with the unfolding and implementation of policy and dealing with major institutional reforms associated with our democratisation and Constitutional changes.

The 1996/97 Budget seeks both to consolidate and build on the achievements of the 1994/95 and 1995/1996 Budgets and to lay a firm base for significant budgetary reforms, many of which will only unfold in the 1997/98 Budget and beyond.

A brief review of the two budgets previously presented by the Government of National Unity serves to locate this year's budget. Firstly, in addressing macro policy objectives the previous two budgets sought to reduce the deficit, contain non-interest recurrent expenditure, improve expenditure efficiency, avoid permanent increases in the overall tax burden, maintain price stability and reduce government dissaving. The 1996/97 Budget will reinforce this policy package.

On the revenue side of the previous Budget, we addressed gender discrimination and certain important areas of tax evasion and the once-off transition levy was removed. In the 1996/97 Budget we address two other major structural problems, namely the tax dispensation of the retirement industry and tax administration. In 1997/98 we will see further implementation of the proposals resulting from the Katz Commission and the Smith Committee and fundamental changes in respect of intergovernmental revenue sharing in accordance with the Constitution.

On the expenditure side, 1994/95 initiated a reprioritisation process through the establishment of the Reconstruction and Development Programme (RDP) Fund. In 1995/96 a major housekeeping exercise was completed as the various expenditure votes were reorganised to reflect the new

Constitutional dispensation and reprioritisation was taken further. This year we will complete and tidy up the housekeeping process and the new Provincial Treasuries will begin to play an active role in determining and controlling expenditure at provincial level. In addition, Government will make a start with addressing the uncompetitive salaries of the professional and specialist classes, as well as the rightsizing of the civil service.

In 1997/98 we will see the inception of multi-year fiscal planning reflecting the implementation of more rigorous standards of accountability.

Mindful of these developments and in terms of all the different dimensions of government involvement in the economy, the following questions need to be addressed:

- What did the Government of National Unity achieve in the 1995/96 Budget?
- In what economic climate is the government presently functioning?
- What policy and operational issues need to be attended to?
- How do we intend to tackle these issues in 1996/97?

Today's Budget should provide some answers to these questions. Let us begin with a review of the 1995/96 Budget.

THE 1995/96 BUDGET

In comparing the 1995/96 and 1996/97 Budgets in more detail a good starting point is an analysis of the trend in the budget deficit. The practice of rolling over unspent funds from one fiscal year to another under certain conditions complicates this analysis. The revised estimated budget deficit for 1995/96 of 6,0 per cent of GDP is based on the premise that the roll-overs of unspent funds to 1996/97 will equal those of the previous financial year. Full details of the revised 1995/96 Budget estimates were given when the Adjustments Estimate was tabled in Parliament during February 1996. In summary:

- the estimated expenditure level is R157,4 billion - R4,1 billion higher than the original budget estimate; while
- total revenue and grants are now estimated at R127,3 billion, which exceeds the budgeted amount by R3,1 billion.

The steady reduction in the budget deficit achieved in the past two years is even more remarkable when viewed against the additional expenditure demands of the democratisation process. It is an achievement of which we are justifiably proud. Reducing the deficit in a responsible manner remains an important policy goal of the Government of National Unity.

Against this background it is necessary to take cognisance of the present economic conditions and prospects for the year ahead in order to determine what the appropriate budget strategy for 1996/97 should be.

ECONOMIC CONDITIONS AND PROSPECTS

The economic recovery which started in the third quarter of 1993 is continuing and the 1995 growth rate of 3¢ per cent was the highest since 1988. This rate was achieved despite setbacks which affected the agricultural and mining sectors. In contrast, the manufacturing sector experienced strong domestic and international demand. The outstanding feature of the recovery has been the strong growth in real gross domestic fixed investment. Private sector companies are showing high levels of confidence and have added significantly to their productive capacity. In 1996 aggregate domestic expenditure is expected to strengthen and, combined with improved agricultural conditions and sustained export increases, a growth rate of between 3¢ and 4 per cent is expected for this financial year.

Growth in employment picked up about a year after the cyclical upswing. In the year up to the middle of 1995, the first year since the low point in the employment cycle, only 55 000 new jobs were created in the formal sector of the economy outside of agriculture. This growth failed to match the rate at which the economically active population is growing - a matter to which I shall return.

Over the past few years the rate of inflation has been declining. The consumer price inflation rate of 8,7 per cent for 1995 was the lowest since 1972. Counter-inflationary policies will be maintained in 1996.

The deficit on the current account of the balance of payments weakened to R12,7 billion or 2,6 per cent of GDP in 1995. This was partly due to an increase of 29 per cent in the value of imports arising from the surge in domestic expenditure in response to the economic upswing. This rise more than compensated for the continued strong growth in exports, the value of which increased by 24¢ per cent. An encouraging feature of the export performance was the strong growth of non-traditional exports in the manufactured goods category.

The current account deficit was more than fully funded by a strong inflow of foreign capital resulting in an increase of R9,1 billion in net gold and other foreign reserves. Despite this improvement in the overall balance of payments, the level of gross reserves at the end of the year was only equal to about 7 weeks of imports, a figure that remains low, yet represents an improvement on last year.

The exchange rate of the rand remained relatively stable during 1995 and by the end of December 1995 the real exchange value was estimated to be about 1¢ per cent stronger than a year earlier. During February 1996 the rand experienced increased volatility as speculators reacted to unfounded rumours. The effective exchange rate of the rand depreciated relatively sharply during the last two weeks of February, to neutralise an appreciation in the value of the rand that took place from May 1995 to the middle of February 1996. The Reserve Bank will continue to intervene to support orderly conditions in the market, but cannot fix the exchange rate in a global regime of a floating exchange rate system.

Having reflected on the successful budget outcome of 1995/96 and taken stock of the economic environment and prospects for the coming financial year, we now turn our attention to various policy and operational issues as well as associated problem areas.

POLICY ISSUES

RECONSTRUCTION AND DEVELOPMENT

The first two years of the Government of National Unity have been an economic success. The macro fundamentals have improved and have combined in a more favourable configuration than during previous upturns in the economy. However, there is no place for complacency.

Recent events in the foreign exchange markets show just how quickly the markets react to perceived or real changes in both internal and external policy and macroeconomic fundamentals. The volatility in the foreign exchange markets has served as a reminder of the discipline imposed by the international economy on a small open economy like ours. More importantly, it is generally accepted that an average growth rate of approximately 3 per cent per annum will not lead to a sustainable transformation of the economy or broader society.

We acknowledge that to address the many backlogs we need to go significantly further. A 6 per cent growth rate, with clear and focused development programmes, about 500 000 new jobs per year and better wealth distribution are important targets. A necessary, if not sufficient, condition to achieve these goals is sound macroeconomic management. However, to achieve a 6 per cent growth rate macroeconomic policies have to be supported by trade and other sectoral and micro reforms. Government is currently engaged in a thorough process to elaborate, coordinate, review and ensure the implementation of the Reconstruction and Development Programme in a manner that generates growth and development capable of attaining our objectives.

This strategy is being subjected to wide consultation in government, but will also enjoy the advantage of dialogue within the National Economic Development and Labour Council or NEDLAC and the active inputs and participation of all stakeholders, including business, labour and multilateral organisations.

It is clearly not possible to reflect fully the scope and complexity of the work and process currently underway. We focus here on a number of crucial issues.

EMPLOYMENT

A key pillar of the Growth and Development Strategy is employment creation. Sustainable growth and development can only be achieved through the creation of jobs. Access to formal wage-earning opportunities takes households out of poverty, gives women and men a stake in the economy and eases the pressure on the fiscus to provide relief. Among the poorest 40 per cent of households, nearly 50 per cent of workseekers are unable to find employment. There are, moreover, racial, spatial, age and gender dimensions to the pattern of unemployment in South Africa. We must address the reality that most of the unemployed are black, many are women, many are young, many are in the rural areas. A strong developmental approach which creates jobs must be at the centre of both social and economic policy. Job creation remains South Africa's biggest challenge.

The economy has performed poorly with respect to employment creation: indeed this is a structural problem that cannot be addressed through conventional economic growth alone. Consequently, employment creation poses one of the most fundamental policy challenges. To address it, we need a better understanding of the labour market. For example, in the formal employment sector we need to understand the consequences of increased sub-contracting, self-employment and more flexible working arrangements. Unless we do, government will not know the actual changes in income generating employment or the wage elasticity of employment.

Similarly, we need to get a better understanding of the informal sector. One of the problems of unrecorded economic activity is that we do not know its income effects and it is difficult to monitor changes in the position of those involved in it. The links between formal sector employment and real income changes and the activities of the informal sector need to be better researched. The Labour Market Commission and the issues raised by the Green Paper on Policy Proposals for a New Employment Standards Statute will assist greatly in taking this analysis forward.

We expect improved employment numbers in the last part of 1995 and in 1996 as unutilised capacity is taken up and fixed investment continues to improve. However, the overriding reason for better coordination of the strategy of government is to maximise the complementarity of macro, trade and industry, infrastructure, human resource, labour market and spatial policies that have been developed.

POVERTY RELIEF

A fundamental objective of the Government is to combine growth and development. Addressing poverty, unemployment and low living standards as speedily as possible, while also promoting growth and competitiveness is key to achieving this objective. Targeted programmes such as school feeding, free health care for children and pregnant mothers and labour-based construction projects have been implemented with a high degree of success. Yet, given the magnitude of the problems, legitimate expectations of improving conditions must be addressed by government actions.

Accordingly, Government gave careful attention to allocating further resources to targeted poverty relief. This would have required sacrifices elsewhere. Careful analysis of the Budget shows that very substantial resources have been shifted to primary health care, education, housing, welfare, rural and urban development and the provision of water. In all these areas delivery capacity is improving. In view of these developments it was decided to place emphasis on improved delivery rather than additional resources that may simply be rolled over.

One of the more contentious debates in South Africa has been around the use of the tax system for poverty relief. The zero-rating of value-added tax on various basic food items is a case in point. This tax exemption is expected to cost the fiscus some R3,3 billion in 1996/97, which could be more effectively utilised in targeted poverty relief measures. Government accepts that VAT is an efficient tax and that zero-rating and exemptions should be kept to a minimum to enhance this efficiency. VAT also causes relatively few economic distortions. However, it is a regressive tax that impacts relatively more on the poor, creating the need for compensatory measures on the expenditure side. The government has decided to retain the present VAT dispensation in this Budget, a decision that has been facilitated by the expected benefits flowing from improved cash management and improved tax collections - aspects to which I shall return later. At the same time, discussions with all stakeholders within NEDLAC will continue to evaluate the equity of the tax structure and the efficacy of expenditure in addressing socio-economic development.

CRIME PREVENTION

An area in which we are presently particularly vulnerable is crime. The government is firmly committed to strengthening crime prevention and the administration of justice, particularly in those areas in which violence and fear have come to dominate people's lives. This position was forcefully and convincingly argued by the President in his Address to Parliament last month.

It is tempting for a government to throw money at those causes that will win it popular support. Therefore one needs discipline to allocate funds on emotional issues in a just and appropriate manner. We think we have kept a cool head and done careful work with Safety and Security to optimise their resource utilisation and to integrate their budgeting into the Policing Plan they will present. We are confident that adequate resources have been made available and will be used effectively. It should particularly be borne in mind that the allocation for Safety and Security does not include improvements in conditions of service from which they will also benefit more during this year than last.

COMPETITIVENESS

South Africa's reacceptance into the international community has made it possible to pursue outward-oriented policies with the goal of increased international competitiveness. This necessitates a meaningful change in the trade and industrial policy support measures.

The challenge facing Government is to effect strategic restructuring actions, increase investment and introduce more focused strategies. Government, business and labour will have to collaborate fully in this process.

The limited domestic market and increased competition as a result of the phasing out of import tariffs on many products necessitate a fundamental shift towards competitiveness and export growth of manufactured goods.

The Department of Trade and Industry will develop and facilitate policies and strategies in manufacturing subsectors aimed at promoting growth, development, competitiveness and job creation. In conjunction with business and labour, the Department is also creating an environment that will assist the manufacturing sector in achieving these aims. Areas of focus include support measures in respect of training, investment, exports, preferential market access, technology, work organisation, productivity and small business development.

Instead of artificially lowering the prices of South African products through the General Export Incentive Scheme (which will be terminated at the end of 1997) and promoting industrial development through excessively high import tariffs and import controls, the policy of the government is to find ways of reducing the cost of South African products through lower input costs and increased efficiency of these inputs.

Various tax restructuring measures have been taken during the past two years and more will be considered to add impetus to the supply-side approach. Although the general pattern of the last few years has been to limit the number of tax incentives, the Departments of Finance and Trade and Industry are investigating the flexibility of well-targeted tax incentive measures.

SAVING AND INVESTMENT

Growth requires resources, which means that societies need to save. Domestic savings can be supplemented to a limited extent by foreign borrowing, but capital inflows without a complementary improvement in domestic savings cannot be the basis of a sustainable growth strategy. Thus the increased investment that we need will have to be supported by higher domestic saving.

Gross domestic savings declined marginally to 16¢ per cent of GDP during 1995, a figure which is well below the target rate of 25 per cent and far off the rate of 35 per cent experienced in some fast growing Asian economies. Private household saving in 1995 was only 1 per cent of GDP, down from 3 per cent in 1994. Dissaving by the general government, however, shrank by 1 per cent to 4 per cent - a significant development as the elimination of government dissaving can play an important role in enhancing total domestic saving and eventually investment. Increasing domestic saving relative to GDP is only going to be possible if we do two things - reduce government dissaving and avoid excessive increases in private consumption expenditure.

BUDGET DEFICIT

From the foregoing it is clear that we need to maintain a balance between macroeconomic adjustments and the effective rendering and restructuring of social services and other government functions. The present fiscal stance, based on an average growth rate of 3 per cent, has been to reduce the budget deficit gradually to about 4 per cent of GDP by 1998/99. If growth is higher - as we hope it will be - more substantial progress will be possible. As the international growth outlook has become less favourable, we are mindful that deficit reduction should now occur more rapidly than the ¢ percentage point of GDP per annum originally targeted.

The policy approach of gradualism is one necessitated by the need to instil stability, sustainability and predictability in an environment of economic and financial uncertainty and volatility. Gradualism is also necessitated by the present transition and the resulting planning and restructuring needs. An expenditure driven boom would not last: conversely a drastic reduction in the deficit would require ill-considered and disruptive curtailment of public services. It is important to remember that the record of "big bangs" in economic history is not encouraging.

OPERATIONAL ISSUES

To underpin the achievement of our policy goals and to address the weaknesses in a consistent and sustainable manner, various initiatives are being put in place. These consist of a mix of financial, institutional, legislative and regulatory measures. Many are the result of the so-called "six-pack" initiative on restructuring the public sector that was announced towards the end of 1994. The following are some of the related actions:

- Public sector and budgetary reform depend entirely on accompanying reforms in the public service. The policies dictated by the Reconstruction and Development Programme require a public service that is capable of sophisticated policy analysis, efficient delivery and the facilitation of efforts by communities and the private sector to drive their own development. The current structure of the public service is not conducive to the achievement of these objectives.

  The remuneration system is complex and remuneration reform within this complexity is exceedingly costly. Accordingly, the Government of National Unity has, in consultation with the unions, embarked upon a major reform of the public service. This year will see the first steps in three major areas: grading reforms and reduced complexity; realigning pension and salary packages; as well as rightsizing and more efficient deployment of personnel. Grading reform and rightsizing do impose higher initial costs but will result in a better paid, more skilled and leaner public service.

- In order to develop a greater medium and long term focus, a macroeconomic policy framework is under discussion to establish a clear and consistent set of fiscal, monetary and exchange rate policies to support the growth and development strategy referred to earlier.

- As far as the budget is concerned, a medium term fiscal framework is being developed to establish guidelines for reprioritisation and lay the basis for multi-year budgeting.
- A major reform of the budget process is underway. This will entail the earlier presentation of future budgets to Parliament, a feasibility study of a change-over to accrual accounting from the present cash accounting system, a different basis of reporting assets and liabilities, a restructuring of the accountability of the various departments and functions and a complete change in intergovernmental financial relations.
- An Expenditure Evaluation Unit is being established to identify activities which could be stopped or scaled down or more efficiently managed in an effort to reduce overall government expenditure. This initiative is one of the outcomes of the belt-tightening programme.
- The need for increased efficiency and higher labour intensity in the economy has also resulted in the current process of reform of the procurement policy. A White Paper on this issue will be published soon.
- In October 1995 the Cabinet approved the restructuring of Inland Revenue and Customs and Excise and the formation of an autonomous revenue collection service, the South African Revenue Service or SARS. It is envisaged that SARS will be launched in April 1996, although full implementation will of necessity have to be a phased process. This process is presently well under way under a Reform Project Team. A business plan for SARS as well as concomitant reforms in areas such as technology modernisation, communication, financial management, human resources development, corporate image, business management and the interface with the Department of Finance are being finalised. Innovative reforms to be introduced include the use of scanners and mechanical sniffers at customs posts. The first of these scanners should be installed in the next ten days. Provision is made in the expenditure level for 1996/97 for an additional R150 million for SARS, pending the successful introduction of a business plan and related reforms.

  The Chief Executive position of SARS is still vacant at this stage, but, judging from the progress in negotiations, an announcement should be possible within the next two weeks.
- We are moving towards the establishment of a fully-fledged state debt management authority in the Department of Finance. In the interim, various measures have been introduced to improve debt and cash flow management, and revised guidelines for the issuing of government guarantees are being negotiated with affected parties.
- The restructuring of various institutions, including the Development Bank of Southern Africa, other development finance institutions, the Land Bank, and various parastatals is far advanced and relevant legislation is imminent. Of essence is the envisaged integration of investment and service delivery of the three levels of government, development finance institutions and private domestic and foreign investment.

Steady progress on the restructuring of state assets is also being made. Restructuring will be supportive of the growth and development strategy in infrastructural financing requirements and will contribute to economic growth through debt reduction, the strengthening of the balance of payments and a greater degree of competitiveness in the economy. However, in the interests of conservative budgeting, no income from restructuring proceeds has been taken into account in the 1996/97 Revenue Estimate.

The Cabinet has also approved the establishment of a state dividend policy as part of a corporate governance framework to be applied to State corporations which generate profits as a result of their business operations. Again, in the interest of conservative budgeting, no budgetary provision has been made for any revenue at this stage, pending final negotiations with the respective corporations. Any dividend flow that materialises will be used to reduce state debt cost or for investment purposes.

- Measures to bring about a gradual relaxation of exchange controls have been successful so far and this policy approach will be adhered to. What gives us the confidence to continue with this policy is the resilience of the rand to adapt to the gradual relaxations, and the improved underlying foreign reserves position. Over the 14 months from 31 December 1994 up to the end of February 1996, the Reserve Bank's net foreign reserves increased by R8 billion. Increased volatility of the rand must, however, be expected as the South African financial markets become more integrated into the global economy.

- Retirement provision is presently under intense debate following the release of the reports by the Smith Committee on Strategy and Policy Review of Retirement Provision in South Africa and the Third Interim Report of the Katz Commission. The Smith Report still requires further and wider discussion and debate. The Joint Parliamentary Standing Committee on Finance intends conducting public hearings on this Report. As in our approach to the Katz recommendations, Government will respond after the Joint Standing Committee Report is to hand and has been studied.

- With the increasingly important role which provinces and local governments are playing in economic growth and development and in ensuring financial stability in the country, proper coordination of intergovernmental financial relations is pivotal. The Ministry of Finance will actively promote this via the various intergovernmental structures. Greater autonomy of provinces and local governments imposes greater fiscal responsibility upon them and we must take leave of the notion that sub-national governments can rely on the national government to stand in for poor financial management and budgeting.

  In order to establish sound financial bases for provinces, the Financial and Fiscal Commission has published important discussion documents on a Framework for Intergovernmental Fiscal Relations in South Africa and on The Allocation of Financial Resources between the National and Provincial Governments. The Borrowing Powers of Provincial Governments Bill, the product of wide ranging consultations will become legislation in the very near future. For the purposes of the 1997/98 Budget, provinces will, after due consultation, be given an early indication of their likely shares of the projected available national revenue, and will have full responsibility for determining their expenditure priorities.

- In the evolving fiscal framework the international environment plays a determining role. In the global village in which we live, there is no escape from the (sometimes harsh) disciplines imposed on individual countries by the international community and international markets. The sanction for stepping out of line politically, socially and/or economically is severe, as this country and many other industrial and developing countries have indeed experienced.

  We intend to steer well clear of any such risk. Indeed, the strengthening of South Africa's image as a trade and investor friendly country remains a high priority. Standard and Poor's recent upgrading of South Africa's credit rating and the 10 year ú100 million Euro-Sterling bond issue - the longest maturity in recent memory - will assist in this regard and are indicative of the progress we have made.

- In the field of development finance our strategy is to maximise the benefit to the country of the normalisation of international relations. South Africa has joined the so-called English speaking African constituencies on the International Monetary Fund and World Bank Executive Boards and will shortly be appointing two advisors to the offices of the executive directors of this group of countries in the two organisations.

South Africa became a member of the African Development Bank on 13 December 1995 and will in due course also take its rightful place in the organisational structure of the Bank and avail itself of the various financial and other facilities. South African companies are already in a position to bid for projects financed by the Bank.

In a regional context South Africa is increasingly playing a more meaningful role, mindful of the need for cooperation to promote growth and development in the region. In this regard, we have assumed responsibility for the finance and investment sector of the Southern African Development Community and a unit to coordinate and manage the process has been established.

- Following the Beijing Women's Conference, South Africa undertook to play a more active role in the development and implementation of policies and programmes set out in the Beijing Platform of Action. Three areas of work have been identified:
  - the development of a statistical database which will provide information on the impact of expenditures disaggregated by gender;
  - the implementation of targets and indicators of gender equality and equity in spending; and
  - the development of a performance review mechanism to evaluate progress and report to Parliament.

Having dealt with the various policy and operational issues, we now turn to specific expenditure, revenue, deficit and loan financing issues of the 1996/97 Budget.

THE 1996/97 BUDGET

EXPENDITURE

The total expenditure level for 1996/97 is estimated at R173,7 billion, an increase of 10,4 per cent on the revised estimate for 1995/96. Included in this amount is R960 million and R600 million to be voted in the Supplementary Estimate and Adjustments Estimate, respectively.

At this stage it is not possible to give a detailed economic and/or functional allocation of the consolidated national and provincial expenditure as the provinces have not presented budgets to their respective executive councils. However, the allocation between functions will reflect the trends established in 1995/96 and also reinforce those shifts reflecting the national priorities. The President referred to these during his address to Parliament in February and specifically dealt with education, health delivery, housing policy and implementation as well as land reform. The Government's commitment to this reprioritisation is illustrated by the policy of a National Health System for Universal Health Care to be implemented by 1 April 1996.

Other challenges referred to included the capacity of government to serve communities and the need for a crime prevention strategy. The Department of Finance will release the functional and economic classification of the consolidated national and provincial budgets about a month after the last provincial budget is tabled.

A few remarks on some national government expenditure items are called for.

State debt costs

State debt costs, which form a first charge against revenue, are estimated to increase to R34,4 billion, an increase of almost 18 per cent on the revised 1995/96 figure. Nonetheless, this figure is still R591 million lower than it would have been given the expected budget deficit, loan redemptions, possible debt conversions and interest rate expectations. The R591 million includes an interest saving of R227 million as a result of a transfer of R1,9 billion from the Central Energy Fund on 1 April 1996, thus reducing the net borrowing requirement. A further R364 million will be saved through the utilisation of surplus government funds invested with the Corporation for Public Deposits. We still expect further savings as a result of better cash management.

In spite of this saving the estimated state debt costs still represent almost 20 per cent of total national government expenditure compared to about 18¢ per cent in 1995/96. This trend is a clear manifestation of the crowding out effect of debt costs on other expenditure items and the increasing lack of fiscal manoeuvrability and points clearly to the need for a continued restructuring programme to lower the state debt.

Reconstruction and Development Programme

The provision made in this Budget and the Adjustments Estimate will bring the contribution to the RDP to R7,5 billion for 1996/97, and the total allocation to date to R15 billion.

Transfers to provinces

Transfer payments to the provinces are shown as global amounts on the Department of Finance's vote. In the absence of legislation for the financing of provinces as prescribed in the Constitution, the budget process which applies to national departments has been extended to provide for the determination of these amounts. An extensive process of consultation was followed in which backlogs, inequalities between provinces and revenue shortfalls were taken into account to arrive at equitable allocations.

Defence

Defence spending to be financed from the national budget this year amounts to R10,2 billion. This is a decrease of 5,0 per cent on last year's revised estimate, continuing an adjustment trend which has reduced the defence budget from 4,5 per cent of GDP in 1989/90 to under 2,0 per cent of GDP presently.

Police

The allocation to the South African Police Service (SAPS) amounts to R9,884 billion, which is 4,6 per cent higher than last year's revised estimate and before taking into account this year's improvements in conditions of service. The ongoing reorientation towards community policing and crime prevention is reflected in the increase of 16 per cent in the allocation for "Community Policing" on the SAPS vote.

Through the utilisation of the South African National Defence Force collateral utility, support will be given to the South African Police Service. This is estimated to be R1,2 billion in 1995/96 and it can be expected that a similar amount of support will be available in the 1996/97 financial year.

Housing

The housing vote has decreased, with the full cooperation of the Department of Housing, from a revised estimate of R4,0 billion in 1995/96 to R1,5 billion in 1996/97. This amount is, however, supplemented by significant resources in roll-overs from the RDP Fund and monies available in the National Housing Fund. This brings the total funds available for this function in 1996/97 to R4,6 billion, which is more than the funds allocated last year.

Trade and Industry

The budget of the Department of Trade and Industry has decreased from a revised estimate of R3,5 billion in 1995/96 to R3,2 billion. This is largely as a result of the phasing out of the General Export Incentive Scheme and the phasing in of the supply-side measures discussed earlier.

Education

The budget for the national Department of Education amounts to R5,5 billion, compared with a revised estimate of R4,3 billion last year. This provides for significant increases in the subsidies to universities and technikons which will contribute to the stabilisation of their financial circumstances. Amounts of R100 million for universities and R50 million for technikons have been earmarked for the erection of new buildings. In addition, an amount of R300 million has been set aside for a national student financial assistance scheme. This allocation is intended to relieve the plight of financially disadvantaged students.

Civil, military and social pensions

For a number of years it has been the policy to adjust pensions on an annual basis to compensate to a certain extent for loss in buying power. Civil pensions will be increased as follows from 1 April 1996:

- The pensions of all civil pensioners who retired on or before 1 April 1995 will be increased by 6 per cent, with a minimum of R24,00 per month.
- The pensions of those who retired later, but before 1 April 1996, will be increased proportionally.

The increase in military pensions will be considered at a later stage, once negotiations on improvements in conditions of service of public servants, to which military pensions adjustments are linked, have been concluded.

Details of increases in social pensions and other grants, which take up a substantial share of the transfers to provinces and reach nearly 3 million people, will be announced by the Acting Minister of Welfare and Population Development.

Legislation will be tabled shortly to commence payment of the special pensions in terms of Section 189 of the Interim Constitution. There has been considerable consultation on this legislation and we hope it will receive the support of all. An amount of R450 million has been allocated for 1996/97 in addition to funds rolled-over from last year.

Supplementary expenditure proposals

Amounts of R10 million and R950 million for the Expenditure Evaluation Unit in the Ministry of Finance and for improvements in conditions of service respectively are proposed as supplementary expenditure.

Included in the Main and Supplementary Estimates is a total amount of R7,45 billion which, together with the anticipated savings flowing from the rightsizing of the public service and adjustments in the pension funds conditions, will enable very significant structural adjustments to be made to the public service salary scales in line with my earlier comments.

REVENUE

Based on the existing tax structure and tax rates and taking into account the macroeconomic projections for 1996/97, total tax and other revenue is estimated to increase by 10,5 per cent to R139,1 billion, in 1996/97.

The government's policy of gradually selling off excess stockpiles of strategic oil reserves makes it possible to transfer some R1,9 billion, being the proceeds from oil sales, to the National Revenue Account. As already explained, this facilitates a reduction in the accumulation of state debt and its accompanying interest costs.

Provision is made for an additional net R2,4 billion to be raised from various tax measures. Some of these proposals form part of the tax reform process emanating from the Katz Commission. Improved revenue collections and the collection of arrear taxes as a result of increased efficiency in tax administration are expected to yield an additional R1,5 billion. This amount is not specified separately in the budget accounts, but is incorporated in the estimates of the respective individual taxes. Collection of this amount represents the first challenge to the restructured SARS, one they accept enthusiastically.

The Katz Commission

During the course of the past year the Katz Commission issued Second and Third Interim Reports. The Second Report dealt with the question of thin capitalisation and transfer pricing rules while the Third dealt with a wide range of issues. These are fully dealt with in the Budget Review.

In the interests of transparency and promoting public debate, the Third Report was referred to the Joint Standing Committee on Finance which in turn called for public comment, held hearings and released its own Report. The Katz Report has also been discussed in the NEDLAC forum, against the background of a mutual understanding of the macro framework for the 1996/97 Budget and the critical fiscal issues put forward by the three social partners in NEDLAC.

Various of the Katz and Joint Standing Committee on Finance recommendations are incorporated in the tax proposals that will be announced today. Some require further investigation and consultation, for example the land tax, taxes on small and micro enterprises, the consideration of capital taxes and regional service council levies; while a few will have to be held in abeyance until SARS is fully operational, for example group income taxation, capital gains tax and taxpayer education. The Budget Review deals in more detail with Government's response to the Katz Commission Report.

The one major outstanding issue on the Commission's agenda is a holistic review of the tax system and recommendations in this regard. This issue will form the centrepiece of the final report which the Commission will be asked to submit early in October 1996.

Against this background I now turn to the various tax proposals for the coming financial year.

Tax proposals

Excise Duties

In keeping with the established local and international practice to adjust excise duties on an annual basis, the following increases are proposed:

- Beer: about 2 cents per 340 ml can
- Sorghum beer: 0,5 cents per litre
- Sorghum flour: 2,5 cents per kilogram
- Unfortified wine: about 4 cents per 750 ml bottle
- Fortified wine: about 6 cents per 750 ml bottle
- Sparkling wine: about 8 cents per 750 ml bottle
- Other fermented drinks, eg cider: about 3 cents per 340 ml can
- Spirits eg whisky, brandy, gin: about 64 cents per 750 ml bottle
- Cigarettes: 8 cents per 10 cigarettes
- Cigarette tobacco: 10 cents per 50 grammes
- Pipe tobacco: 73 cents per kilogram
- Cigars: 67,5 cents per kilogram

The increases are the result of consultations with all interested groups and take cognisance of industry specific issues, market conditions, health considerations and government policies.

An amount of R500 million is expected during 1996/97 from these proposals which take immediate effect. In accordance with Section 58(1) of the Customs and Excise Act, 1964, I now lay the formal tax proposals for excise on the Table for consideration by Parliament.

Fuel levy

In line with the principle of regular adjustments an increase of 3 cents per litre on both leaded and unleaded petrol as well as diesel is proposed with effect from 3 April 1996. These increases will coincide with the monthly fuel price adjustment, if any. The yield from these increases is expected to be R450 million for 1996/97.

As a first step in the phasing out of the tariff protection level of the synthetic fuel industry, the Equalisation Fund levy will be reduced at various stages during 1996/97 with an equal increase in the fuel levy. The pump price will, however, not be affected by this measure which should yield R610 million to the fiscus during 1996/97.

Accrual and incurral of interest on financial instruments

Last year's Budget introduced the accrual basis for taxing interest on financial instruments. As was envisaged then this measure will now be extended to encompass those instruments issued on or before 15 March 1995 which are not as yet within the scope of the accrual basis.

This proposed change is expected to yield an additional R140 million during 1996/97.

Estate duty and donations tax

As an interim measure in anticipation of the Katz Commission's detailed proposals on a capital transfer tax, it is proposed that with effect from 14 March 1996, the present rate of 15 per cent in respect of estate duty and donations tax be increased to 25 per cent and that the donations tax exemption threshold be increased from R20 000 to R25 000.

For 1996/97 the additional revenue from this proposal will be nominal due to normal lags in the collections of these kinds of taxes.

Secondary Tax on Companies

In acceptance of the Katz Commission's recommendations, endorsed by the Joint Standing Committee on Finance, it is proposed that the secondary tax on companies be reduced from 25 per cent to 12¢ per cent in respect of all dividends declared after 13 March 1996. This proposal is expected to be revenue neutral.

The tax rates for gold mines that elected to be outside the dual tax system will be amended accordingly, with an associated revenue loss of R35 million.

Marketable securities tax and stamp duty on the registration of the transfer of marketable securities

Both the Katz Commission and the Joint Standing Committee on Finance recommended the abolition of these taxes, subject to budgetary constraints.

Recognising the need to bring duties more in line with international levels, it is proposed that these duties be reduced from 1 per cent to 0,5 per cent with effect from 1 April 1996. Consideration will also be given to the amendment of the marketable securities Act, 1948, to include transactions where a broker acts as a principal.

This change will result in revenue losses for 1996/97 estimated at R200 million for marketable securities tax and R150 million in the relevant stamp duty.

The lowering of the marketable securities tax and the secondary tax on companies are further measures aimed at establishing South Africa as an investor-friendly country and improving our international competitiveness.

Value-added tax on financial services

It is generally agreed that all financial services should be subject to VAT. However, since the introduction of VAT in 1991 certain financial services have been exempted from VAT due to uncertainty as to the effects of the tax as well as time constraints at that stage. Following investigations by the Katz Commission and after discussions with interested parties, it is proposed that with effect from 1 October 1996 VAT be levied on all fee based financial services currently exempt in terms of Section 2 of the VAT Act, 1991, with the exception of:-

- premiums payable in respect of life policies issued in terms of the Insurance Act and contributions to pension, provident, retirement annuity and medical aid funds; and
- compulsory charges built into the selling price of units in unit trust schemes.
- It is estimated that this will result in additional VAT collections of R150 million in 1996/97 and about R300 million for a full year.
- At the same time the financial services levy, which was introduced as a "proxy" for VAT, will no longer be levied on the banking industry. This does not, however, apply to the insurance and "super-annuation" fund industries. The estimated revenue loss is R50 million for 1996/97 and R200 million for a full financial year.

Value-added tax on gambling

The Katz Commission's recommendations on the taxation of gambling have been accepted. These are:

- that the present income tax rules apply to all gambling other than the envisaged national lottery;
- that the present policy of imposing VAT on gambling, with the exemption of the national lottery, be continued; and
- that in addition to these taxes provinces may impose betting or other taxes for their own accounts.

It is also proposed that gambling in the former TBVC states which is presently zero-rated become subject to the standard rate of VAT on 1 October 1996. This allows time for any adjustments that the provincial authorities may need to make.

The expected additional VAT collections from this source are R150 million.

Stamp duties

The stamp duty payable on certain debit entries was last increased in 1992 and it is proposed that this be increased from 15 cents to 20 cents per entry from 1 June 1996.

Equity considerations and the escalation in the use of private and in-house retail cards make it necessary to bring debit entries posted to such accounts within the ambit of the Stamp Duties Act. Inland Revenue will consult with the issuers of such cards on how to bring this about. To allow sufficient time, 1 August 1996 is proposed as the implementation date. An additional R60 million is expected from these proposals in 1996/97 and some R100 million for a full financial year.

A revised scale for stamp duties on instalment credit agreements is also proposed to take effect on 1 June 1996. The yield is expected to be an additional R5 million in 1996/97.

Statement of taxpayer rights

The Government accepts the proposal of the Katz Commission and the Joint Standing Committee on Finance that basic rights of taxpayers should be articulated in a clear public statement of Taxpayers' Rights. This would include, among others, principles such as expeditious and timeous tax administration, as well as fair, impartial and consistent application of the law. A statement in this regard will be issued soon.

Retirement fund industry

In its Third Report, the Katz Commission proposed a new approach to the taxation of retirement funds, and put forward various recommendations. The Joint Standing Committee on Finance in turn held discussions with several interested parties and has subsequently endorsed the Commission's main proposals.

The recommendations have attracted considerable comment, including representations from the retirement industry.

Government accepts that the following principles should be reflected in a new system of retirement fund taxation:

- consistent tax treatment of private and public sector funds;
- tax neutrality between forms of retirement provision;
- minimisation of opportunities for arbitrage in as far as this is tax related;
- an incentive in favour of a lifetime annuity (that is, a pension); and
- taxation of income as it arises rather than when paid out.

The Government acknowledges the complexity of this issue and the need for further consultation, which will be led by the Department of Finance and SARS. The Katz Commission itself listed several issues that require more work. Since then the list has grown substantially. More time is needed for the refinement of the details of the tax dispensation in respect of retirement funds.

As a first step in the implementation of the taxation of the income of retirement funds, it is proposed that an initial tax be introduced with effect from 1 March 1996. This tax will be imposed at a rate of 17 per cent of the monthly gross interest and net rental income received by or which accrued to all pension, provident and retirement annuity funds, whether private, state or semi-state controlled or administered. More details with regard to, for instance, specific exemptions as well as the method of payment of the tax are provided in the Budget Review.

This proposal is not an ad hoc revenue generating measure incompatible with the other elements of the tax dispensation regarding retirement. Rather, the proposal represents a significant step towards a wider coverage of the tax system as a whole, thereby improving equity in the distribution of the tax burden, reducing the scope for tax avoidance and arbitrage and reducing tax distortions affecting savings and retirement choices.

The Department of Finance, working with the Katz Commission and taking due cognisance of the Smith Committee proposals, has attempted to determine the wider economic effects of this measure, particularly on lower income groups. Given the nature of the complex changes that could take place and the assumptions that have to be made, such analysis cannot be precise. It is our view that no significant additional burden is imposed, particularly on the poor. This should also be seen in the context of the general incidence of the entire fiscal package proposed today.

It has become evident that developments and speculation surrounding retirement fund taxation have given rise to much uncertainty and persons employed both in the public and private sectors are contemplating early retirement to escape what they fear will be more burdensome taxation of lump sum payments. Such a step may not be in their own or in the country's interest.

In order to ensure certainty and to allay these fears the Government is prepared to give the following assurances should the final tax dispensation include a tax on pension benefits disadvantageous by comparison with the existing dispensation:

- The benefits payable by retirement funds to members will only be taxed according to the new method as from the year of assessment commencing on 1 March 1997 at the earliest.
- The vested rights of members of public sector funds which have been established by law to receive their lump sum payments on retirement or retrenchment and their withdrawal benefits on resignation will be protected by reference to number of years of service up to the date the changes are introduced as well as the final salary applied in the determination of their retirement or withdrawal benefits.
- In the case of private sector members of retirement funds who become entitled to lump sum benefits after the implementation of the new provisions and who are presently entitled to a deduction from their lump sum payment on retirement or retrenchment and who may receive a smaller deduction if the proposed new formula is introduced, the deduction under the previous dispensation will be phased out over a period of five years.

With these assurances there should be no reason for members of any retirement fund to consider early retirement for fear of higher taxes on their lump sum payments.

Personal income tax

Government is committed to reducing the overall burden of personal income tax; broadening the tax base; reducing the number of tax brackets, the maximum marginal tax rate, as well as the gradation of the marginal rate schedule; raising the tax threshold, and adjusting the tax structure for inflation.

Due to fiscal constraints all these objectives can obviously not be achieved simultaneously and Government has embarked on a gradual approach. Last year saw gender equality being achieved together with tax relief to the lower income groups. The proposals in this Budget aim at alleviating fiscal drag partially, increasing the level of income at which the maximum marginal rate takes effect and continuing with the process of tax relief for the lower and middle income earners.

In terms of the proposed rate structure, the income level at which the maximum marginal rate of 45 per cent is reached is raised from R80 000 to R100 000. Furthermore, the combined effect of the proposed rate structure and the proposed increase in the primary rebate from R2 625 to R2 660, is that the minimum tax threshold for persons under the age of 65 is increased from R14 600 to R15 580 (or by 6,7 per cent).

For example, last year a taxpayer under the age of 65 with a normal taxable income of R25 000 would have had a tax liability of R2 125. This year his or her tax liability will be R1 890, a tax saving of R235 or some 11 per cent for the year.

On the other hand, a taxpayer under the age of 65 with a taxable income of R85 000 would have had a tax liability of R26 310. This year his or her tax liability will be reduced to R24 940, which is a tax saving of R1 370 or just over 5 per cent.

Furthermore, some individuals older than 65 are currently exempt from the payment of provisional tax if their annual taxable income from salary, interest and rental does not exceed R35 000. It is proposed that this exemption threshold be raised to R50 000.

The cost to the fiscus of these personal income tax proposals is R2 billion.

All the tax measures proposed today as well as a few consequential measures are discussed in detail in the Budget Review and in notices released by Inland Revenue and Customs and Excise.

THE BUDGET DEFICIT AND FINANCING

With total expenditure and revenue estimated at R173,7 billion and R144,9 billion respectively, the resulting deficit amounts to R28,8 billion or 5,1 per cent of GDP. This represents a significant decrease from the revised estimate of 6,0 per cent in 1995/96. If the once-off transfer from the Central Energy Fund is excluded the estimated deficit amounts to 5,5 per cent of GDP compared to 6,1 per cent in the previous year. In keeping with past practice it was assumed that the amount of roll-overs in 1996/97 will be the same as in 1995/96. Whatever the eventual amount, it will not influence the goal of a phased deficit reduction.

Loan redemptions during 1996/97 total some R16,5 billion, which together with an expected R200 million premium on government stock, will result in a gross borrowing requirement of R45,1 billion.

As in the past the bulk of this amount will be financed in the domestic market. The size of this demand is not expected to influence interest rates in any way. Provision is made for only R2,5 billion in new foreign funding.

To this financing need must be added an estimated discount on sales of new government stock of R2,8 billion bringing total projected government debt to R311,6 billion (or 55,6 per cent of GDP) compared to R280 billion (or 56,0 per cent of GDP) in 1995/96. This projection, although on a comparable basis, does not include further forward cover losses on the Gold and Foreign Exchange Contingency Reserve Account and any changes in government debt that may result from the utilisation of switch facilities and a revaluation of existing foreign loans due to changes in the exchange rate. It also excludes R1,1 billion representing debt of former territories which was dealt with in the Adjustments Estimate as well as pre-independence Namibian debt which at 31 January 1996 amounted to R1 billion. Legislation to effect the take-over of these debts will be introduced during this year.

THE BUDGET IN PERSPECTIVE

This Budget will not please everyone: budgets never do. Yet the Budget is the result of wide-reaching consultations with various stakeholders. In our sport analogy referred to earlier, the government has been discussing its tactics and strategies with the various team members. Since its start, some 12 months ago, the budget process involved parliamentarians through discussions with the Joint Standing Committee on Finance; had representations from the Standing Committee, departments, provinces, labour and business on the Budget Committee; a so-called budget paralleling process in NEDLAC where, as the budget issues developed, they were simultaneously debated in that forum; and bilateral discussions with the above groups as well as other interested parties especially those most affected by budget measures - this Budget for example involved particular liaison with the liquor, tobacco and retirement fund industries as well as the labour movement. Various press and other briefings were also held: an example of allowing the spectators to see better. We are again publishing the Citizen's Guide to the Budget in all eleven official languages in an ongoing effort to inform the public better about the Budget and its role in our lives. Copies of this Guide are available today.

The Government is approaching the year full of confidence after achieving a good measure of success over the past two years in respect of macroeconomic balances, expenditure control, debt management and revenue collection. During 1996/97 our aim is to consolidate, build on and reinforce these initiatives and to focus intently on implementation and delivery.

The Budget must not be seen as a once-off financial exercise designed exclusively for 1996/97. It is rather part of an ongoing process of reform and restructuring, building on past achievements to secure future successes. Some of the measures taken this year should yield results in the short-term, others would probably take a year or more, while some should facilitate changes envisaged for later years.

To reiterate our priorities - we have to make a meaningful impact on unemployment and poverty. The preconditions for this are clear: a strategy that addresses the socio-economic imperatives of health, education, housing and welfare and combats criminality within a sustainable macroeconomic framework. We will devote special attention to designing an appropriate social security system.

If we succeed, people will increasingly be drawn into the economic system, able to contribute to and share in the wealth and well-being of the country.

From a macroeconomic perspective, this Budget should strengthen the economic recovery through the tax and borrowing proposals. It is not seen as an impetus to inflation and the reduction in absolute terms of R1,3 billion in the budget deficit should be positively received in the domestic and foreign financial markets as evidence of continued financial discipline. It needs to be pointed out that this reduction was achieved in spite of an estimated increase in state debt costs of R5,2 billion and a further RDP allocation of R7,5 billion for 1996/97.

In terms of our fiscal guidelines this Budget remains firmly on track. The estimated budget deficit, as percentage of GDP, is down from an estimated 6,0 per cent in 1995/96 to 5,1 per cent in 1996/97. The national budget represents at last a primary budget surplus of 1 per cent of GDP or, put differently, total estimated revenue is expected to exceed total estimated non-interest expenditure by 1 per cent of GDP. The estimated decrease in the total debt to GDP ratio from 56,0 per cent to 55,6 per cent is, partly, the result of this surplus. Non-interest current expenditure is also expected to show a decline from 22,9 per cent of GDP to 22,3 per cent between 1995/96 and 1996/97. National government dissaving, i.e. the difference between total estimated current expenditure and total estimated current revenue, is expected to decrease from 3,6 per cent of GDP in 1995/96 to 3,0 per cent in 1996/97. These trends are all very encouraging.

Tax revenue as a percentage of GDP is, however, estimated to increase marginally to 25,1 per cent from 24,6 per cent in 1995/96, partly due to improved collections. Estimated capital expenditure, also as a percentage of GDP, is expected to be reduced to 2,5 per cent from 2,7 per cent last year. This can be explained by lead-time delays in the financing and execution of capital projects in previous years, making a share of those funds available during 1996/97. A smaller budgetary provision for capital expenditure is thus possible.

To return to our sport analogy: we have a balanced and well-prepared side, having gone through many vigorous planning and training sessions. This must be the year to get points on the scoreboard - the year of meaningful delivery in terms of the National Strategic Vision and related initiatives.

We cannot afford to fail our people. They have been waiting patiently for results and we owe them that. With the 1996/97 Budget we hope to get on the scoreboard in a big way.