MEDIUM TERM BUDGET POLICY STATEMENT 97 - FOREWORD

The fundamental objective our Government pursues is the creation of a democratic, non-racial, non-sexist and prosperous society.

To this end and very early in its life, it adopted the Reconstruction and Development Programme (RDP) as the policy framework within which it would work to achieve this objective.

Subsequently, Government elaborated the Growth, Employment and Redistribution Strategy as one of its principal instruments for the realisation of the policy objectives contained in the RDP.

These three categories – the fundamental objective, the policy framework and the principal instruments – represent the stable policy base which will inform Government activity for a long time to come.

Naturally, from time to time, adjustments will be made to the practical programmes emanating from this base, to respond to the changing realities of our economy and society and the world environment.

The Budget is one of the further principal instruments available to Government to advance the objectives contained in our policy base.

It gives practical expression to our ambitions and priorities. It indicates the limits of what we can do immediately, while further strengthening our possibilities to build a better life for all, on a sustainable basis.

Thus, while reflecting short-term year-on-year decisions, it creates the conditions for our future medium and long-term programmes.

To make it possible to engage in a rational and focused process of resource allocation stretching beyond the immediate, our Government decided to evolve a Medium Term Budget Policy Statement.

The Budget Policy Statement does not constitute a new policy. It is the operational plan in the sphere of the national budget, designed to give effect to the objectives already spelt out in our established policy base.

We publish this Budget Policy Statement both to indicate Government's views on this issue and to enable broad participation in the decision-making process affecting our medium-term budget perspectives.

We believe that these decisions should be taken in partnership:

- partnership within the national government, as we decide our priorities collectively;

- partnership among the national and provincial governments, as we address our reconstruction and development needs together;
- partnership with our legislatures, as we discharge our responsibilities to the people who elected us; and
- partnership between government and the people, as we give substance through the budget to our agreed social goals.

Consistent with our established policy base, this Budget Policy Statement highlights our
hared commitments:

- meeting the basic needs of the people;
- accelerating infrastructure development to address these needs and to reorient the budget towards development rather than consumption expenditure;
- laying the basis for sustained economic growth, development and job creation;
- development of our human resources;
- ensuring the safety and security of the citizen and the state; and
- transforming the organs of government to reflect the developmental and people-centered nature of our democratic state.

In addition to these and other objectives, the budget process must also reflect the constraints within which policy is implemented. It takes account of the likely evolution of the economy and therefore the resources available to the public sector.

It rests on a review of the implications for services of spending trends and policy choices, within the framework of what is affordable.

This Budget Policy Statement thus sets the context for Government's deliberations on the budget.

In addition, it constitutes a further step in the direction of transparency and accountability in the budget process. It empowers the nation as a whole to participate in the discussion in the run-up to the next Budget, by ensuring that there is a shared understanding of the social, economic and fiscal policy framework within which the Budget is framed.

It is a further step towards more inclusive policy making and the reinforcement of the partnership within Government and throughout the nation.

Accordingly, on behalf of our Government, I commend this Medium Term Budget Policy Statement to the people.

Trevor A Manuel, MP
Minister of Finance
2 December 1997

MEDIUM TERM BUDGET POLICY STATEMENT 97 - INTRODUCTION

Relationship with the budget

Government’s spending plans for the next three years will be published in March 1998. These plans will give substance to Government's reconstruction and development commitments, within an overall level of spending that the nation can afford.

These are the most important choices any government can make. The Budget must reflect Government's social and economic priorities, and its expenditure plans define the nature and scale of the Government's ambitions for the nation.

What is the Budget Policy Statement?

This Medium Term Budget Policy Statement sets out the policy framework for the coming budget. It describes Government’s goals and objectives. It explains the economic environment within which those objectives are being addressed, and projects the total level of resources that will be available. The Policy Statement analyses the trade-offs and choices that the nation confronts in addressing its reconstruction and development priorities.

The Medium Term Budget Policy Statement is an important step forward in the budget process. In keeping with our commitment to open, transparent and cooperative policy-making, it invites the nation to share with Government the important choices that must be made.

The Medium Term Expenditure Framework

Medium term budgets

The key features of the new medium term budgeting system are:

- publication of three-year forward estimates on Budget Day, consistent with Government’s policy priorities and commitments;
- detailed analysis of the policy implications of budget projections;
- cooperative teams, composed of national and provincial treasuries and line departments, analysing key sectors and reporting to Cabinet and Executive Coucils;
- quantified, analysed policy options presented to political office-bearers for decision; and
- he publication of a Medium Term Budget Policy Statement, to enable Parliament and the institutions of civil society to participate meaningfully in the debate.

Rolling budgets

The Medium Term Expenditure Framework initiates a process of rolling three-year budgets. The MTEF projections published on Budget Day will be considered again in the course of 1998, and revised according to new information and policy priorities. The three-year allocations will represent the starting point for that process, and departments will therefore have agreed spending trajectories within which to plan.

Departments will be expected in future to frame their policy proposals within their three-year allocations. The introduction of resource-based planning represents a significant change in the planning environment and will initiate a major process of programme reprioritisation and redesign within spending departments.

Public debate of plans

As in previous years, Parliament will be asked to vote only on the Budget allocations for the coming year, and not on all three years of the spending projections. But the detailed three-year spending plans will provide an opportunity for Parliament, the National Economic Development and Labour Council (NEDLAC) and civil society to evaluate the Budget allocations for the year immediately ahead in the context of the medium term evolution of Government's expenditure priorities. Parliament will be invited to debate the expenditure plans, and to ensure that they reflect national goals and priorities.

This process therefore provides new opportunities for all stakeholders to analyse and discuss the expenditure projections, and to ensure that alternative views are fully taken into account in framing the subsequent MTEF.

The MTEF and budget reform

Overhaul of the budget process

The publication of the Medium Term Budget Policy Statement, and the publication in March of three-year budget projections, are first steps in a wider overhaul of the budgetary process, emphasising transparency, output-driven programme budgeting and political prioritisation. The MTEF provides the bridge between the technical preparation of budgets and the need to reflect political priorities in expenditure plans.

A brief account of the new budget process is set out at the end of this chapter. Further steps in budget reform will be taken in 1998. These will include a transition to greater devolution of managerial autonomy, within a framework of improved incentives and greater accountability, accompanied by reforms of financial management.

Provincial and local government

The policy goals of Government will be reflected not only in the national budget, but also in the budgets of provincial and local government. Provincial and local government will receive their equitable share of nationally raised revenues as well as other transfers. However, they have the responsibility of developing their own budgets, within expenditure allocations consistent with the nation's policy priorities. The national government does not control the details of these budgets, but can influence them indirectly through agreed policies and framework legislation setting norms and standards.

The introduction of three-year budgets and their consolidation into resource envelopes for the major provincial services is an important step in the evolution of the institutional framework for intergovernmental policy making and budget planning. The intergovernmental forums of the spending departments will, for the first time, have expenditure projections within which to develop and refine the norms and standards for service delivery.

Role of Accounting Officers

Once Parliament and provincial legislatures have approved their budget proposals, departments must adjust their expenditure to ensure that they stay within their budgets. It is the responsibility of Accounting Officers, appointed by political office-bearers, to ensure that allocations are applied to their intended purposes and spending limits are respected. This principle will be strictly enforced by the proposed Treasury Control Bill which is due to be introduced in Parliament next year, replacing the ten Exchequer Acts which govern provincial and national financial management.

Conclusion

The publication of the Medium Term Budget Policy Statement is a step forward in the openness of the budget-making process. It empowers all stakeholders to have a real part in the discussion of the nation's priorities. It makes transparent the budget framework through which Government seeks to achieve the nation's social and economic development goals.

MEDIUM TERM BUDGET POLICY STATEMENT 97 - SOCIAL DEVELOPMENT & ECONOMIC TRANSFORMATION

Introduction

Reconstruction and development

The Reconstruction and Development Programme (RDP) sets out Government's commitment to the elimination of poverty in a rapidly growing and more equitable economy and in the context of an open, peaceful and democratic society. It establishes a programme for orienting the activities of Government fully and effectively towards reconstruction and development goals, within a sound fiscal and macroeconomic framework.

The Medium Term Expenditure Framework seeks to give budgetary content to Government's RDP commitments, within the context of an agreed macroeconomic strategy, while identifying and clarifying some of the crucial systemic reforms that are needed if public policies are to succeed in accelerating social and economic progress.

Macroeconomic strategy

A key step forward in establishing this framework was taken with the publication of the Growth, Employment and Redistribution Strategy in June 1996. Government's macroeconomic strategy focuses on the need to enhance the international competitiveness of the economy and consolidate the fiscal position. It points to the links between an improved growth performance and the sustainability of Government's social and developmental programmes.

The macroeconomic framework emphasises the importance of redistribution in government expenditure priorities and the role of sectoral policies in meeting basic needs and improving services to previously disadvantaged people and the poor. These and other policy commitments have been elaborated in considerable detail in departmental White Papers and other official publications. Government's approach is that economic growth should be translated into redistribution of incomes and opportunities through appropriate social development programmes, economic empowerment and deliberate promotion of employment creation.

Demographic transition

South Africa is undergoing a demographic transition with profound consequences for social policy and economic transformation.

1996 Census

The preliminary 1996 census results published by the Central Statistical Service suggest that urbanisation has accelerated and average fertility rates have declined steadily for two decades or more. It now appears that the present generation aged 10-14 represents a demographic peak, and age cohorts that follow will be smaller in absolute size.

The graph below illustrates the age distribution reflected in the preliminary 1996 census results.

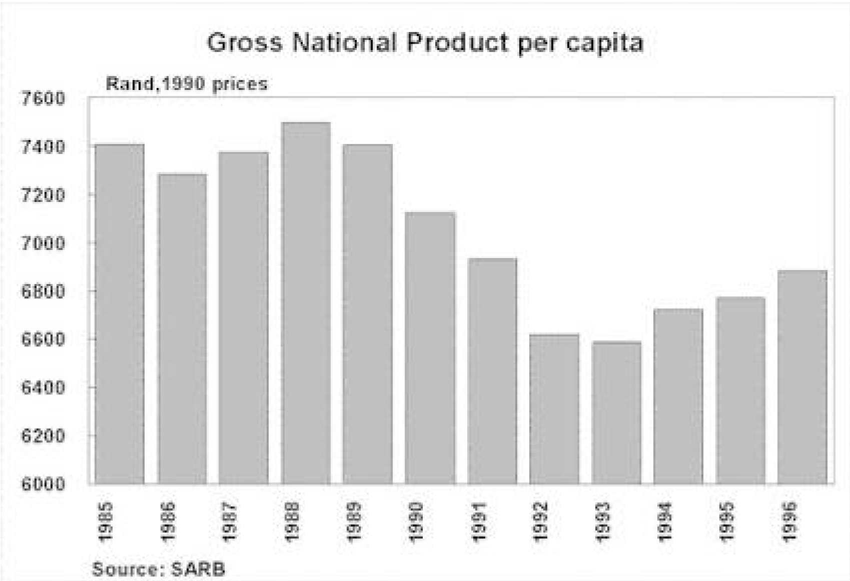

Figure 2.1: Estimated 1996 age distribution

Labour market

Demographic trends, education and urbanisation impact critically on the entry level labour market.

The number of young people leaving secondary or tertiary education and entering the labour market each year has increased from perhaps 350 000 in the mid-1980s to about 450 000 today. As the throughput of the school system improves and the demographic peak reaches school-leaving age, the inflow into the labour market will swell to over 600 000 in the early 21st century.

Job creation remains very slow, however. The result is that South Africa faces an escalating mismatch between demand for and supply of job placements in the first-time entry labour market.

Growing youth unemployment is a powerful determinant of current crime trends, puts pressure on welfare, health, education and training systems and threatens the integrity of family and community structures. This is perhaps the single greatest challenge that faces South African social, economic and labour market policies.

Effects of HIV

The high prevalence of HIV amongst large segments of the South African population adds to this challenge. In the absence of any major breakthrough in countering HIV infection or curing the disease, AIDS will impact significantly on future mortality, family structure, labour market participation and demands on health and welfare services.

Government has taken account of these trends in setting expenditure priorities and identifying outstanding policy issues. Economic development policies are aimed at accelerating job creation. The further education system needs to be expanded and overhauled. The needs of children and the reform of the child and youth care system are the focus of coordinated initiatives. Housing programmes and infrastructual development take account of urban migration and related social needs.

Employment creation

Employment strategy

The central objective of Government's employment strategy is to increase the labour absorptive capacity of the economy. To do this, we need to improve the skills base of labour, remove structural impediments to job creation and identify key employment generating opportunities.

Under the auspices of the Department of Labour, a coordinated approach to addressing the unemployment problem is envisaged. The strategy will:

- identify key policies initiatives to be strengthened or accelerated, focused on those policies that will offer the most employment generating potential;
- facilitate mutually supportive policy clusters to ensure policy alignment and maximum impact on employment creation;
- seek a common vision which would commit social partners to specific actions in support of employment creation, to be presented at the Presidential Job Summit to be held in mid-1998;
- develop an implementation and monitoring plan for the realisation of the employment strategy.

Employment creation is an aim of a range of industrial support policies, tourism promotion, small business development and agricultural support. The employment strategy will focus on those policies that create a conducive environment for employment creation and measures which create employment directly. These include employment promotion in the private sector and special labour-based programmes of government.

Government spending priorities include social development and infrastructure projects with significant employment potential and targeted employment relief schemes. During 1996/97, the working for water programme, the municipal infrastructure programme and the community-based public works programme provided about 50 000 temporary job opportunities. These are effective poverty alleviation initiatives and should be expanded.

Skills development strategy

It is evident that the mismatch between job opportunities and young work-seekers cannot be addressed by labour-based projects targeted at unskilled workers. Government has tabled a skills development strategy that aims to raise the level of investment in training across the economy as a whole. A key focus of the strategy is the creation of learnerships that would bridge the gap between formal schooling and work experience, contributing both to skills enhancement and improved labour market mobility.

Education

Challenges

South Africa now has near-universal schooling, and a slowdown in the expansion of enrolment in education can be expected. However, much of the school system suffers from poor management, high repetition and absenteeism, inadequate work effort and considerable deficits in basic infrastructure and support materials. The main challenge confronting South African schooling is improving the quality of education. This can only be achieved if glaring inequalities are addressed, efficiency is increased and effectiveness improved.

There are marked shifts in the composition of the school population which require policy responses, including significant shifts of teaching personnel and resources. This and the challenge of addressing inequality require adaptability in personnel management, school financing and resource allocation, as well as enhanced education management systems. Major initiatives are in progress aimed at addressing these needs, involving the national and provincial authorities and drawing on non-governmental and private sector support.

Training & vocational education

In the context of the challenges we face in the market for first-time work-seekers, the evolution of training and vocational education is crucial. Achieving an improved fit between training needs and resource allocation is dependent both on sound budgetary decisions and a stronger mobilisation of private sector resources, driven by the productivity and competitiveness gains associated with skills development. Government is exploring a new approach to financing further education, to put fiscal resources to better use and to encourage growth of private spending on training and education.

Higher education

A thorough review of higher education has led to proposals for a more output-driven approach to government funding, greater support for student financial assistance and a rationalisation of existing programmes and institutions. South Africa has a dynamic and extensive higher education sector, which provides both a firm foundation for educational development and an important source of research and skills for social and economic development.

Health services

Existing provision

South Africa has a dynamic private health sector, financed through medical scheme or insurance coverage of between a fifth and a quarter of the population. Public health services, mainly under provincial management, include hospital and clinic services available to everybody, financed largely through the fiscus.

Medical schemes

Medical schemes are increasingly adopting managed-care strategies in containing costs, and individuals can now choose from a wide range of health assurance options. Medical scheme contributions by employers are favourably treated in the income tax system, which has underpinned the growth of the industry over several decades.

Primary health care

The public health system is reorienting its resources in favour of a district-based primary care service, aimed at raising utilisation of primary health services from 1,8 to 3,5 visits a person a year. The strategy assumes that uninsured people will increasingly use public facilities rather than fee-for-service private practitioners.

Hospital services

Government also aims to rehabilitate and rationalise the existing network of some 420 public hospitals, many of which are in disrepair and are badly managed. A hospital strategy project has been initiated, focused on improving hospital management, while preliminary work has been undertaken on a major physical rehabilitation programme.

Social security and developmental welfare

Social grants

Social security and welfare programmes are strongly redistributive. Household survey data indicate that social grants are a crucial source of income to poor households, particularly in rural areas. Nearly 90 per cent of expenditure on social security and welfare services is taken up by categorical social grants, of which the old age pension is the most important.

Against a background of inadequate management of social security entitlement programmes, the provinces and the national Department of Welfare have embarked on a major investment in information technology and coordinated system restructuring. It is expected that this will lead to significant savings through reduced fraud and improved management.

Child support grant

Government has agreed to introduce a new child support grant, targeted at children under the age of seven, to be phased in from 1998 onwards. This will replace the existing child maintenance programme, providing a cash benefit to a larger constituency of beneficiaries, on an equitable and affordable basis.

Developmental welfare

Welfare services are targeted towards children, youth, women, families in need, the aged and people with disabilities. These services are presently undergoing transformation, focused on prevention of distress, early intervention and developmental care. Government aims to ensure adequate care and protection, reduction and alleviation of poverty, and compliance with international conventions such as the UN Convention on the Rights of the Child.

Security and stability

Government is implacably committed to the rule of law and to stepping up the war against crime.

Social dislocation, impoverished urban living conditions and increasing numbers of frustrated young work-seekers have contributed to a serious escalation in violent crime and associated insecurity. Social development and employment creation will, over time, alleviate this scourge. For the present, and in the context of the medium-term expenditure framework, a comprehensive and vigorous attack on crime must be central to Government's planning and budgeting.

Crime prevention strategy

High levels of crime and social instability are threats to South Africa's economic growth and development prospects. The Government has therefore adopted a wide-ranging crime prevention strategy, based on aligning the activities of the component parts of the criminal justice system to improve effectiveness and shift the focus from controlling to preventing crime. Major new initiatives are underway aimed at streamlining and strengthening the focus of policing, the administration of justice and the management of correctional services.

Civil justice

The Constitution provides a clear framework for the protection of human rights and the establishment of institutions in support of civil liberties. Government has given effect to these commitments and will continue to uphold a culture of democracy and respect for civil rights.

Defence

There has been a substantial phased reduction in public spending on national defence. A full-scale defence review has clarified the role and future structure of the armed forces. The SANDF contributes to several components of the national crime prevention strategy, and has established a Service Corps to prepare ex-combatants for integration into civil society.

Maintaining safety and security and protecting the rule of law are unambiguously core functions of the State. These are costs that have to be met by taxpayers, but Government has also recognised the considerable gains that can be won from improved management, better organisation and coordination of the various arms of the criminal justice system.

Promoting economic development

Economic development requires improved competitiveness and employment creation across many sectors of the economy. South Africa continues to be an important mining economy, in which advanced mineral beneficiation projects and a wide range of extractive industries generate significant foreign exchange earnings and create incomes and employment for large numbers of people. But mining cannot be a long-term engine of growth, and employs fewer workers each year as gold mining slows and more capital intensive technologies are adopted.

Industrial incentives

Government is aggressively promoting more rapid industrial development. Tax incentives have been introduced for new investments in manufacturing plant, equipment and buildings, and a tax holiday is now available to new industrial projects for a period of time determined by regional location, job creation and industrial priority.

Closely related to these measures are twelve industrial priority investigations and regional industrial location studies, and a comprehensive review of competition policy. The Simplified Regional Industrial Development Programme has been adapted as a grant programme tailored to the needs of small and medium-sized firms.

Tourism promotion

South Africa has considerable tourism potential. Tourism promotion has been strengthened, and substantial investments in the hotel and accommodation industry and related services are in progress.

Small business development

Several initiatives aimed at supporting small and medium-sized business development are gathering momentum. The National Small Business Act was passed in November 1996, providing for the establishment of Ntsika Enterprise Promotion Agency and a National Small Business Council. The Khula Enterprise Finance Company is operational, and has initiated a credit guarantee scheme and a capacity building project targeted at retail financial intermediaries.

Agricultural development

Significant progress has been made in the deregulation of agricultural marketing during the past few years. Marketing schemes and control boards have largely been phased out. An overhaul of financial support schemes is in progress, together with the restructuring of the Land Bank, agricultural credit facilities and various regional development agencies. A special programme has been introduced to give the landless poor access to land, and various measures of support are provided to resource-poor farmers.

State asset restructuring

The restructuring of state assets continues to offer significant opportunities to attract private investment into reconstruction and development priorities, and also to rationalise functions carried out directly by the state and to promote empowerment and other economic policy objectives.

Infrastructure investment

Government's macroeconomic framework provides for a marked acceleration in investment spending. This partly reflects the need for transport and communications infrastructure associated with increased trade and industrial activity. Substantial social infrastructure backlogs must also be addressed, including shortfalls in the national housing stock and the absence of sport and recreation facilities. Investments in water supply and improved housing infrastructure are amongst the most cost-effective options for enhancing the quality of life of the poor.

Backlogs

Major audits have now been conducted by the health and education authorities, assessing and quantifying rehabilitation and construction needs – some R8 billion for hospitals and up to R30 billion for schools over a 10-year period. Housing delivery and urban and rural development also depend on strategies to meet substantial infrastructure needs. It is estimated that 15 per cent of the urban population rely on untreated water sources, 30 per cent share unimproved latrine facilities, 32 per cent do not have access to electricity and 30 per cent do not have formal road access or storm water drainage.

These are areas in which the adoption of a three-year budget framework, procurement reform and better coordination across provinces should contribute to improved performance. Actual construction of clinics and classrooms has lagged behind budgetary provision in recent years, partly because of delays in tender procedures but also as a consequence of more careful planning and design.

Public-private partnerships

Alongside these important aspects of financial reform, investigations are in progress on the scope for public-private partnerships in infrastructure development. There are various options, ranging from full privatisation of service provision to limited contractual participation.

Where private partnerships are accompanied by increased cost-recovery from users, reforms may well have significant distributional effects. Where costly services have been inequitably provided in the past, new financing and governance arrangements can have the effect of lowering the fiscal contribution to privileged services, facilitating greater equity. Across a broad spectrum of services – transport, communications, water, health and education – there is scope for focusing public finance on the needs of the poor by bringing private finance into services used by those who are able to bear some of the costs themselves.

MEDIUM TERM BUDGET POLICY STATEMENT 97 - MACROECONOMIC POLICY & PROSPECTS

Macroeconomic policy framework

Government has adopted a macroeconomic policy framework which will deliver job creation, better export performance, more investment, greater efficiency and equity of government spending and enhanced human resource development.

Challenges

This is a policy framework that takes into account the structural challenges the economy must confront:

- Economic expansion in South Africa tends to lead to a rapid growth of imports, putting the balance of payments under pressure and constraining the prospects for sustained growth.
- Investment and savings levels, which have been uncharacteristically low in recent years, will need to be substantially increased if strong growth is to be sustained.
- Unemployment remains a major economic weakness, contributing both to the high degree of income inequality and social fragmentation that characterise South Africa. Not enough jobs are being created as the economy grows.

The macroeconomic dimensions of Government's response to these challenges were outlined in the *Growth, Employment and Redistribution* framework published in June 1996.

Real output and expenditure trends

Gross domestic product

The economy is currently in its fifth year of economic expansion. For 1997, total real national income was 2,2 per cent higher in the first half of the year than in the corresponding period of 1996. Average growth of around 2 per cent is expected in 1997/98. This is somewhat less than anticipated at the time of the last Budget, reflecting both lower levels of agricultural output and slower growth in gross domestic expenditure. However, manufacturing output has been boosted by strong export demand, in part prompted by the sharp real depreciation of the rand during 1996.

Consumption

Sluggish growth in private consumption has been the primary reason for the slowdown in domestic expenditure in 1997. Household spending has been constrained by high levels of private indebtedness and relatively high interest rates. Having risen by an average of 3,9 per cent annually between 1993 and 1996, private consumption grew by 2,2 per cent in the first half of 1997 compared to the first half of the previous year.

Investment

The growth in gross domestic fixed investment slowed to 2,6 per cent in the first half of 1997, after expanding by 8,6 per cent a year over the previous three years. This is in part because several large projects have reached completion. Government aims to promote a marked improvement in the investment trend over the next three years.

Inventory levels appear to have been reduced in 1997 in response to the slowdown in domestic expenditure.

Prospects for growth

The continuation of the policies outlined in Government's macroeconomic strategy will lay the foundations for stronger economic growth. However, domestic economic growth has slowed in 1997, and emerging markets worldwide have experienced increased financial uncertainty.

Structural transformation of the economy takes time to impact favourably on growth and development. Recognising the uncertainty in future economic trends, the budgetary projections for 1998/99 to 2000/01 incorporate more cautious economic assumptions than the integrated scenario set out in the 1996 *Growth, Employment and Redistribution* framework.

Over the next three years, GDP is expected to accelerate as a result of further export growth, a recovery of domestic demand and continued investment in productive capacity. Real GDP is projected to grow by about 3 per cent in 1998/99, 4 per cent in 1999/00 and 5 per cent in 2000/01.

Inflation and monetary policy

Objectives

The main objectives of monetary policy continue to be the maintenance of financial stability and the reduction in the rate of inflation. Monetary policy contributes to attracting foreign investment, preventing the outflow of domestic savings and reducing price distortions within the economy.

Inflation trend

Inflation has exhibited a declining trend since 1993, fluctuating between 5 and 10 per cent, well below the average for the previous two decades. Although inflation increased to over 9 per cent for the first eight months of 1997, this was a comparatively muted response to the exchange rate depreciation in 1996, indicating that inflationary pressures within the economy remain firmly on a downward trend.

Consumer price increases averaged 9,3 per cent for the first eight months of 1997, after recording an average 7,4 per cent increase in 1996. The year-on-year inflation for October was 7,5 per cent, confirming a declining trend that is expected to continue into 1998.

Money supply

Having declined significantly in the early 1990s, the growth of broad money (M3) increased rapidly after 1993 and has averaged over 14 per cent for the last three years, primarily as a result of private credit growth. This has contributed to the need for a cautious monetary stance.

For the first eight months of 1997, M3 growth averaged 15,1 per cent in comparison to 13,6 per cent for 1996. M3 growth for 1997 will exceed the previous year's level, as a result of the continued growth in domestic credit and substantial net capital inflows, which have increased foreign reserves. In the second half of the year a declining trend has been evident.

The slowdown in M3 and private sector credit growth enabled the Reserve Bank to announce a reduction in the bank rate from 17 per cent to 16 per cent on 17 October 1997.

Prospects

For the next three years, real wage increases in line with productivity growth, a stable real exchange rate and the fiscal policy stance should contribute to a further moderation of inflation and associated downward adjustments in interest rates. A GDP inflation rate of 7½ per cent is envisaged for 1998/99, declining to 6½ per cent in 1999/00 and 6 per cent in 2000/01.

Balance of payments and the exchange rate

Current account

Faster growth of demand than supply over the past two years has resulted in persistent deficits on the current account of the balance of payments. For the first half of 1997, the current account deficit was 0,9 per cent of GDP. For the year as a whole, the deficit is expected to be 1 per cent of GDP or approximately R6 billion. The lower deficit for 1997 is the result of accelerated export growth as envisaged in the macroeconomic strategy, and lower import demand as a result of slower domestic expenditure growth.

Tariff reform

Further improvements in the current account depend in part on the elimination of the bias against exports that tariff protection has imposed upon the economy. The macroeconomic strategy suggests that the average customs duty expressed as a share of total imports should be reduced from 10 per cent to 6 per cent by 2000. The envisaged acceleration of the tariff adjustments to which South Africa is committed in terms of World Trade Organisation agreements will encourage additional investment and job creation in competitive sectors of the economy. Tariff liberalisation is a complex process, however, involving large numbers of individual tariff lines and many stakeholders, including South Africa's regional SADC partners. Trade reform is being pursued through both ongoing domestic consultation and international negotiations.

Exchange rate

Government recognises that stability in the real exchange rate is an important foundation for sustained development of export industries. The real effective exchange rate depreciated by an average of 8,2 per cent in 1996, after a 0,2 per cent appreciation in 1995. Government accepts that the depreciation in 1996 represented a necessary improvement in the competitiveness of the currency. The 1996 depreciation was partly reversed during the first four months of 1997, in a context of substantial capital inflows. The exchange value of the rand is expected to continue to depreciate in line with South Africa's somewhat higher inflation rate than that of our major trading partners.

Capital account

From the third quarter of 1994 to the first quarter of 1997, capital inflows of some R35 billion flowed into South Africa, while the cumulative current account deficit over this period amounted to R22,9 billion. Net capital inflows were particularly strong in the first half of 1997. The substantial inflow has raised the country's foreign reserves well beyond past records. At the end of September, foreign exchange reserves were more than double their level at the time of the 1994 elections.

Exchange controls

Exchange controls discourage foreign investment and undermine domestic investor confidence. Government is therefore committed to the gradual removal of exchange controls. These have been relaxed in several steps, aiming towards the complete abolition of restrictions on foreign exchange transactions.

Adjustments to the exchange control regime in 1996 included an enhancement of the access of foreign investors to domestic credit, an increase in the limit to which institutional investors are subject in acquiring foreign assets and adjustments to various quantitative restrictions.
Exchange control relaxation in 1997 has included provisions allowing limited transfers of capital abroad by individuals and measures aimed at encouraging corporate investments in the SADC region.

Implementation of exchange control reforms has proceeded smoothly, with no adverse consequences for exchange rate management.

Prospects for the balance of payments

During the next three years, current account payments should continue to exceed receipts by between 1 and 2 per cent of GDP. Strong expenditure growth and higher investment levels will lead to rising imports, but it is expected that domestic capacity expansion and export growth will keep the current account deficit within moderate bounds.

Large and unpredictable capital movements are a feature of the global economy. It is anticipated that net capital inflows will match or exceed the current account deficit over the 1998-2000 period, including increased levels of direct foreign investment. Fiscal policy is sound, real interest rates are attractive and the projected growth creates profitable opportunities for foreign investors. Government's overall macroeconomic framework continues to contribute to confidence in the rand and the South African economy.

Investment and savings

Gross domestic fixed investment

Gross domestic fixed investment reached 16,8 per cent of GDP in the first half of 1997. Investment has averaged under 17 per cent of GDP since 1995, after falling to just 15,5 and 16 per cent of GDP in 1993 and 1994. As anticipated in the macroeconomic strategy, foreign capital inflows continue to be an important factor in securing an adequate level of domestic investment.
Public sector investment

The national accounts indicate that gross domestic fixed investment by public authorities in the second quarter of 1997 had increased by 4½ per cent in real terms over the same period in 1996, and by 8½ per cent over the 1995 level.

As Government delivers its RDP objectives, several areas of public investment spending are gaining momentum. The housing programme has accelerated and significant investments are being made in community water supply projects, electrification and telecommunications infrastructure. Progress has also been made in identifying public-private partnership arrangements in water supply, municipal infrastructure and prison construction, in effect transferring demand for capital from the fiscus to the private sector.

Substantial backlogs in education and hospital infrastructure will remain areas of priority spending for years to come. Government investment spending will focus on redressing social and economic backlogs, particularly in townships and rural areas.

Savings

Gross national savings have declined from 17 per cent of GDP in 1995 to 16 per cent in 1996 and to 15,5 per cent in the first half of 1997. Dissaving by general government amounted to 3,7 per cent of GDP in 1996, highlighting the importance of fiscal deficit reduction in the overall macroeconomic strategy.
Government's macroeconomic policy aims to achieve a substantial increase in the level of domestic savings available to finance investment, a sustained increase in public sector investment spending and continued growth in direct foreign investment.

Encouraging growth and employment

Employment trends

Rising levels of output since 1993 have not resulted in equivalent increases in total employment in the formal sector. Formal sector employment statistics have shown a disappointing trend, with job losses continuing in many sectors. The recorded employment series do not fully reflect labour market developments, but it is clear that job creation is not keeping pace with the growth of the labour force.

Elements of a growth strategy

Increasing the rate of job creation requires a structural reorientation across several fronts of the South African economy. Government has initiated a number of spatial investment projects, aimed at building a dynamic interface between infrastructure investment and industrial expansion. Tourism promotion generates jobs across a broad spectrum of services. A range of export support programmes are in place, and industrial investment is encouraged through tax incentives and several supply-side schemes. Land and agriculture policies are aimed at achieving social stability as well as strengthening income-generating ventures. Education and skills development programmes are designed to put longer term employment and productivity enhancement on a sound footing.

Government's direct efforts to reduce unemployment include increased public investment and support for labour-based development schemes, enhancement of employment services and policies focused on the first time entry job market.

Economic outlook

GDP growth

Economic growth is expected to strengthen over the next three years, building on the structural transformation of the economy that is in progress.

Demand

Steady increases in private consumption expenditure and significantly stronger investment will underpin the expansion in domestic demand. Private consumption should grow by 3 to 4 per cent a year and gross domestic fixed investment by 5 to 9 per cent a year.

Balance of payments

The positive export trend of 1997 is projected to continue over the next three years, reinforced by robust world economic output trends and the response of domestic industry to improved competitiveness and export opportunities. Increased domestic demand is expected to lead to continued growth in real merchandise imports.

Sufficient capital inflows are anticipated to accommodate the envisaged deficit on the current account of the balance of payments of up to 2 per cent of GDP. The nominal average effective exchange rate is expected to depreciate by around 4 per cent per year.

Financial stability

Growth in consumption expenditure is expected to be an important source of overall growth in demand, but this should allow for a modest improvement in domestic savings. The realisation of a healthy net capital inflow, including both direct investment and portfolio flows, is an important pre-requisite of the projected improvement in economic performance. Capital inflows not only raise the level of investment, but are also needed to provide liquidity to money and capital markets and ease upward pressure on market interest rates. The continued maintenance of sound fiscal policies is also important in sustaining a stable financial environment and improved economic prospects.

Macroeconomic projections: 1998/99 to 2000/01

Key macroeconomic projections for 1998/99 to 2000/01 are set out below.

GDP growth and inflation

Real GDP growth is expected to improve from about 2 per cent in 1997/98 to reach 3 percent, 4 per cent and 5 per cent over the 1998/99 to 2000/01 period. GDP inflation is projected to fall to 6 per cent in 2000/01 from about 9 per cent in 1997/98.
There projections will be revised in the light of current economic performance and additional information before finalising the 1998/99 to 2000/01 medium term expenditure framework.

Table 3.1 Macroeconomic projections 1998/99 to 2000/01

Year-on-year growth	1998/99	1999/00	2000/01
Real GDP growth	3,0 %	4,0 %	5,0 %
Real private consumption growth	3,0 %	3,6 %	3,7 %
Real gross domestic fixed investment growth	5,0 %	7,0 %	9,0 %
GDP inflation	7,5 %	6,5 %	6,0 %

MEDIUM TERM BUDGET POLICY STATEMENT 97 - FISCAL POLICY & THE BUDGET FRAMEWORK

Introduction

Government’s tax and spending policies are set out below, together with an account of recent developments in fiscal policy and budget reform. This chapter outlines the fiscal projections for the period 1998/99 to 2000/01, on which the Medium Term Expenditure Framework is based.

The fiscal policy framework

Objectives

Government’s fiscal policy aims are to:

- ensure sound public finances and that government debt does not grow faster than its ability to repay it;
- ensure that debt service costs decline as a share of expenditure, so that these resources can be reallocated to the delivery of public services;
- improve domestic savings, to support a higher level of investment and reduce the need to borrow from abroad;
- ensure that excess consumption does not push up inflation or lead to a deterioration of the trade deficit;
- support an export-friendly trade and industrial strategy to improve South Africa's competitiveness; and
- counter inflationary pressures, to prevent interest rates from having to rise.

Deficit target

Government is therefore committed to reducing the budget deficit to 3 per cent of national income by the end of the decade and reaffirms its adherence to the deficit targets set out in its macroeconomic strategy.

By reducing the deficit, Government will reverse the upward trend in government debt, and the corresponding interest bill. Debt interest costs currently absorb 21 per cent of national budget expenditure.

The tax burden

Government plans to limit the share of national income taken by tax to around 25 per cent. The overall tax burden, including mandatory collections by social security and other statutory funds, is presently somewhat higher than this level.

Public expenditure

Public spending must be financed either from revenues or from borrowing. Government's commitment to reducing the deficit and the limits on the overall tax burden together determine the level of public expenditure over the next three years.

Composition of spending

Within the spending totals, Government is committed to reprioritising spending to meet reconstruction and development objectives, to deliver services more equitably, and to address infrastructure backlogs.

Government therefore plans to:

- ensure that eventually borrowing is not used to finance current expenditure, but only for investment;
- reduce government consumption spending as a share of national income;
- limit pay increases to within fiscally responsible limits; and
- increase public sector investment in social and economic infrastructure.

Sound public finances

This is a responsible fiscal policy, aimed at ensuring the sustainability of South Africa's economic transformation, promoting jobs and investment, and ensuring that public services reflect the Government's priorities.

Public finance

Progress in the main elements of fiscal policy over the period 1990/91 to 1996/97 is summarised below. These estimates refer to the general government as a whole (including national and provincial government, extra-budgetary accounts and agencies, social security funds and local government).

Dissaving

Government dissaving (that is, borrowing in excess of investment) has fallen steadily from a peak of 6,4 per cent of GDP in 1993 to 3 per cent in 1997, and is expected to fall to below 2 per cent in 1998.

Public sector borrowing requirement

Since 1993/94 the public sector borrowing requirement has been reduced from 10,4 per cent of GDP to 5,9 per cent in 1996/97. Since the national budget accounts for most public sector borrowing, the public sector borrowing requirement is projected to decline in line with the trend for the main budget.

Consolidated general government revenue

Tax revenue, including social security contributions and local rates and taxes, is estimated at 27,7 per cent of GDP in 1996/97, having risen from 25,6 per cent in 1992/93. Non-tax revenue has remained roughly constant at around 4 per cent of GDP over the same period.

Consumption expenditure by general government grew in real terms by just over 5 per cent in 1996. The 1997/98 budget provided for a constant real level of consumption expenditure.

Remuneration

Remuneration of general government employees comprises 75 per cent of consumption expenditure. The three-year wage agreement signed in the Central Bargaining Chamber in 1996 increased the national and provincial wage bill by R6,5 billion in 1997/98 and in 1998/99, or an average increase of 10,0 per cent per year. In addition, the wage bill will increase because of promotions and notch increments.

Investment

Because of lags in delivery, capital expenditure by the general government has not increased in recent years, despite increased budgetary provision. However, total public sector capital spending (which includes public sector enterprises and corporations) increased by about 8 per cent in 1996 in real terms. This trend will accelerate as telecommunications, municipal infrastructure, roads construction and other projects gather momentum.

Government recognises the importance of improving the quality of capital expenditure, within the available resource constraints, to contribute both to strengthening growth prospects and enhancing social infrastructure capacity.

Functional composition of government spending

Changes in the functional composition of consolidated national and provincial government spending are illustrated below.

- expenditure on *interest payments* has risen from 4,3 per cent of GDP in 1990/1 to a projected 6,2 per cent in 1997/98;
- expenditure on *defence* has fallen dramatically, from 4 per cent to 1,7 per cent of GDP, while spending on public order and safety has increased from 2,4 per cent to 3 per cent of GDP;
- spending on *social services*, including health, education, welfare, housing and land reform has increased as a share of the total, from 12,1 per cent of total expenditure in 1990/91 to 14,4 per cent in 1997/98;
- spending on *education* has risen slightly from 6,1 per cent to 6,5 per cent of GDP;
- spending on *social security and welfare* has risen from 2 per cent to 3 per cent of GDP; and
- the share of spending on *economic services* has declined, mainly because of the phasing-out of regional industrial incentives and the general export incentive scheme.

Table 4.1: Functional classification of consolidated national and provincial budget expenditure

% of GDP	1990/91	1994/95	1997/98
General public services	2,4	3,0	2,1
Defence	4,0	2,9	1,7
Public order and safety	2,4	3,2	3,0
Education	6,1	7,1	6,5
Social security and welfare	2,0	3,1	3,0
Other Social Services	4,0	4,5	4,9
Economic Services	4,0	4,0	3,0
Interest payments	4,3	5,6	6,2
Total expenditure (as % of GDP)	29,2	33,3	30,4

Source: Budget Review 1997

Budget reform

Challenges

Budgetary planning and procedures have a crucial role to play in ensuring that Government's social and developmental goals are translated into implementation strategies.

South Africa faces a critical tension in its budget reform programme, associated with the substantial role of provinces in the provision of services. On the one hand, there is a strong emphasis on decentralised management in Government's approach to transforming public service delivery. On the other hand, recent reviews have indicated serious deficiencies in financial and management capacity in several provincial governments or particular departments, leading to pressures for greater centralisation of control.

Personnel management issues have also been identified as a major area of budgetary concern. Personnel costs have absorbed a rising share of expenditure, and inflexibilities make it difficult to control costs and reprioritise expenditure.

New legislation

The evolution of new intergovernmental financing arrangements is not yet complete. Legislation currently before Parliament deals with some aspects, including the formal establishment of the Budget Council and the establishment and functions of the Financial and Fiscal Commission.

Medium term expenditure plans

The adoption of a three-year expenditure framework is a major reform initiative undertaken jointly by the Departments of Finance and State Expenditure and provincial treasuries.
The publication of three-year expenditure plans will have a number of important advantages. It will:

- encourage agencies to evaluate their policy proposals within realistic budget projections;
- create a framework within which the Government can assess the financial implications of policy proposals;
- foster medium term planning by spending agencies, which will improve their efficiency;
- facilitate the management of rollovers, since with three year plans, agencies will be able to enter into contracts that will involve future payments; and
- improve the credibility of fiscal policy targets, and hence reduce the cost of government borrowing.

Improved analysis

The analysis underlying the Medium Term Expenditure Framework provides a tool which links expenditure inputs to service outputs. It will take a number of years to develop the analytical framework more fully. In the short term, the analysis has concentrated on some key services: health, education and welfare at the provincial level; defence, criminal justice at the national level; and personnel management. As capacity develops the analysis will be broadened and deepened.

Financial management

The success of the medium term expenditure framework is in part dependent on other dimensions of fiscal planning. Medium term planning, improved reporting, careful expenditure evaluation and appropriate flexibility of line agencies are important elements in achieving expenditure restructuring.

White Paper

The Government expects to publish a White Paper on budget reform early next year. This White Paper will set out the principles of budget reform more fully, and make proposals for their implementation.

Fiscal projections 1998/99 to 2000/01

Assumptions

The Medium Term Expenditure Framework is based on the projected acceleration in the growth of real GDP from 2 per cent in 1997/98 to 3 per cent, 4 per cent and 5 per cent in the following years. Inflation is projected to decline from 9 per cent in 1997/98 to 7½ per cent, 6,½ per cent and 6 per cent in the following years.

These assumptions will be revisited in future years in the light of actual economic performance.

Table 4.2: Economic assumptions for medium term expenditure planning

	1997/98	**1998/99**	**1999/00**	**2000/01**
GDP growth		3,0%	4,0%	5,0%
GDP inflation		7,5%	6,5%	6,0%
GDP (R million)	618 570	684 920	758 610	844 340
National Budget Revenue (Rm)	161 980	178 080	195 720	216 150
National Budget Expenditure (Rm)	186 750	202 050	218 480	241 480
Deficit (Rm)	24 770	23 970	22 760	25 330
per cent of GDP				
Revenue	26,2%	26,0%	25,8%	25,6%
Expenditure	30,2%	29,5%	28,8%	28,6%
Deficit	4,0%	3,5%	3,0%	3,0%

The expenditure level

Projections for GDP, the Government’s deficit reduction and tax targets and the total available expenditure over the MTEF period are set out in table 4.2 above.

This expenditure level refers to the total nationally-collected revenue to be shared between the national, provincial and local spheres of government, as described in more detail in chapter five of this Budget Policy Statement.

Amounts set aside

Before expenditure is equitably divided among the three spheres of government, three items are set aside from the total. These are:

- debt service costs – the nation's obligations to pay debt service costs represent a first charge against expenditure;
- standing appropriations – legally binding contributions to international institutions; and
- the Reserve – a proportion of the total available resources is not allocated at this stage (explained in more detail below).

Debt service costs

Provision is made for debt service costs on the following assumptions:

- a budget deficit of 3,5 per cent of GDP in 1998/99, falling to 3,0 per cent in the subsequent two years;
- refinancing of all domestic and foreign loans as they mature;
- continued borrowing mainly in long-dated domestic securities, supplemented by limited foreign bond issues and domestic short-term securities; and
- gradual declines in capital market rates, as inflation falls, to an average of 12 per cent in 2000/01.

It is expected that state debt costs will fall from 21,2 per cent of spending in 1997/98 to 20 per cent in 2000/01. This will reduce debt interest from 6,4 per cent of GDP to 5,7 per cent over the same period, and will bring the debt to GDP ratio down from 55 per cent in 1997/98 to 50 per cent in 2000/01.

Table 4.3: Projected funds available

R million	1997/98	1998/99	1999/00	2000/01
National Budget Expenditure (Rm)	186 750	202 050	218 480	241 480
Less amounts set aside				
Debt service costs	39 640	42 320	45 000	48 400
Standing appropriations	300	330	350	380
Reserve	2 150	5 000	7 000	10 000
Total expenditure to be shared	144 660	154 400	166 130	182 700

Expenditure growth rates

Total budget expenditure, excluding debt interest and standing appropriations, and excluding provincial and local government own revenues will grow by 9½ per cent a year, on average, over the next three years. In real terms, this amounts to 2¾ per cent a year.

As the table below shows, national budget expenditure grows in real terms in each year of the MTEF, by 1 per cent next year, accelerating to over 5 per cent by the end of the MTEF period.

The acceleration of expenditure in the outer years of the projections is dependent on the performance of the economy. If the economy does not grow as fast as the projections set out in Chapter 3 of this Statement, then expenditure growth will have to be contained below these levels.

Table 4.4: Growth of non-interest budget expenditure[1]

	1998/99	1999/00	2000/01	Average over MTEF
Non-interest spending (Rm)	159 400	173 130	192 700	
Nominal growth	8,6%	8,6%	11,3%	9,5%
Real growth	1,0%	2,0%	5,0%	2,7%

[1] National and Provincial budgeted expenditure, excluding interest, standing appropriations and expenditure financed by provincial own revenues, but including the reserve.

The Reserve

Uncertainty

Public expenditure projections over three years are inherently more uncertain than those that extend only a year ahead. Over the course of the next three years there are likely to be changes to macroeconomic conditions and price trends, the Government’s policy priorities, and unforeseen emergencies and expenditure pressures.

In order that the public finances should not be thrown off track by such developments, and to increase the certainty surrounding the proposed allocations, a Reserve has been allocated within the expenditure totals.

The Reserve comprises two parts: a "policy reserve", and a "contingency reserve". These are explained below.

Policy reserve

A policy reserve has been set aside from the total available spending to enable Government to meet specific policy priorities without compromising the proposed budgets of other services. This policy reserve will be allocated to programmes between now and Budget Day.

Contingency reserve

Another part of the Reserve will remain unallocated in this year’s budget, in order to deal with any costs arising from unforeseen natural or other disasters. This ensures that Government can make funds available for unforeseen circumstances in the year in question without breaching its overall expenditure ceiling.

A component of the contingency reserve in the second and third years of the projections will be allocated as part of the 1999 and 2000 MTEF processes. This part of the Reserve may be used to address emerging policy priorities or changes in economic circumstances. It enables Government to address its priorities in future budgets without having to disrupt the expenditure plans of other services.

Credibility of plans

This allocation of a substantial Reserve within the expenditure ceiling ensures that Government’s expenditure plans are prudent and credible:

- it makes room in future years for emerging new priorities, without these having to be funded from reductions in other programmes;
- it ensures that funds are available to deal with contingencies as they arise in year without exceeding the expenditure ceiling;
- it increases the stability of the expenditure plans, which provides greater stability and certainty within which public services can plan; and
- it means that the three-year budgets can adapt to possible divergences of macroeconomic performance from the projections made at this stage.

Growth and spending

There is a correlation between the amount available for spending on public services and the performance of the economy. Slower growth or lower inflation in future years would require adjustments to expenditure projections and the size of the available Reserve.

Table 4.5 below sets out the size of the Reserve over the MTEF period.

Table 4.5: The Reserve

R million	**1998/99**	**1999/00**	**2000/01**
Policy reserve (to be allocated now)	3 000	3 000	3 000
Contingency reserve (to be partly allocated in future MTEFs)	2 000	4 000	7 000
Total	5 000	7 000	10 000

MEDIUM TERM BUDGET POLICY STATEMENT 97 - INTERGOVERNMENTAL FINANCIAL RELATIONS

Constitutional context

Background

There are three spheres of government: national, provincial and local. Each has responsibility for its own financial management and expenditure planning. Respect for this principle is the foundation of the budget process.

Equitable shares

The Constitution provides that each sphere of government is entitled to an equitable share of revenue raised nationally to enable it to provide basic services and perform the functions allocated to it. The equitable division of revenue takes into account the functions assigned to each sphere under the Constitution and the capacity of each government to pay for these functions through own receipts and revenues.

The equitable share is an unconditional allocation to the national government, to each of the nine provinces and to local government. Provincial and local governments, being distinct spheres of government, are fully responsible for these funds and are directly accountable for how they are spent. Government policies influence provincial and local government spending indirectly, through cooperative agreements and framework legislation setting norms and standards.

Other allocations

In addition to their equitable share, provinces and local governments may also receive other allocations from the national share to which the national government may attach conditions.

Financial and Fiscal Commission

In reaching agreement on the equitable division of revenue and on other allocations to provincial and local governments, the Government has benefited from the advice of the Financial and Fiscal Commission (FFC). The Commission’s proposals have been taken as point of departure in the deliberations of the Budget Council, comprising the Minister of Finance and Members of Executive Councils responsible for provincial finance. In brief, the recommendations of the FFC for the division of revenue between the national government and provinces were aimed at achieving:

- effective and efficient resource allocations;
- fiscal equity in the provision of services and the raising of provincial taxes; and
- development of fiscally sound and democratically responsive provincial governments.

In respect of local government, the aim of the equitable share is to provide a fair and transparent subsidy to municipalities to support the provision of basic services to low-income communities.

Division of Revenue Bill

After consultation with provincial governments and organised local government, proposals for the equitable division of revenue will be presented to Parliament. On Budget Day, the Minister of Finance will table a Division of Revenue Bill along with the national budget. The Division of Revenue Bill will specify:

- the equitable share for each of the three spheres of government as well as for each of the nine provinces; and
- all other conditional and unconditional grants from the national share.

This will give effect to the constitutional requirement that an Act of Parliament provide for intergovernmental financial arrangements, and that it take into account the needs and interests of the national government, the need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them, and other relevant considerations.

Resources available

Economic projections

The resources available to be shared by the national, provincial, and local spheres of government over the coming three financial years are estimated on the basis of projections of the economy's performance over the medium term. These projections are set out in Chapters Three and Four of this Statement.

The Constitution requires that all revenue raised nationally be divided equitably between the three spheres of government. In addition to collecting revenue, government currently borrows to meet its expenditure requirements. Debt service and repayment obligations arise from this borrowing. It is the balance of national revenue plus borrowing, less debt obligations, that represents the total pool of resources available for sharing.

The Constitution provides for national legislation to govern the power of provinces and local government to borrow. Subject to national oversight, loans may be raised for capital expenditure and to bridge temporary current revenue shortfalls.

Own revenues

Provincial and local government own-revenues are not included in the calculation of equitable shares. The Constitution places limitations on the power of provincial and local government to raise revenue, and indicates that any additional revenues raised by a province or municipality cannot be deducted from its equitable share.

The vertical division

Definition

The *vertical division* is the allocation of the total available resources - after provision for debt service costs - between the three spheres of government.

Table 5.1: The vertical division

R million	**1997/98**	**1998/99**	**1999/00**	**2000/01**
National share	66 140	70 720	74 800	82 010
National share % of total	45,7%	45,8%	45,0%	44,9%
Local government equitable share	1 120	1 210	2 360	2 620
Local government share % of total	0,8%	0,8%	1,4%	1,4%
Provincial equitable share	77 410	82 480	88 970	98 070
Provincial share % of total	53,5%	53,4%	53,6%	53,7%

Note: The tables in this chapter do not reflect allocation of the policy reserve. The national share includes amounts that will be transferred to provincial and local governments through conditional and unconditional grants.

Projected shares

The projected division of revenue for the 1998/99-2000/01 period is set out in table 5.1. This division maintains a broadly stable share for each sphere, apart from identified function shifts. The preliminary division of revenue excludes the amounts set aside as policy and contingency reserves, discussed in Chapter 4.

The national government share is about 46 per cent, 53 per cent is allocated to provinces and about 1 per cent goes to local government. The national government share includes various amounts that will be transferred to provinces and local government through conditional grants. The local and provincial equitable shares must be viewed in the context of these additional transfers.

The projected increase in the local government share between 1998/99 and 1999/00 is a consequence of the envisaged Transfer of Staff to Municipalities Bill (discussed further below).

Improvements in remuneration

Improvements in conditions of service can either be transferred to provinces as a conditional grant from the national government share, or they can be met directly by the provinces from the provincial equitable share. In either case, the equitable share would be adjusted to reflect the assignment of responsibility for the costs of improvements. The table above shows funds for improvements in conditions of service as part of the provincial equitable share. The provincial budget allocations will exclude provision for improvement if this function is kept on the national budget.

Priorities

The division of funds between the spheres must reflect the nation's policy priorities. If the share of expenditure going to social services is to be increased, this will take effect through increases in the equitable share of provinces, or additional grants to provinces from the national share. If the criminal justice system is to be strengthened, this would require an increase in the national share.

Government's allocation of the policy reserve could alter both equitable shares and the proportion of the national share taken up by grants to provinces and local government. Such changes will be reflected in the allocations published in the 1998 Budget.

Horizontal division – equity between provinces

Definition

An explicit revenue sharing formula is used to divide the provincial equitable share between the nine provinces – this is called the *horizontal division*. It directs funds to provinces based on their demographic and economic profiles, as these provide an indication of the demand for basic services within the provinces.

Formula elements

The formula is comprised of the following six components:

- an education share, based on the average of the size of the school-age population and number of learners actually enrolled;
- a health share, based on the proportion of the population without private health insurance and weighted in favour of women, children, and the elderly;

- a social security component, based on the estimated numbers of people entitled to social security grants;
- a basic share, based on total population, with an additional 50 per cent weight in favour of rural communities;
- an economic output share, based on the estimated distribution of gross geographic product (GGP); and
- an institutional component, equally divided among the provinces.

Components of the equitable division

Table 5.2 sets out the contributions of the components of the formula to each province's equitable share of revenue.

The elements of the equitable division formula are not indicative budgets. The education, health or social security shares are not conditionally allocated to these functions. Provinces budget for these functions within their overall resource constraints, informed by their own processes of prioritising spending within the context of national policies.

Demographic data

The revenue sharing formula relies on provincial population estimates for the education, health and social security components and the basic share. At this stage, the preliminary results of the 1996 census are used, including estimates of the age distribution by province prepared by the Department of Finance in consultation with the Central Statistical Service.

Table 5.2: Components of the equitable shares formula

	Education	**Health**	**Social security**	**Basic share**	**Economic output**	**Institutional**	**Weighted average**
Weight	*39,0%*	*18,0%*	*16,0%*	*15,0%*	*8,0%*	*4,0%*	*100,0%*
Western Cape	8,5%	10,2%	9,1%	9,3%	14,1%	11,1%	9,6%
Eastern Cape	18,5%	17,3%	18,8%	16,6%	7,6%	11,1%	16,9%
Northern Cape	1,8%	2,0%	1,9%	1,8%	2,1%	11,1%	2,3%
KwaZulu-Natal	21,3%	21,1%	21,0%	21,2%	14,9%	11,1%	20,3%
Free State	6,3%	6,7%	6,6%	6,1%	6,2%	11,1%	6,6%
North West	8,0%	8,3%	8,8%	8,7%	5,6%	11,1%	8,2%
Gauteng	13,8%	15,6%	13,3%	15,8%	37,7%	11,1%	16,2%
Mpumalanga	7,5%	7,0%	7,2%	7,5%	8,1%	11,1%	7,6%
Northern Province	14,3%	11,8%	13,3%	12,8%	3,7%	11,1%	12,5%
Total		**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**

The full census results will become available during 1998. They will be used in the revenue sharing formula for next year's budget process and may affect the last two years of the MTEF allocations. Once firm evidence of inter-provincial migration trends becomes available, it will also be possible to adjust provincial allocations for variations in population growth.

Tax shares

The economic output component of the formula directs a proportion of nationally collected revenue back to the provinces where the revenues are generated. This serves as a proxy for the provincial own-revenue that would be raised were provinces to raise additional taxes themselves. The possible future role of provincial tax powers is currently under review by the Commission of Inquiry into the South African Tax Structure.

This component acknowledges the link between investment and infrastructure needs and related economic services, and the level of economic output in a province.

Institutional component

The institutional component, which is divided equally among the provinces, provides for the cost of maintaining public administration, building essential capacity, and participating in intergovernmental forums. These costs, unlike those associated with basic services, are not directly related to a province's demographic profile but represent fixed costs that are borne equally by all the provinces.

Phasing

The revenue sharing formula yields a distribution across the provinces that differs somewhat from the current distribution of funds. Government has agreed that the new shares will be phased in over five years – that is, by 2002/03.

Redistribution

By relying on provinces' demographic and economic profiles, the revenue sharing formula represents a sharp break from historical funding patterns. The result is a significant redistribution of resources to reflect an equitable provision for services provided by provinces, taking into account demographic trends.

The 1996 census results suggest that the distribution of people between provinces is shifting in favour of the Western Cape and Gauteng. Elderly people, women and children are still disproportionately resident in provinces with large rural populations, such as the Eastern Cape, the Northern Province and KwaZulu-Natal. These are factors that impact directly on the provincial revenue shares.

Table 5.3: Impact of equitable shares formula

	1997/98 Equitable shares	**2002/03 Target shares**	**Percent change**
Western Cape	10,0%	9,6%	-3,8%
Eastern Cape	17,9%	16,9%	-5,7%
Northern Cape	2,6%	2,3%	-11,8%
KwaZulu-Natal	19,2%	20,3%	5,9%
Free State	6,9%	6,6%	-4,9%
North West	8,9%	8,2%	-7,3%
Gauteng	14,6%	16,2%	10,4%
Mpumalanga	6,3%	7,6%	20,0%
Northern Province	13,7%	12,5%	-8,9%
Total	100,0%	100,0%	

* Formula to be phased-in over five years. The "equitable shares" exclude other unconditional and conditional grants to the provinces from the national share.

Table 5.3 illustrates the impact on provincial equitable allocations of the revenue sharing formula. Shifts between provinces reflect:

- the poverty-related weighting of the rural population in the social security and basic components of the formula;
- the bias in favour of the school-going population and education enrolment in the education component;
- the bias in favour of people without private medical insurance in the health component;
- the weighting in favour of women, children and the elderly in the health and social welfare shares; and
- the increased share of the total population accounted for by Gauteng and the Western Cape in the preliminary 1996 census results.

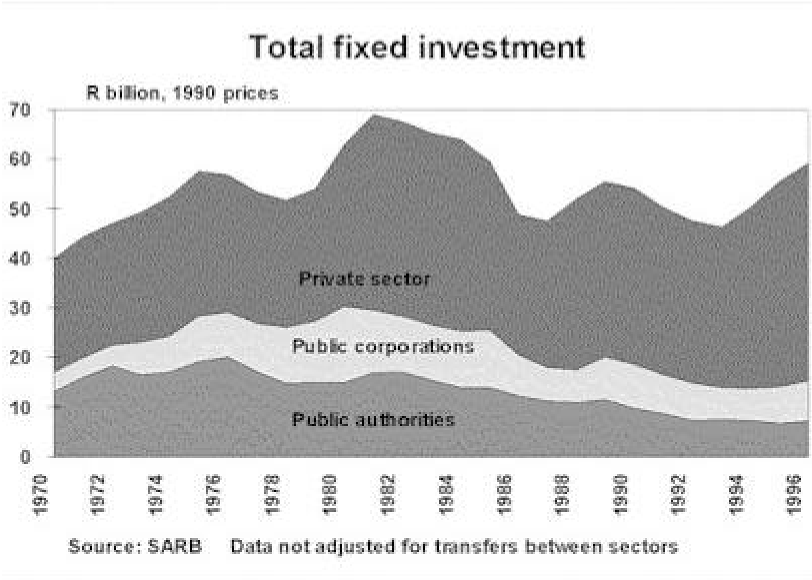

Figure 5.1: Equitable shares distribution

Per capita equitable shares

Figure 5.1 above illustrates the equitable allocations *per person* (using current population estimates) in 1997/98 and 2002/03 that are implied by the agreed revenue sharing formula, expressed as percentages above or below the national average. It should be noted that these shares exclude any conditional grants to provinces from the national share.

Conditional grants

The Constitution provides for transfers to provinces or local government out of the national equitable share of revenue. These grants can be assigned for particular purposes or be subject to specific conditions. Drawing on both the recommendations of the FFC and the work of MTEF sectoral teams, Government proposes the introduction of several conditional grants in 1998/99 as part of the overall share of resources to be available to provinces.

Health services

Past inequities have resulted in a geographically distorted health care system. Delivery of tertiary health care and medical training functions are concentrated in four provinces. These services are not restricted to the residents of those provinces and whilst there is a health component in the revenue sharing formula, it does not adjust for cross-boundary flows. Recognising the importance of central referral hospitals and medical training facilities as national resources, it has been agreed that conditional grants should provide for these services.

Components

The conditional health grant has three components:

- medical research and training – to compensate provinces for the additional costs associated with training health professionals;
- central hospital services – to contribute to the costs of providing tertiary level care and other referral services across provincial boundaries; and
- redistribution of tertiary services – to facilitate a redistribution of tertiary services to under-provided provinces.

It is envisaged that the total allocation for tertiary services should over time be more equitably distributed between provinces. This would enable the conditional grant to be reduced, with the funds returned to the equitable share for provinces and distributed according to the health component of the formula. The balance of the conditional grant for tertiary services would then focus on medical training and specialised services of national interest.

Primary School Nutrition Programme

The Primary School Nutrition Programme is a Presidential Lead Project that was originally funded through an RDP allocation. Provinces received a total of R496 million for this programme in the current financial year, and it is envisaged that this should continue to be funded through conditional allocations to provinces from the national share of revenue. A consultant has been appointed to support the management of the programme, and these costs will also be met from the programme’s allocation.

Other grants

Other conditional grant amounts in 1998/99 include provision for outstanding commitments on school classroom building projects and a KwaZulu-Natal peace initiative task team.

Government is considering the possibility of conditional grants to support targeted capital spending in the provinces, in particular to address health and education infrastructure needs. Government is also looking into a proposal for a matching grant mechanism between the national and provincial governments to fund Curriculum 2005.

Local government share

Kinds of transfers

Intergovernmental transfers to local authorities in 1997/98 will exceed R5,9 billion. They include operating subsidies, capital grants, payments for specific agency services and transfers implicit in municipal services provided by provincial departments.

Advised by the FFC, an "equitable share" for local government will be introduced in 1998/99. This equitable share, which will be phased in, will replace the current patchwork of operating subsidies to local authorities from other spheres of government and will meet the constitutional requirement that local government receive an equitable share of revenue raised nationally.

The local government equitable share will replace the existing grants for operating costs of local government. Capital transfers to local government, such as the Consolidated Municipal Infrastructure Programme and the rural water supply and sanitation programme, will continue to be financed from the national share.

Proposed new system

The Department of Finance has developed a transparent formula-driven approach to subsidising the operating costs of local government, aimed at providing support to the extension of basic services to low-income communities. The new system will be phased in over a five- to seven-year period by replacing existing allocations incrementally.

Transfer of municipal staff

The new approach will have a significant impact on provincial budgets. Several provinces are still meeting the costs of municipal staff in so-called R293 (former homeland) towns. Government expects that the Transfer of Staff to Municipalities Bill will be passed at the beginning of the 1998 Parliamentary session to facilitate the transfer of the affected staff to the relevant local authorities in the course of 1998.

Conditional grant for local government

Beginning in 1998/99, it is proposed that all explicit operating transfers except R293 and Department of Water Affairs funds should be allocated in terms of the new subsidy system. This will take account of both the new formula allocations and existing levels of grants. As a transitional measure in 1998/99, the R293 transfers will go to provinces as a conditional grant for funding the services they provide in R293 towns. The water services transfers would also be dealt with as conditional grants.

With effect from 1999/00, all operating transfers will be allocated in line with the phase-in programme. By this time, provinces will have had sufficient time to carry out the transfer of R293 staff to the relevant local authorities. It is envisaged that operating subsidies for water services should also be phased in as part of the equitable share by the end of 1999/00.

Further consultation

Details of the division of the local government equitable share between municipalities are currently being finalised by the Department of Finance, in consultation with the South African Local Government Association and provincial governments. The proposal will be made public early next year.

Evolution of intergovernmental financial relations

Further refinement

Arrangements for the sharing of revenue between the national, provincial and local sphere of government will evolve further in future years. Whilst addressing some outstanding concerns, this year's approach has also raised further issues that need to be addressed. This year's formula will serve as the starting point for calculating the horizontal division in subsequent years, but it is likely that adjustments will also be made to the framework.

The present approach has drawn strongly on the reports of the Financial and Fiscal Commission dealing with both the provincial division and the financing of local government. Comments of the FFC on this year's approach to provincial revenue sharing have contributed to the refinement of the model and new population data have been introduced. The FFC will make recommendations in 1998 to be taken into account in preparing the framework for the 1999 Budget.

Foundation for future financial relations

Overall, a better understanding of actual expenditures is important for informing decisions about the vertical division. In addition, incorporating final census figures, other new data and elements of demographic change will be necessary. Government recognises, however, that stability in the overall intergovernmental financial framework is a pre-condition for sound financial planning and responsible government. The approach outlined here serves to establish a firm foundation for future intergovernmental financial relations.

MEDIUM TERM BUDGET POLICY STATEMENT 97 - A POLICY FRAMEWORK

Introduction

Reconstruction and development

The Medium Term Expenditure Framework takes the nation's Reconstruction and Development Programme as its point of departure. A broad range of social development and economic transformation goals flow from this commitment. Their expenditure implications have to be accommodated within a sound macroeconomic and fiscal framework, consistent with the division of responsibilities between national, provincial and local government. These dimensions of the MTEF are set out in the preceding chapters of this Statement. An introduction is provided below to the expenditure trends and the policy choices that the MTEF represents.

Government cannot achieve all its goals immediately, because there are constraints on the capacity to deliver and on resources available. It is the responsibility of government to determine priorities from among the nation's goals. The RDP provides clear guidance on these choices. The needs of the poor, and the prospects for our children, come first.

The purpose of the MTEF is to articulate these choices systematically and comprehensively. This empowers the Government, Parliament, civil society and the nation as a whole to determine priorities collectively. This chapter summarises the links between policy choices and Government's expenditure plans. It draws on cooperative planning and policy analysis undertaken by national and provincial departments, and valuable perspectives on education and health submitted by the NEDLAC fiscal and monetary chamber.

Cooperative government

The development of medium term expenditure plans is a cooperative undertaking of the national and provincial governments, drawing on both ongoing departmental planning and focused analyses of selected functions and programmes. The provinces are responsible for nearly 60 per cent of expenditure on public services. They work within a framework of nationally determined norms and standards and of cooperative governance, and act in the interests of shared national objectives. But they exercise considerable discretion over the management of resources, how they go about meeting those objectives, and the relative priority they give to competing spending pressures.

Publication of medium term plans

Three year expenditure plans will be published by the national government on 11th March 1998 and by the nine provinces shortly afterwards. The first drafts of these plans were prepared in mid-1997, and both the Cabinet and provincial Executive Councils have been integrally involved in the policy reviews and expenditure planning that have accompanied the refinement of budget projections. A broad outline of the expenditure trends and policy issues that have emerged from the MTEF process is provided below.

This Medium Term Budget Policy Statement makes explicit the policy framework within which these expenditure plans will be finalised. It provides Parliament and civil society with an opportunity to discuss the nation's medium term fiscal commitments and to contribute to resolving outstanding issues.

Policies and programmes

Spending pressures

Government's RDP and public service transformation expenditure commitments can be organised into several clusters of policies and programmes. The following section lists some of the initiatives that will put upward pressure on national and provincial budgets during the MTEF period.

Public institutions

Reorganising the public service, strengthening democracy and building capacity – spending pressures include the establishment of commissions and regulatory agencies; organisation of the 1999 elections; public service transformation, affirmative action and reform of personnel policies; public sector training; creation of an autonomous revenue service; and consolidation of financial management systems.

These are straightforwardly government responsibilities, requiring well-managed and accountable departmental programmes and public institutions, supported where appropriate by a range of non-governmental and civil initiatives.

Building the economy

Investment in economic infrastructure, industrial promotion and small enterprise development – government commitments include spatial development initiatives; improvement in roads and other transport infrastructure; industrial cluster studies and supply-side support programmes; a consolidated municipal infrastructure programme; rural development and agricultural support; electrification and telecommunications promotion; water supply and sanitation; small enterprise finance and advisory services; and tourism promotion.

Government infrastructure investment is, where practical, subject to transparent cost-benefit analysis, and costs are often directly recovered from users. Investment in industrial development is largely undertaken in the private sector, supported by targeted incentives.

Education & training

Strengthening human resource development – spending pressures include expansion and restructuring of higher education; skills development, employment services and financing of training; education for learners with special needs; extension of further education and college programmes; Curriculum 2005; redressing education infrastructure backlogs; and strengthening the financing of provincial schooling.

Education and training are high priority commitments, reflecting the promotion of equal access to learning opportunities, extension of further and higher education and promotion of skills development throughout the economy. Education and training yield benefits to individuals and employers and thus attract private spending, over and above government expenditure.

Criminal justice

Re-engineering the criminal justice system – this includes integration of information systems; expansion of prison capacity; reorganisation of crime prevention and detection services; improvement in court management and prosecuting capacity; extension of legal aid; and a renewed focus on priority crimes.

A sound criminal justice system is an essential foundation of a stable and secure society, underpinned by the rule of law and protection of human rights.

Welfare services

Developmental welfare, social security reform and poverty relief – commitments include development programmes focused on women and children; support for income-generating and employment-enhancing social welfare services; transformation of the child and youth care system; special protection measures for children; transformation of the welfare financing system; introduction of the child-support benefit and phasing out of the maintenance grant system; integration and better management of grants programmes; investment in job creation and poverty relief.

Government welfare and social security are the means through which society collectively provides a safety net to protect the poor and vulnerable. Improvements in the quality of life of the poor are also promoted through water supply, transport, energy, housing and other development programmes. In addition, the tax system encourages individuals who can afford to do so to invest contractually in advance of retirement.

Health care

Equitable and affordable access to health services – priorities include clinic building and district health services; free primary care; hospital rehabilitation; and rationalisation of central hospital services.

Government is responsible for ensuring equitable access of the poor to a full schedule of primary health care and hospital services. Beyond this public provision, individuals have access to private sector services, and medical schemes provide a degree of risk-pooling to income-earners who seek this protection.

Reprioritisation

Each of these programmes makes a contribution to reconstruction and development objectives. Each represents a pressing claim which Government should try to accommodate. However, neither the economy nor the public sector has the capacity or financial resources to meet all these claims immediately. Government must find ways to reprioritise in favour of these RDP commitments, and to deliver them as cost-effectively as possible.

Better targeting

Government therefore has to ensure that resources are well targeted towards the poor and the interests of future generations. Delivering greater equity and accelerated social development will require a continuing redirection of resources. Government has to find ways to ensure that people who can afford to pay for services do so, thereby releasing resources which can be redirected towards the poor.

Public-private partnerships

Government is responsible for ensuring that high quality public services are delivered equitably. In many cases, it will discharge that responsibility by working in partnership with the private sector and civil society, rather than producing the services directly itself. This enables Government to harness the skills and capacity of the business sector and non-governmental organisations and to promote small and medium sized enterprises. It also permits the Government to focus on its core role of specifying, regulating and subsidising the services, and not secondary roles such as engineering and construction.

Public utilities

There are functions that remain public sector responsibilities but should be performed by corporatised institutions, with appropriate oversight over pricing and financial accountability. Improved governance of public corporations and utilities has a key role to play in achieving efficient and equitable delivery of services.

Macroeconomic priorities

In deciding its public spending priorities, Government must also take account of the particular economic challenges facing South Africa, looking towards faster growth and development in the next century. Government's macroeconomic strategy implies several priorities for government:

- accelerated investment in infrastructure – both social and residential infrastructure, which are strongly redistributive, and investment in transport, communications and other economic services, which are necessary complements to more rapid industrial growth and urbanisation;
- training – a significant expansion in the contribution of public spending to training and vocational education, of both the employed and the unemployed;

- poverty relief and jobs – a labour-intensive shift in government spending on poverty relief and basic infrastructure development; and
- redistribution of social services – redistribution within the education, health and welfare service budgets in favour of historically under-served communities.

Reallocation and reprioritisation

Confronted by many pressing needs, Government cannot allocate substantially increased resources to all priority services. Medium term expenditure plans must strike a careful balance between reallocation of resources between functions and reprioritisation within the budgetary constraints of the main spending programmes.

The criminal justice system and education, health and welfare spending already consume over 60 per cent of total expenditure. These services may increase somewhat further as shares of total spending, but they cannot do so indefinitely if, for example, infrastructural investment is to be accelerated.

This means that equity and enhancement of services in the criminal justice system, education, health, welfare and social security will mainly have be funded by improving efficiency and cutting back on lower priority spending within these sectors, rather than increased spending shares. Increased delivery of services to the poor will require a re-examination of the degree to which services people could pay for themselves are subsidised.

Principles

Government has agreed on several principles governing the reprioritisation of expenditure on high priority functions:

- The criminal justice system must be strengthened, but with appropriate encouragement of greater integration of programmes and activities across component parts of the system;
- Welfare and social security spending should continue to be firmly targeted towards meeting development and income support needs of the poor, and allocations for employment-based relief projects should be extended;
- Growth of education spending on personnel needs to be curtailed, with additional resources assigned to key quality-enhancing initiatives and improved management in the education system; and
- Promotion of a district-based primary health system should continue to be the first priority in health services, but together with a coordinated programme of hospital rehabilitation and strengthened hospital administration and service delivery.

Reprioritisation and public service transformation consistent with these principles will be reflected in the medium term budgets to be published in March 1998. The MTEF process has identified a range of policy issues to be confronted in taking this transformation programme further.

MTEF sectoral reviews

Introduction

The 1997 MTEF programme included sectoral reviews conducted by six work teams, comprising officials of national and provincial line departments and treasuries. The sectoral teams examined medium term spending plans in health, education, welfare, the criminal justice cluster and defence, and investigated public sector personnel management issues. Their task was to analyse the policy implications of projected expenditure, and to identify policy options for political office-bearers to consider.

Some of the main conclusions of the sectoral reviews are summarised here.

Education

The sectoral review of education found that current personnel spending trends will lead to higher expenditure than envisaged in the preliminary medium term provincial education estimates. Personnel costs absorb too high a share of available funds, leaving insufficient resources for renewed infrastructure, curriculum reform and learning materials. Improved financial management and greater flexibility in personnel management are required if inequality in education spending is to be redressed and quality-enhancing initiatives supported.

In order to achieve equitable financing of public schools, consideration may need to be given to subsidising schools that serve higher-income communities on a standard per learner basis, making these institutions responsible for meeting costs above their equitable entitlement through fees and other own revenue.

It is recognised that the financing of further and higher education should continue to draw strongly on private sources. This means that bursary and loan schemes should be strengthened to ensure that students are not denied access as a consequence of inability to pay, but there is also scope for rationalising existing institutions and strengthening cost-recovery from learners and employers, coordinated in part through the evolution of Government's skills development strategy.

Health services

Reprioritisation in favour of district-managed primary health services is in progress in all provinces. Further efficiency gains will need to be achieved if the targets for primary health care are to be reached, but there is considerable evidence of improved utilisation of clinics and district hospitals. Expenditure management has proved difficult in hospitals with medical training and tertiary care facilities, as they face both rising referral rates and pressure to rationalise and reduce costs.

The health sectoral team has proposed a system of conditional grants to supplement the budgets of provinces with medical schools and central hospitals, and to facilitate the redistribution of tertiary health services.

There is considerable scope for further decentralisation of hospital management and greater competition of public hospitals for fee-paying patients, including preferred provider and other contractual arrangements with medical schemes and employers.

Welfare

The MTEF review of welfare and social security identified strong upward pressures on spending associated with increased registration of social grants beneficiaries in most provinces. The introduction of the new child support programme will add to this trend over the next few years, offset somewhat by the phasing out of the former maintenance grant. Several provincial welfare budgets will need to be reviewed, taking account of both the phasing in of the child support grant and the need to budget fully for beneficiary numbers.

The welfare team recommended that efforts to improve social security management and to root out fraud and abuse should be strengthened, building on the progress that has been made in integrating provincial information systems. It was noted that managerial control and financial responsibility for social security should be located together, either at a national or a provincial level.

There is scope for favouring more discretionary programmes focused on the needs of the poor and limiting expenditure growth on broader entitlement programmes. In the longer term, private contractual savings needs to be extended to a larger share of the work force, thereby limiting the burden of retirement provision met by the public sector.

Defence

An MTEF team examined defence spending needs, in the light of the Defence Review and the security threats South Africa faces. Spending on defence has fallen considerably in real terms since the 1980s. The review recommended that defence spending should be stabilised at around 1½ per cent of GDP during the MTEF period. In the short term this will require a substantial reduction in the numbers of service personnel. The report also recommends efforts to improve defence budgeting and inventory management.

Criminal Justice

The MTEF process has included a joint review of the criminal justice system, focused mainly on police, correctional services and the law courts. Work is continuing on coordination between the government agencies involved and improved case management through the system. It has been recommended that the budget should make provision for integrated projects involving the whole criminal justice cluster.

Personnel management

The MTEF review of personnel issues concluded that improving the management of personnel is the single most important priority for Government. It is the key to improving service delivery, making the provision of services more equitable, and enabling Government to meets its reconstruction and development priorities within a level of spending that can be afforded. This requires dismantling over-centralised and bureaucratic controls, empowering managers to manage staff, and providing incentives to keep personnel costs under control. The team recommended the introduction of an affordable right-sizing instrument, amendments to the Public Service Act to improve disciplinary procedures, restructuring the salary and grading system to give managers greater flexibility, decentralisation of collective bargaining, tight control of personnel budgets and improvements in information systems.

Transforming service delivery

In addition to strengthening RDP programmes, scaling down lower priority spending and concentrating on core Government business, resources can be released for improved and more equitable services by improving the delivery of services.

Human resources

At the heart of improved service delivery is better use of human resources. Government has prioritised improved training and organisational transformation in the public services. An employer-initiated right-sizing instrument together with social plan measures in support of affected groups, more streamlined public service disciplinary proceedings and greater devolution of discretion over pay and personnel management, within a broad framework and clear budgetary constraints, are amongst the reforms necessary to achieve more effective and more productive use of personnel in public sector service delivery.

Extra-budgetary agencies

The growth in the number of *extra-budgetary government agencies* that are not subject to the constraints of the public service staff code and pay agreements has led to concern that salary structures are sometimes neither disciplined by market pressures nor subject to appropriate regulatory oversight. Without bringing off-budget agencies under the ambit of the full public service code, it is important that their salary structures should be standardised, regulated and transparently reported.

Other measures

Other possible measures to improve service delivery include:

- greater cost-recovery from users that can afford to pay, which would release fiscal resources for redistribution and more equitable service delivery;
- changing regulations that have the effect of raising costs, such as levels of support service and hardware prescriptions in defence or protection services, building and other infrastructure standards and excessive tender specifications;
- improved coordination and rationalisation of government structures, including rationalisation and better cost control of commissions and regulatory agencies;
- strengthened coordination between national and provincial departments and local government and between spending departments and treasuries; and

- improved financial management, including information systems development, particularly in provincial treasuries and line departments.

Cutting back low priorities

Defence

Against the background of considerable reductions in defence spending in recent years and the policy commitments envisaged in the Defence Review, there may not be much scope for further cutbacks. The capacity of the defence force to respond to emergencies of various kinds contributes to several public policy objectives, in addition to providing protection against external threats. Nonetheless, Government will continue to seek ways to achieve these goals more cost-effectively, with the aim of releasing resources where possible.

Subsidies

There are a number of economic and social subsidies which could be reviewed and better targeted towards the poor or to achieve their purposes more efficiently. Examples include the interest subsidy payable in export credit schemes, subsidies implicit in below-cost pricing of government water schemes or transport projects, and subsidies to research organisations, cultural foundations and education or health facilities that mainly serve higher income communities.

Private sector involvement

In addition, consideration should be given to rationalisation or greater private sector involvement in some services or institutions. There are opportunities for greater private sector involvement in the funding of colleges, universities, technikons and hospitals. Opportunities for transfer to the private sector of government services include the government printing works, government garages and central computer services.

Projected expenditure trends

Based on preliminary national and provincial budgets for the next three years, it is possible to project likely consolidated spending trends. These estimates include provincial expenditure from their own revenue, and thus exceed somewhat the aggregate expenditure levels set out in Chapters Four and Five.

Table 6.1: Expenditure growth

R billion	1997/98	1998/99	1999/00	2000/01	Average annual growth
National government					
Debt service costs	39,9	42,6	45,4	48,8	6,9%
Spending on national functions	60,8	64,9	69,8	76,8	8,1%
Conditional grants to provinces	4,5	4,9	5,0	5,2	5,4%
Provincial government					
Spending excluding conditional grants	81,8	85,1	92,6	100,5	7,1%
Policy reserve	2,1	5,0	7,0	10,0	
Total national and provincial spending	189,2	202,5	219,8	241,3	8,5%
Total non-interest expenditure	*149,2*	*159,9*	*174,4*	*192,5*	*8,9%*

This table differs from Table 4.5 because provincial own revenues are included, and because the table does not include the local government equitable share or grants to local government for operating costs.

Projected growth

Table 6.1 shows that non-interest expenditure by national and provincial governments is expected to grow by some 8,9 per cent a year on average over the next three years.

Provincial spending is expected to grow less rapidly than national spending because of a projected decline in own revenues. The equitable shares of national and provincial government grow at the same rate over the MTEF period.

Non-interest expenditure on national and provincial functions is expected to grow by 8,1 per cent and 7,1 per cent a year, respectively. Non-interest expenditure growth accelerates over the MTEF period, as the share of debt service costs falls and expected economic growth increases.

Expenditure by type of service

Table 6.2 presents a projected breakdown of expenditure in 2000/01 classified by type of service, together with a comparable classification of the consolidated 1997/98 budgets. These are estimates based on preliminary departmental allocations and are subject to appreciable changes as budgets are further refined. The classification below does not fully correspond with the standard functional breakdown of expenditure that is published at budget time and used in Table 4.1.

Table 6.2: Projected breakdown of spending by type of service

	1997/98		2000/01		
	R billion	% of non-interest spending	R billion	% of non-interest spending	Average annual growth
Education	38,6	26,2%	49,5	27,1%	8,7%
Health	20,1	13,6%	24,9	13,6%	7,4%
Welfare	16,0	10,9%	20,7	11,4%	9,0%
Other social and provincial services	22,1	15,0%	25,8	14,1%	5,3%
Defence	10,8	7,4%	12,4	6,8%	4,6%
Justice, police & prisons	18,3	12,5%	24,1	13,2%	9,5%
Economic services	14,5	9,8%	17,1	9,4%	5,7%
General administration	6,7	4,5%	8,0	4,4%	6,2%
Total	147,1	100,0%	182,5	100,0%	7,5%
Reserve	2,1		10,0		
Total non-interest expenditure	149,2		192,5		8,9%

Social services

Education, health and welfare services are expected to receive stable or increased shares of total non-interest spending. Other social and community services, including housing and various provincial functions, will grow somewhat more slowly.

Protection services

Within total expenditure, defence spending grows relatively slowly, while the criminal justice cluster takes up a significantly increased share of the total. The strongest growth is projected for the correctional services function, which is expanding to cater for increasing numbers of prisoners and improved quality of rehabilitation and care.

Economic services

Economic services are projected to grow more slowly than total non-interest spending. These are functions of government that are complemented by infrastructure projects and other activities of various public sector corporations and extra-budgetary government agencies.

Capital and current spending

Investment

Government aims to increase the amount of public spending going towards investment. This is required if the nation is to address the substantial inherited infrastructure backlogs, and to provide higher quality and more equitable public services.

Public sector spending on infrastructure development is mainly the responsibility of public utilities and corporations and municipalities. There is nonetheless an important role for government spending, including support for housing development, roads construction and water schemes.

Based on preliminary budget estimates and before taking into account the unallocated reserve available, government capital spending is projected to remain about 8 per cent of non-interest expenditure over the MTEF period. Government aims to strengthen the capital spending trend implied by these projections.

Consumption spending

An increase in capital spending as a share of the total requires tight control over consumption expenditure and transfers. Since most consumption spending is wages and salaries of public servants, this means that pay increases must be held at fiscally responsible levels.

Almost 50 per cent of non-interest expenditure is budgeted for personnel costs. The total wage bill is projected to increase by an average of 8,4 per cent a year over the period of the MTEF, marginally more slowly than total expenditure.

Conclusion

This Medium Term Budget Policy Statement sets out Government's objectives, together with an assessment of the resources that are available over the next three years. The task of Government is to design policies to deliver those objectives within the resources available.

This chapter sets out Government's preliminary ideas on how that can be achieved. It is unlikely that there will be very substantial transfers of resources into the social services and protection services, although these sectors are anticipated to increase their share of spending. This means that the Government must deliver its objectives by targeting resources on services for the poor, reprioritising spending from lower priorities, focusing on the proper role of government, improving personnel management and securing greater efficiency from the money that is available.

Government is committed to delivering a Budget which expresses the priorities of the whole nation. All stakeholder groups, and all citizens of the new South Africa, are invited to reflect on the policies and priorities set out in this Medium Term Budget Policy Statement, and to express their opinions to enable the Government to take them into account as the Budget is finalised.

MEDIUM TERM BUDGET POLICY STATEMENT 1997

Launch – 2 December 1997

Minister of Finance
Trevor Manuel

Next year, Parliament will for the first time in the history of this country consider a three-year budget for the national government. Provincial Finance MECs will similarly present three-year expenditure plans to their legislatures. This heralds a clear break with the past. More importantly it speaks of the government's commitment to building the institutions capable of effecting sustainable transformation.

The Statement released today makes public the policy framework within which these budgets will be framed. It makes clear the links between the Reconstruction and Development Programme, the Growth, Employment and Redistribution strategy, and the Budget.

This is a significant step in increasing transparency, openness and co-operative government.

For too long, budgets, have been made behind closed doors. These are important decisions which affect all our futures.

We are publishing today the same information that is before Government as we finalise the Budget. Every citizen, every stakeholder will be able to read this Statement and see what we are trying to achieve, and the resources we have available.

We cannot achieve all our reconstruction and development goals in a single year. We have neither the capacity nor the resources.
So, we have to choose what to put first. These priorities must be the nation's priorities. They are for us all to decide together.

This Statement takes the RDP as its point of departure. It highlights how, within the limits of the resources available, we will:

- Meet the basic needs of our people;
- Accelerate infrastructure development;
- Lay the basis for sustained growth and job creation;
- Develop our human resources;
- Ensure the safety and security of the citizen and of the state; and

- Transform the organs of government to reflect the developmental and people-centred nature of our democratic state.

The Statement also makes clear how the Constitution affects the budget process.

It explains how the available funds will be distributed between national, provincial and local government.

It sets out the elements of the revenue sharing formula that determines an equitable division of resources between provinces. It introduces the notion of "conditional grants" to provinces for specialised health services and clinical training, and for the continuation of the primary school nutrition programme.

It also introduces an equitable share of revenue for local government, and explains how this will be phased in.

Although the macroeconomic framework is set out here, and you will find broad projections of government spending on education, health, welfare, economic services and safety and security, this is not the Budget. This is not the medium term expenditure framework. The detailed plans will be published at the usual time, in March next year.

The Statement does not constitute new policy. Rather it sets out the operational plan to give effect to existing policies .

It makes clear that:

- We are budgeting for a deficit of 3½ per cent of GDP next year, and 3 per cent thereafter;
- Although our macroeconomic targets for growth remain in place, we have based the Budget on more cautious economic projections – 3 per cent for the next this fiscal year, increasing to 5 per cent by 2000/01;
- Sound fiscal management means that state debt costs will fall from 6,4 per cent of GDP this year to 5,7 per cent in 2000/01, releasing substantial resources for social and economic development;
- We have set aside a Reserve, increasing to R10 billion in 2000/01, to provide both for key policy priorities and to allow for unforeseen contingencies;
- Non-interest expenditure will increase by 9 per cent a year, or about 2¾ per cent a year in real terms, over the three-year MTEF period.

The Statement also makes clear that budget-making is a difficult business.
You will find reference here to many of the new initiatives of Government that have put upward pressure on national and provincial budgets since 1994.

- We are building a new democracy and new institutions of democratic accountability.
- We are investing in economic infrastructure and broadening participation in the economy.
- We are strengthening education and training.
- The criminal justice system is undergoing a comprehensive overhaul.
- Developmental welfare services, social security reform and better targeted poverty relief programmes are amongst our priorities.
- We are committed to building a district-based primary health system and to rehabilitating historically neglected hospitals.

These are not commitments that can be met without some hardship. We have cut spending back severely in areas like Defence. We have withdrawn or reduced subsidies to historically advantaged welfare services, hospitals, schools and colleges. We have eliminated or restructured subsidies to business and commercial agriculture.

This transformation of public services will continue. Its purpose is to ensure that the needs of the poor are properly served, that our social services are equitably financed, that our administrative structures are efficient and effective.

The Budget Statement makes clear that responsibility for this transformation challenge is shared collectively within Government. Parliament will be invited to debate the medium term expenditure plans , and to solicit inputs from NEDLAC and from all of civil society.

The Budget Statement also sets out the shared responsibilities of distinct spheres of government: national, provincial and local. This has been a testing year for our new institutions of cooperative governance. In many municipalities, budgets are under review. Several provincial budgets have come under pressure in recent months. My colleagues in Cabinet and in provincial Executive Councils have faced tough choices in this budget process, and we know that there are formidable challenges ahead of us.

Key programmes, in education, health, welfare, in safety and security, and throughout the public service, require reprioritisation, improved financial management and more efficient service delivery, if our shared goals are to be realised.

Government releases today a Statement that shares this challenge with our partners.
The Freedom Charter promised that “The People shall Govern!” That remains a radical call to arms. To govern is not to elect a Government every five years. It is to have a real voice in the direction we take. In order to Govern, the people must choose.

The nation's Budget will define our ambitions and our priorities. The Government must share with the nation an understanding of our collective goals, and the constraints we face. For the people to govern, they must first be informed and empowered to make real choices. Today's Medium Term Budget Policy Statement is a significant step in ensuring that it is the people who govern the new South Africa.

MINISTRY OF FINANCE

MEDIA RELEASE

2 DECEMBER 1997

THREE YEAR BUDGET POLICY STATEMENT PUBLISHED

Introduction

Today we publish South Africa's first Medium Term Budget Policy Statement.

This is a hugely significant step in increasing transparency, openness and co-operative government. For too long, budgets have been made behind closed doors. These are important decisions which affect all our futures.

We are publishing today the same information that is before Government as we finalise the Budget. Every citizen, every stakeholder will be able to read this Statement and see what we are trying to achieve, and the resources we have available.

We cannot achieve all our reconstruction and development goals in a single year. We have neither the capacity nor the resources. So we have to choose what to put first. Those priorities must be the nation's priorities. They are for us all to decide together.

The Freedom Charter promised that 'The People Shall Govern!' That remains a radical call to arms. To govern is not to elect a Government every five years. It is to have a real voice in the direction we take. In order to govern, the people must choose.

The nation's Budget will define our ambitions and our priorities. The Government must share with the nation an understanding of our collective goals, and the constraints we face. For the people to govern, they must first be informed and empowered to make real choices. Today's Medium Term Budget Policy Statement is a significant step in ensuring that it is the people who govern the new South Africa.

Purpose

The objectives of publishing a Medium Term Budget Policy Statement are:

- **Openness and transparency**
  All stakeholders should have an opportunity to participate in the budget-making process, on an informed basis.

- **Realistic policy debate**
  Proposals and debate should be based on a realistic understanding of what can be afforded and delivered, and not wish lists.

- **Certainty**
  The Policy Statement sets the boundaries of the budget debate, and so enhance the certainty of the public service and of the markets.

Contents

The Medium Term Budget Policy Statement sets out the information that Government uses to draw up its budget. It contains:

- A summary of Government’s goals and objectives.
- New macroeconomic projections for the next three years;
- Projections for tax revenues, deficit and the total affordable level of spending;
- An explanation of the way revenue is shared between national, provincial and local government;
- A summary of the policy framework and the choices underpinning the Medium Term Expenditure framework.

This is not the Budget. That will be published in March. It does not contain detailed spending plans or tax proposals. The projections may be revised between now and the time of the Budget.   It is also not a new policy statement. It does not replace the RDP or GEAR. In fact it sets out the operational plan to give effect to existing policies. There is no point in publishing a Policy Statement if it simply means publishing the Budget three months early. The purpose is to open up the debate before the Budget is finalised.

Key points

The key points in the policy statement are:

- Government reaffirms its commitment to reconstruction and development objectives set out in the RDP, and the macroeconomic strategy set out in the Growth, Employment and Redistribution strategy.
- Government reaffirms its commitment to its deficit reduction programme - bringing the deficit to 3 per cent of GDP by the end of the decade;
- The macroeconomic targets for growth remain in place, but the Budget is to be based on cautious economic projections, for reasons of prudent planning to ensure sound public finances.
- The new proposals for sharing funds between national, provincial and local government will result in more equitable distribution of funds.
- Total public spending is to grow over the next three years by 9 per cent a year, allowing real increases in spending on public services.
- Pressures on priority programmes, particularly education, health, welfare, and safety and security will require reprioritisation within budgets, and cuts in low priority programmes.
- The Government will aim to increase the share of infrastructure spending within the budget, which will require tight control of current spending.

Medium Term Expenditure Framework

Government will publish detailed three-year spending plans for the first time in March 1998. These plans will give substance to Government's reconstruction and development commitments.

As in previous years, Parliament will vote on the budget allocations for the coming year. The publication of the three-year spending plans will enable Parliament to consider the allocations for the year immediately ahead in the context of the Government's medium term expenditure priorities. Parliament will be invited to debate the medium term expenditure plans, and to solicit inputs from NEDLAC and from all of civil society.

The plans for the later two years will be considered again in the course of 1998, and revised in the light of reaction from stakeholders, new information and emerging policy priorities.

KEY FIGURES

Projections for spending, revenue and the deficit are set out in the table below.

Table 1: Economic assumptions for medium term expenditure planning

	1997/98	1998/99	1999/00	2000/01
Rand billion				
Revenue	162,0	178,1	195,7	216,2
Expenditure	186,8	202,1	218,5	241,5
Deficit	24,8	24,0	22,8	25,3
per cent of GDP				
Revenue	26,2%	26,0%	25,8%	25,6%
Expenditure	30,2%	29,5%	28,8%	28,6%
Deficit	4,0%	3,5%	3,0%	3,0%

After allowing for the payment of debt interest, this permits growth in public expenditure of around 9½ % a year over the next three years – a increase of 2¾ % a year after taking account of inflation.

Table 2: Growth of non interest spending

	1998/99	1999/00	2000/01	Average over MTEF
Non-interest spending (Rm)	**159,4**	**173,1**	**192,7**	
Nominal growth	8,6%	8,6%	11,3%	9,5%
Real growth	1,0%	2,0%	5,0%	2,7%

In keeping with established principles of sound public finance, these budget reproductions are based on more cautions economic assumptions than the integrated scenario set out in the 1996 *Growth, Employment and Redistribution* framework. The table below sets out the macroeconomic projections on which the budget is based.

Table 3: Economic assumptions for medium term expenditure planning

	1997/98	1998/99	1999/00	2000/01
GDP growth (%)	2,0%	3,0%	4,0%	5,0%
GDP inflation (%)	9,0%	7,5%	6,5%	6,0%
GDP (R billion)	618,6	684,9	758,6	844,3

There is a correlation between the amount available for spending on public services and the performance of the economy. If economic growth exceeds these assumptions, than more money will be available for public services. Similarly, slower growth in the future years would require spending projections to be reduced.

The Constitution provides that each sphere of government is entitled to an equitable share of revenue raised nationally to enable it to provide basic services and perform the functions allocated to it. The principles on which the division between national, provincial and local government, and the division between the nine provinces, is based, are set out in chapter 5.

Table 4: The vertical division between spheres of Government

% of non interest spending	**1997/98**	**1998/99**	**1999/00**	**2000/01**
National	45,7%	45,8%	45,0%	44,9%
Provincial	53,5%	53,4%	53,6%	53,7%
Local Government	0,8%	0,8%	1,4%	1,4%
Total	***100,0%***	***100,0%***	***100,0%***	***100,0%***

To summarise:

The publishing of the medium term budget policy statement represents:

√ **Change -** a major step in the budget reform process

√ **Collective input -** enabling broad participation in the decision-making process

√ **Confidence** - certainty and credibility enhanced by opening the budget making process

√ **Constitutionality -** fulfilling our Constitutional requirements of dividing revenue equitably

√ **Co-operative governance -** enabling all three spheres of government to agree on policy priorities.