

Introduction and overview

The proposed policy framework for the 2004 Budget promotes growth and development through investment in infrastructure, reinforcing education and skills development, support for targeted poverty reduction programmes and continuing improvements in public service delivery.

Following the strengthening of the currency during 2002 and 2003, a marked reduction in inflation and lower interest rates, the South African economy is well placed to take advantage of both an international recovery and buoyant domestic demand.

Building on the reconstruction and development achievements of South Africa's first decade of democracy, Government aims to accelerate growth and employment creation and to broaden participation in the economy over the decade ahead. Poverty reduction measures to be reinforced include social grants targeted at children in need, labour-based public works programmes and skills training for the unemployed. Higher education institutions are undergoing a comprehensive transformation. Land restitution and land reform are gaining momentum. Investments will continue in housing and basic water, sanitation, energy, transport and communication services. Reforms are under way to deliver more effective functioning of the courts, police and the justice system. Funds are set aside to support broad-based black economic empowerment.

The 2003 Medium Term Budget Policy Statement outlines these and other policy priorities, within a fiscal policy framework that retains a moderate overall tax burden, declining debt service costs as a percentage of GDP, strong growth in public sector investment spending and a rising share of the national budget allocated to provincial services and support for municipalities.

The ten year review

As South Africa looks towards its second decade of democratic governance, progress since 1994 – and priorities for the years ahead – have been the subject of close scrutiny.

South Africa's democratic elections in 1994 raised the curtain on an epic transformation drama. *The Reconstruction and Development Programme*, the outcome of an extensive process of public consultation, provided the script for a comprehensive

The RDP provided the policy framework for transformation in the first decade of democracy

overhaul of public policy and services. The stage-setting included a new Constitutional order, three distinct spheres of government, an extensive set of protected human rights, an independent judiciary and a market-based monetary and economic system. Against the backdrop of the systematic inequalities of apartheid social relations, the RDP was framed around five key objectives – meeting basic needs, building the economy, democratising the state and society, developing human resources and nation-building.

The 10 year review identifies progress in meeting Government's objectives, while identifying challenges for the decade ahead

Government's performance in addressing these objectives, and in implementing subsequent policies and programmes, has been examined over the past year with a view to informing priorities and strategies for the decade ahead. A preliminary report, titled *Towards a ten year review*, assesses progress in five thematic areas: governance, social development, economic performance, justice crime prevention and security and international relations, peace and security. The report outlines progress and shortcomings, drawing in part on an assessment of human development measured by seven composite indicators of infrastructure development, quality of life, political participation, economic participation, safety and security and social inclusion. It offers the following summary conclusion:

South Africa is at the confluence of major possibilities arising out of progress that has been made in the First Decade of Freedom. The fruits of good macroeconomic management are being reaped in social services; programmes for microeconomic interventions have been developed, and experience has been gained in implementing government programmes, including crime prevention and improving the global positioning of the country...

Yet, ... in respect of the dynamic of economic inclusion and exclusion, we could soon reach a point where the negatives start to overwhelm the positives. This could precipitate a vicious cycle of decline in all spheres. Required are both focus and decisiveness on the part of government, the will to weigh trade-offs and make choices, as well as strategies to inspire all of society to proceed along a new trail. If decisive action is taken on a number of focused areas, the confluence of possibilities is such that the country would enter a road of faster economic growth and job creation, faster and more efficient provision of quality services, increased social cohesion and reduction of the paradigm of exclusion prevalent among sections of society.

Census results reveal both achievements and challenges ahead

Results of the 2001 Census and several other statistical indicators highlight the critical social and economic dynamics that underlie this analysis.

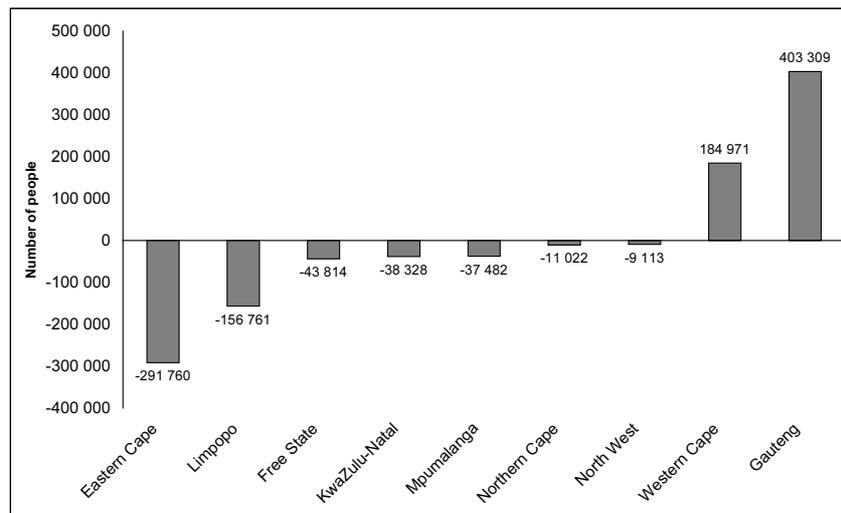
Highlights of Census 2001

- **Total population:** **October 1996: 40 583 573** **October 2001: 44 819 778**
 Increase since 1996 – 2,0 per cent a year

- **Population by province**

| | | | | | |
|---------------|-----------|------------|-----------|--------------|-----------|
| Eastern Cape | 6 436 763 | Free State | 2 706 775 | Gauteng | 8 837 178 |
| KwaZulu Natal | 9 426 017 | Limpopo | 5 273 642 | Mpumalanga | 3 122 990 |
| Northern Cape | 822 727 | North West | 3 669 349 | Western Cape | 4 524 335 |

Net loss or gain of people in each province through inter-provincial migration between 1996 and 2001



Highest level of education of those aged 20 and older (%)

| | 1996 | 2001 |
|--------------------------|------|------|
| None | 19,3 | 17,9 |
| Primary Schooling | 24,2 | 22,4 |
| Some secondary schooling | 33,9 | 30,8 |
| Std 10/Grade 12 | 16,4 | 20,4 |
| Higher | 6,2 | 8,4 |

Official unemployment rate (Labour Force survey, September 2001):

Male — 26,1% Female — 33,3% Total — 29,5%

Household characteristics

| | 1996 | 2001 |
|---|------------|------------|
| • Number of households | 9 059 751 | 11 205 705 |
| • Average household size | 4,5 people | 3,8 people |
| • Living in formal dwellings | 56% | 64% |
| • Use of electricity | | |
| Lighting | 58% | 70% |
| Heating | 46% | 49% |
| Cooking | 47% | 51% |
| • Access to piped water | 81% | 85% |
| • Access to toilet facilities | 88% | 86% |
| • Telephone in dwelling or cellular phone | 29% | 42% |

Notable demographic and social trends include the following:

- Rising unemployment...*

 - Although employment has increased as economic output has expanded since the mid-1990s, the economically active population has grown considerably faster, so that the official unemployment rate had increased to 29,5 per cent by 2001.
- Migration to urban areas*

 - Migration from rural areas to towns and cities has gathered momentum, resulting in significant shifts of population between provinces; adding to the demand for housing and services in low-income urban neighbourhoods.
- Improvements in living conditions*

 - Steady progress has been made in building houses, improving water services, electrification and communication services, but many communities remain marginalised from the mainstream of economic opportunity and lack commercial, cultural or recreational cohesion.
- Progress in education*

 - Near-universal primary school enrolment and major gains in realising equity of per learner expenditure in schools have been achieved, but progress has been slow in advancing the quality of educational attainment and the range of further education opportunities.
- Health care coverage*

 - A comprehensive network of primary health care facilities has been constructed and a hospital revitalisation programme is under way, but health systems management remains uneven.
- Expanding number of social grants recipients*

 - The number of social grant recipients has increased from three million five years ago to just under seven million today, mainly as a result of the phasing in of a child support grant, but significant numbers of poor households remain vulnerable to income or food insecurity, particularly where drought conditions affect rural livelihoods or crime and unemployment impact on communities.
- Challenges of HIV and Aids*

 - Confronted with an estimated overall rate of HIV infection rate of 11,7 per cent and rising Aids-related morbidity and mortality, health and welfare services face difficult, and fast-changing, demands and institutional pressures.
- Stabilisation of crime, but justice system improvements needs*

 - Although official statistics show an improvement or stabilisation in the incidence of most categories of serious crime, and progress is being made in reducing backlogs in courts, crime levels remain unacceptably high and the efficiency of the justice system has to be improved.
- Employment creation remains a critical challenge*

 - While economic growth of just under 3 per cent a year since 1994 is a considerable improvement on the average of 1 per cent a year achieved over the previous decade, both investment and output growth still lag behind the rates required to reduce unemployment and achieve greater equity in the distribution of income.

Addressing these challenges is the point of departure of Government's policy framework for the 2004 Budget, and for the years ahead.

Towards a ten year review proposes four broad themes for the next decade.

Four overarching themes...

The first is the idea of a "framework of encompassing interest" – the shared social and developmental vision "which not only helps better integrate the activities of government, but also harnesses the efforts of support of civil society to realise the national development objectives." The RDP goals are the departure points of such a framework. The United Nations Millennium Declaration targets also serve as key benchmarks – decreasing poverty and hunger by half, reducing child and maternal mortality, combating HIV and Aids, Tuberculosis and other major diseases, and ensuring environmental development and sustainability. The Growth and Development Summit objective that unemployment should be halved by 2014 is similarly central to addressing South Africa's dynamic of inclusion and exclusion.

Elements of a social compact – agreed social and development goals

The second challenge for the decade ahead is to improve the performance of the State – to consolidate the institutional reforms of the democratic transition, to build capacity where service delivery falls short and to promote greater participation and interaction of people with organs of government.

Improving service delivery and the performance of the state

A third major challenge is to address the consequences of South Africa's social transition. This is partly about promoting greater coherence and integrity in the spatial landscape, appropriate promotion of both human and industrial potential, and addressing the spatial disjuncture between home and work by increasing residential densities and reducing long-distance commuting. It is also about raising the labour absorptive capacity of the economy, and responding to social and economic stresses of unemployment, poverty and the burden of disease and disability.

Addressing the social and demographic transition

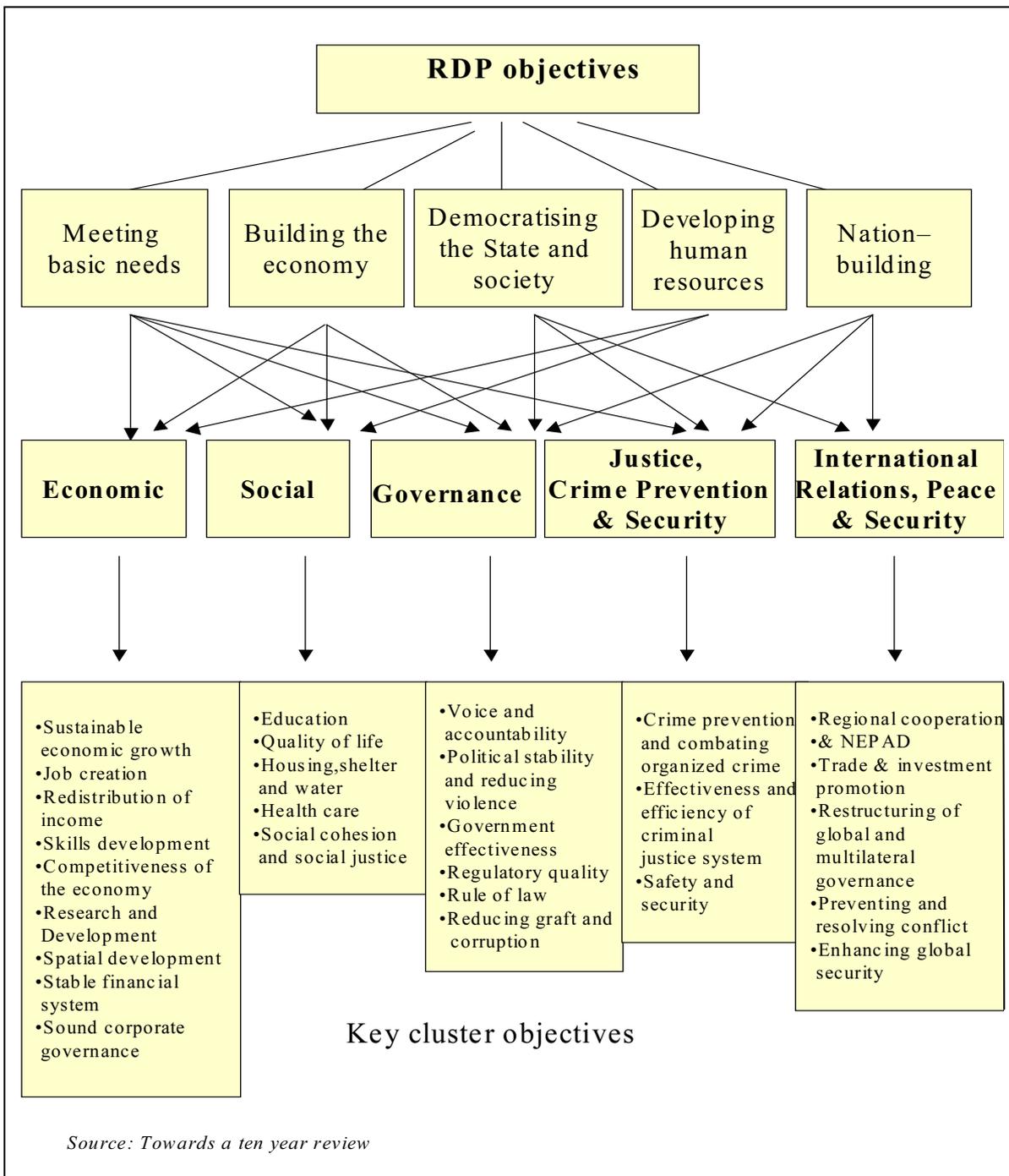
A fourth theme focuses on improving the regional environment and implementing the New Partnership for Africa's Development. The institutions of the African Union have to be put on an operational footing, socio-political normalcy restored in Angola, Zimbabwe, the Democratic Republic of Congo and Burundi, and strategic relations with major countries and regions of the South promoted.

International cooperation and implementing NEPAD

This is a formidable policy agenda, with implications for many public services, programmes and cooperative initiatives. *Towards a ten year review* provides a broad matrix of key cluster objectives, reproduced in figure 1, linked to the founding principles of the Reconstruction and Development Programme. Translating these high-level objectives, in turn, into specific

outputs and targets for departmental programmes and government agencies is a central focus of the national budget process. Detailed measurable objectives are set out for all national programmes in the *Estimates of National Expenditure*, and similarly in provincial budget documents, published on Budget Day.

Figure 1.1: High-level Government objectives



Overview of the Medium Term Budget Policy Statement

Macroeconomic developments

Chapter 2 of the Medium Term Budget Policy Statement reviews trends in the international economic environment, growth and development policy considerations and the medium term outlook for the South African economy.

Table 1.1 Macroeconomic projections

| Calendar year | 2002 | 2003 | 2004 | 2005 | 2006 |
|---|----------------|----------------|----------------|----------------|----------------|
| | | Estimate | Forecast | | |
| <i>Percentage change unless otherwise indicated</i> | | | | | |
| Final household consumption | 3,2 | 2,8 | 3,2 | 3,5 | 3,7 |
| Final government consumption | 3,7 | 3,6 | 3,3 | 3,1 | 3,4 |
| Gross fixed capital formation | 6,5 | 7,7 | 6,1 | 6,7 | 7,0 |
| Gross domestic expenditure | 4,2 | 4,7 | 3,7 | 3,8 | 3,9 |
| Exports | -1,4 | -4,2 | 4,6 | 6,3 | 6,9 |
| Imports | 3,1 | 5,8 | 6,6 | 6,7 | 6,4 |
| GDP growth (real) | 3,0 | 2,2 | 3,3 | 3,7 | 4,0 |
| GDP deflator | 8,5 | 5,8 | 4,6 | 5,9 | 5,0 |
| GDP at current prices (R billion) | 1 098,7 | 1 187,5 | 1 283,5 | 1 409,0 | 1 539,4 |
| CPIX (Metro & urban, year average) | 9,3 | 6,9 | 4,9 | 5,4 | 5,1 |
| Current account balance (% of GDP) | 0,3 | -0,8 | -1,4 | -1,7 | -2,0 |

A recovery in global economic activity is under way, particularly in the United States and East Asia. South Africa benefits from buoyant commodity prices, although sluggish growth in Europe and the strength of the rand have contributed to a weakening of the current account of the balance of payments and declining profits from mining and export-oriented industries. Complemented by a strong expansion in public sector spending on economic infrastructure, business investment has remained robust in the first half of 2003. Lower inflation and interest rates underpin prospects for continued growth in capital formation in the years ahead.

Global economic recovery and strong investment spending underpin growth

In keeping with Government's commitment to an encompassing partnership with business, organised labour and community constituencies, a Summit on Growth and Development was held in June 2003, focused on policy priorities for improving growth and broadening participation in the economy. Building on stable foundations – a moderate current account deficit, the favourable inflation outlook and healthy public finances – the Summit Agreement presents a shared vision for improving the performance of the South African economy. Key initiatives include:

Growth and Development Summit focused on broadening economic participation

- Improving the regulatory environment and resolving obstacles in the way of small business development

- Enhancing public infrastructure capacity and reinforcing investment in support of employment creation
- An expanded public works programme, extending job creation initiatives across a broad development front
- Expanding education and training and accelerating enrolment in learnerships to underpin long-term job creation
- Deepening social security programmes to provide income support to the most vulnerable
- A broad-based black economic empowerment strategy, and
- Strengthening sectoral partnerships and local development initiatives.

Inflation expected to remain in target range, with growth rising to 4 per cent in 2006

Although GDP growth is expected to slow to 2,2 per cent this year, more robust performance in the years ahead is projected. CPIX inflation fell to 5,4 per cent in September 2003 and is expected to remain within the target range of 3 to 6 per cent over the MTEF period ahead. The prime interest rate has fallen to its lowest level in nearly 17 years, contributing to favourable prospects for both domestic consumption and investment trends. GDP growth is expected to be 3,3 per cent in 2004, rising to 3,7 per cent in 2005 and 4,0 per cent in 2006.

Fiscal policy and tax considerations

Fiscal policy emphasises investment spending

The proposed framework for the 2004 Budget again gives priority to strengthening investment, creating a conducive environment for more rapid growth and job creation while also deepening social security spending and extending infrastructure and services to address poverty and vulnerability.

Chapters 3 and 4 review the fiscal policy stance and budget framework and outline developments in tax policy.

Revenue expected to be R4,6 billion below budget estimate in 2003/04

The budget framework takes into account that revenue will fall short of the February estimate for 2003/04 by about R4,6 billion, mainly because corporate profits have fallen in the wake of the economic slowdown and the appreciation of the rand. For the years ahead, a stable tax-GDP ratio of just under 25 per cent is projected for the national budget.

Strong growth in non-interest spending over MTEF

Non-interest expenditure will continue to rise strongly, averaging growth of 4,4 per cent a year over the MTEF period ahead. Increased expenditure is mainly focused on infrastructure investment, municipal services and the broadening of social grants programmes. Real growth in gross fixed capital formation by the general government is forecast to rise to 6,0 per cent over the medium term.

Budget deficit to rise to 3,2 per cent of GDP next year

The fiscal stance has contributed to moderating the slowdown since 2002 and aims to reinforce stronger growth next year and beyond. For the current year, a budget deficit of 2,6 per cent of

GDP is anticipated, rising to 3,2 per cent next year before declining to 2,8 per cent by 2006/07. The overall public sector borrowing requirement is expected to average about 3,5 per cent of GDP over the next three years and should not put undue pressure on domestic capital markets.

Debt service costs are projected to decline as a share of GDP, falling from 4,2 per cent in 2002/03 to a projected 3,7 per cent in 2006.

Interest on debt continues to fall as percentage of GDP

Key elements of the proposed framework for the 2004 Budget are summarised in table 1.2.

Table 1.2 Main budget framework, 2002/03 – 2006/07

| R billion | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 |
|---|--------------|--------------|-----------------------|--------------|--------------|
| | Outcome | Estimate | Medium-term estimates | | |
| Total revenue | 278,4 | 299,9 | 325,7 | 357,8 | 391,0 |
| <i>per cent of GDP</i> | 24,8% | 24,8% | 24,8% | 24,8% | 24,8% |
| Total expenditure | 291,8 | 331,5 | 367,5 | 403,1 | 435,3 |
| <i>per cent of GDP</i> | 26,0% | 27,5% | 28,0% | 28,0% | 27,7% |
| Debt service cost | 47,3 | 47,2 | 51,3 | 54,6 | 57,8 |
| <i>per cent of GDP</i> | 4,2% | 3,9% | 3,9% | 3,8% | 3,7% |
| Non-interest expenditure | 244,6 | 284,3 | 316,2 | 348,5 | 377,5 |
| <i>per cent of GDP</i> | 21,8% | 23,5% | 24,1% | 24,2% | 24,0% |
| <i>real growth (non-interest expenditure)</i> | 3,4% | 10,1% | 5,7% | 4,6% | 3,1% |
| Contingency reserve | – | – | 2,0 | 4,0 | 8,0 |
| Deficit(-) | -13,4 | -31,6 | -41,8 | -45,4 | -44,3 |
| <i>per cent of GDP</i> | -1,2% | -2,6% | -3,2% | -3,1% | -2,8% |
| <i>Gross domestic product</i> | 1 124,0 | 1 207,3 | 1 313,3 | 1 440,9 | 1 573,5 |

As set out in more detail in Chapter 4, the major tax reforms of recent years – the introduction of a capital gains tax, adoption of a residence-based income tax system and various other base-broadening measures – have put tax policy on a sound footing and allow for a period of consolidation in the years ahead. Certainty in both the tax policy framework and its administration are important elements in creating an environment conducive to growth and investment.

Consolidation in tax policy

Refinements to the tax structure this year or under consideration for the years ahead include:

Tax refinements include support for investment and rationalisation of VAT on grants and subsidies

- Reform of the taxation of retirement savings
- Introduction of accelerated depreciation allowances for designated urban development zones
- Tax relief to support business investment, research and development and business start-up expenses
- Relief of tax on dividends from foreign investments
- Rationalisation of the principles governing VAT on government grants to public entities and subsidies to businesses

- A levy on plastic bags, in recognition of environmental considerations, and
- Introduction of a royalty regime for mineral and petroleum products.

The Medium Term Expenditure Framework and division of revenue

The 2004 Budget will continue with the progressive strengthening of Government's core spending priorities that has been the hallmark of the MTEF in recent years.

Spending priorities include job creation, infrastructure investment and education transformation

Drawing on the findings of the ten year review project and the 2003 Growth and Development Summit, spending plans for the next three years will include an expanded public works programme to contribute to job creation, reinforcement of infrastructure investment and maintenance allocations, provision for higher education transformation and skills development, and further investment in municipal infrastructure and services.

Table 1.3 Medium term expenditure framework and division of revenue

| | 2003/04 Revised | 2004/05 | 2005/06 | 2006/07 |
|--|--------------------|------------------------------|--------------|--------------|
| R billion | | Medium term estimates | | |
| National | 110,8 | 120,6 | 131,2 | 139,1 |
| Provincial | 161,5 | 179,4 | 197,4 | 213,3 |
| Local government | 12,0 | 14,2 | 15,9 | 17,1 |
| Total to be shared | 284,3 | 314,2 | 344,5 | 369,5 |
| Changes from baseline¹ | 4,3 | 8,0 | 12,0 | 17,0 |
| National | 1,9 | 3,0 | 4,9 | 5,2 |
| Provincial | 2,5 | 4,0 | 5,8 | 10,2 |
| Local government | – | 1,0 | 1,3 | 1,6 |

1. Baseline allocations comprise the medium term estimates published in the 2003 Budget, together with standard increases of 6 per cent in 2006/07 over the 2005/06 allocations.

Division of revenue increases the shares going to provinces and local government

The proposed division of revenue is summarised in table 1.3. Allocations to provinces and municipalities rise as a share of the total, reflecting Government's commitment to improving social services and investing in low-income neighbourhoods and under-served communities. Infrastructure grants to provinces and municipalities will be partially earmarked for labour-based public works projects over the years ahead, to be supported by a technical assistance unit based in the national Department of Public Works.

Social service priorities include extension of the child support grant

Within the social services, rapid spending growth is anticipated in social security and welfare functions over the forthcoming MTEF period, mainly because of the phasing in of the extension of the child support grant to children under the age of 14. Consolidation of social grants programmes in a National Social Security Agency is being planned. The years ahead will also

see about R3 billion spent on the transformation and recapitalisation of higher education institutions, and rapid growth in the numbers of workers and learners benefiting from skills programmes overseen by sector education and training authorities (SETAs).

The budget framework makes provision for the roll out of treatment programmes in response to HIV and Aids. Allocations have been made for improved remuneration of medical professionals. Also in the provincial share, funding of learner support materials and other supplies for schools will be strengthened and the primary school nutrition programme will shift from health to education departments.

HIV and Aids treatment programmes, and improvements in schooling in provincial budgets

Spending on justice, crime prevention and security services will expand moderately over the years ahead, with additional resources earmarked for establishing Child Justice Centres, modernisation of court management and information systems and further expansion of the Police Service.

Child Justice Centres and modernisation of courts

The strengthening of the rand results in downward revisions in the costs of the strategic arms procurement programme on the Defence vote. Commitments on this programme begin to phase down in 2006/07, resulting in a reduction in the anticipated share of consolidated expenditure going to defence and intelligence functions from 7,9 per cent in 2002/03 to 6,4 per cent in 2006/07.

Defence spending falling as percentage of total

Priorities in economic services and infrastructure spending include extension of the municipal infrastructure programme, further investment in water services and sanitation, provision for infrastructure associated with industrial development zones and enhanced spending on land restitution and land reform. Strong support continues for investment in housing and basic water, sanitation, electrification, transport and communication services. The budget framework includes amounts of R1 billion in 2004/05, R2 billion in 2005/06 and R3 billion in 2006/07 set aside to support the broad-based black economic empowerment strategy.

Economic priorities include municipal infrastructure, industrial development and land reform

Several other policy priorities figure prominently in the 2004 Budget framework. South Africa's diplomatic services and peace-keeping operations, in support of NEPAD objectives, regional development and international cooperation will be enhanced. Provision is made for forthcoming elections, and allocations to support improved services of the Department of Home Affairs are proposed.

Increased support for NEPAD objectives

Conclusion

Budget priorities founded on RDP and 10 year review

The 2003 *Medium Term Budget Policy Statement* proposes a progressive strengthening of public expenditure across a broad set of policy priorities, informed by this year's Growth and Development Summit and Government's ten-year review of progress towards its Reconstruction and Development objectives.

Growth-oriented fiscal policy stance

These expenditure plans are framed within a consistent and growth-oriented fiscal policy perspective and a stable overall tax burden.

The MTBPS aims to encourage debate in Parliament and throughout civil society on Government's plans and priorities. Comment on the proposals set out for the 2004 Budget can be emailed to tipsfortrevor@treasury.gov.za, or posted to:

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