

**Address to the National Assembly on tabling the 2005 Medium
Term Budget Policy Statement and the 2005/06 Adjustments
Appropriation Bill**

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Madam Speaker,

In tabling the national Budget on 21 February 2001, at the start of the present expansionary phase in fiscal policy, I used the words of the poet David Diop

:

*Africa tell me Africa
Is this you this back that is bent
This back that breaks under the weight of humiliation
This back trembling with red scars
And saying yes to the whip under the midday sun
But a grave voice answers me
Impetuous son, that tree young and strong
That tree there
In splendid loneliness amidst white and faded flowers
That is Africa your Africa
That grows again patiently obstinately
And its fruit gradually acquire
The bitter taste of liberty*

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Are we ready to return to that tree, to measure its growth, to gather its fruit? Shall we take stock of our harvest, and have we planted well for the season ahead?

The years since 2001 have seen steady improvements in the momentum of economic growth, employment creation has accelerated, investment expenditure remains brisk and government revenue in 2005/06 will once again exceed the main budget estimate by a substantial margin.

The Medium Term Budget Policy Statement provides an overview of these developments, and sets out a broad framework of spending plans for the next three years. I am also tabling an Adjustments Appropriation Bill for the consideration of the House, the implications of which are set out in the Adjusted Estimates of Expenditure for 2005/06.

Before returning to these budget proposals, Madam Speaker, allow me to comment briefly on the broader challenge of accelerating growth and broadening participation in our economy.

Under the leadership of the Deputy President, work is in progress on an *accelerated and shared growth initiative* – an in-depth review of the dynamics of economic progress and the constraints that hold back our development. This is a project that includes consultation with international experts, because we are keen to learn from the experience of other countries. But we are also mindful that our growth strategy has to address our particular history and the special structure and circumstances of the South African economy. And so our search is not for a blueprint that receives dispassionate approval in distant banks or academic journals. Our search is for a vision that brings South Africans together, investing in our shared future, jointly confronting challenges and celebrating opportunities, constructing a strategy that will confidently be embraced by business leaders and workers, provinces and cities, civic organisations and community activists.

This is work in progress, and it builds on the policy foundations and the economic transformation that has been under way over the past decade. Many of the new programmes and budget priorities of the past few years will

gain further impetus as components of the growth initiative, and several social and economic policies will undergo further refinement. The focus is clearly on accelerating growth, but there are profound implications also for equity and empowerment.

Firstly, Madam Speaker, accelerated growth expands the resource envelope. It makes a redistribution of wealth and income possible through the process of development, and not at its expense. It is the dynamic that underlies employment creation. It is the source of increasing revenue collections and the resulting expansion in public services.

But the causality also runs the other way. Against the background of South Africa's unequal history, investment in people's capabilities, investment in housing, water services and electrification and investment in our second economy are also necessary, growth-enhancing initiatives. By broadening participation and opportunities, we will also strengthen the dynamic of growth itself.

A growth strategy rests on understanding and analysis, but it is primarily an action agenda. It is about putting plans and implementation schedules in place, and then monitoring progress and ensuring delivery. In that spirit, Madam Speaker, the Medium Term Budget Policy Statement invites all South Africans to join this project, to engage with us in building a faster growing, broad-based engine of economic mobilisation and discovery of opportunities.

Growth and investment

Economic growth as measured in the national accounts has increased steadily, from 2,8 per cent in 2003 to 3,7 per cent last year and an estimated 4,4 per cent this year. These are preliminary figures – once the full-year survey data has been incorporated into the accounts I expect the growth estimates to be revised upwards, as in past years. Several supplementary indicators signal that a notable acceleration in growth is underway. These include broad measures of demand and spending in the economy, such as the increase in VAT receipts over the past two years, strong real growth in wholesale and retail trade and the expansion in credit extension. They also

include key indicators of production trends, such as cement sales, food and beverage output growth and furniture production, which have grown at over 10 per cent in real terms, and continued expansion in employment and improvements in productivity.

More important for the sustainability of the growth acceleration: gross fixed capital formation increased by 9 per cent in 2003 and 9,4 per cent last year, and will continue to increase steadily as a share of expenditure and GDP over the years ahead. This is a key foundation of our growth strategy. Our estimates indicate capital expenditure plans of the public sector amounting to R111 billion next year, rising to R136 billion in 2008/09. Private sector investment also remains healthy, including residential construction growth of over 20 per cent and manufacturing sector investment growth of 6,5 per cent in the first half of 2005. Subdued inflation and the low interest rate environment have contributed to particularly buoyant conditions in the property market and demand for mortgage advances.

In the present context of higher oil prices and slower growth internationally, we may see some moderation of South African growth next year, and inflation is expected to rise to an average of 5,2 per cent for the year. But the overall impact on our economy is offset by buoyant prices for our commodity exports, and the fact that a large share of our oil needs are met by domestic synthetic fuel production. These are strengths on which we can build. A healthy alignment between fiscal and monetary policy over the past three years has contributed to greater macroeconomic stability. Governor Mboweni and I have agreed that the inflation target for CPIX, or consumer prices excluding mortgage interest costs, will remain 3-6 per cent over the three-year period ahead.

On the growth and investment front, Madam Speaker, our plantation is well and truly flourishing. But there is more to be done. Our growth initiative recognises that capacity and systems must be upgraded in our freight logistics sector, that we need to see lower prices and greater competition in telecommunications, we need to strengthen our research and technology capabilities and there are aspects of pricing and market conduct that need

attention in several sectors. These are under review, and financial sector development, trade promotion and labour market policies will also come under scrutiny for their contribution to maintaining and enhancing a favourable investment environment.

Economic participation and the second economy

If economic growth is our first joint project, Madam Speaker, then bringing the second economy into the mainstream of economic life must be our second. These are closely related challenges.

Improved economic growth means that we are now seeing measurable advances in employment, and the official unemployment rate has declined from nearly 30 per cent in 2001 to 26,5 per cent in March this year.

The increase in employment is partly reflected in formal sector job opportunities, but it also arises from strengthened linkages between formal businesses and emerging entrepreneurs, and an improving environment for informal and small-scale trade. However, we don't yet know enough about the dynamics of employment. Following a review last year, the present six-monthly labour force survey will be replaced in due course with a simplified, quarterly survey. The new survey will be piloted in 2007 in parallel with the present series, and I know that the Minister of Labour will join me in welcoming this contribution to improving the frequency and reliability of our information about labour market trends.

The policies and programmes that contribute to building bridges between the first and second economies are many and varied. They include procurement policies of both the public sector and large private businesses, focused on small enterprise support and black economic empowerment. They include our expanded public works programme and associated training and skills development activities, our land restitution and land reform initiatives, agricultural support programmes, consolidation of small enterprise support in the new Small Enterprise Development Agency, and new directions in housing policy, community investment and local economic development.

Developments in the financial sector also play their part. Over 1,98 million people have gained access to bank accounts through the Mzansi initiative. Better consumer protection is incorporated in the new Credit Control legislation. A framework has been developed for extending R42 billion in housing finance on affordable terms to households largely excluded from the mortgage market until now. New institutions have been proposed to support community savings and loan facilities and to provide credit services to emerging farmers. Within the framework of the Financial Sector Charter, greater impetus will be given to mobilising private sector resources in support of housing, small businesses, emerging farmers, community development and public infrastructure development.

In bridging the divide between the first and second economies, Madam Speaker, I believe a central challenge ahead is to strengthen cooperation between the state, the business sector and community organisations. Cooperation means trust and a shared vision, and it also means tough negotiations, firm agreements, co-financing arrangements and careful attention to risks, rewards, targets and performance measures. We have an excellent policy framework, we now need to construct the developmental partnerships that will translate policy into practice.

Social security, health care and human development

The third platform of our shared vision is the social solidarity on which health, human development and welfare services rest. In this cluster, budget allocations and how effectively they are used feature most strongly. The recently published Provincial Budgets and Expenditure Review for 2001/02 to 2007/08 provides a valuable guide to our progress and the challenges ahead in meeting education, health and social development needs, which together account for nearly 60 per cent of consolidated non-interest expenditure.

Over the past five years, the fastest growing component of social expenditure has been income support to vulnerable people. Social assistance grants to the elderly, the disabled and to support vulnerable children now reach more than 10 million beneficiaries. The administration of grants will in future fall under a national Social Security Agency, and I am confident that better

information systems and management reforms will yield significant returns in the years ahead.

Welfare services will remain a provincial function, and will see considerable reform over the years ahead as part of Government's progressive extension of improved protection and care to older persons, families affected by HIV and Aids and children in conflict with the law.

Expansion of income support for the vulnerable has been the priority of the past five years. These programmes will continue to be responsibly financed and managed. But for the decade ahead, we need to give particular priority to strengthening and improving public health care and education.

Cabinet, together with provincial Premiers and Finance MECs, has agreed on several key initiatives to be reinforced in the 2006 Budget:

- Upgrading and revitalisation of hospitals, and additional funding for medical equipment and information systems
- Consolidation of primary health care services under provincial administration
- Increased funding for school buildings, facilities and curriculum materials, together with phasing out of fees at schools serving low-income communities
- Progressive expansion of early childhood education opportunities
- Introduction of a new national subsidy programme for community libraries
- Investment in facilities and equipment at further education colleges, modernisation of curricula and improved linkages with skills development programmes
- Increased funding for school sport and community sport participation.

Health care, education, retirement provision and welfare services are not exclusively the responsibility of the state – we will continue to encourage private sector development and to seek partnerships that contribute to improved service delivery and more efficient management and use of resources. Changes in the tax environment and regulatory reform also play their part in promoting fairness, transparency, equity and long-term development.

The work of the Pensions Fund Adjudicator is a reminder not just to the regulatory authorities but also to this House that we have important work to do in ensuring that savings and consumer interests are appropriately protected. In measuring progress in social solidarity, we need clear indicators of performance for the public sector, and also broader measures of the complementary progress of public and private sector provision towards greater equity, broader access and improved quality and reliability of services.

Improving the capacity of the state

Improved public administration is part of the challenge we face in health and education, Madam Speaker, and it is also an aspect of growth and development in its own right. Governance and administration is a fourth cluster around which targets must be set, performance monitored and accountability strengthened. We are surely all in agreement that in our classrooms, hospital wards, courts, police stations and municipal offices, public service must be characterised by diligence, honesty, care, compassion and personal responsibility.

Key initiatives include management training and improved reporting systems, investment over the next three years in a new Integrated Financial Management System to replace outmoded information processing systems, and targeted support for municipalities under stress and for critical infrastructure development capacity in identified provincial departments and local authorities.

Measurement of service delivery progress against published targets is central to the public administration reform challenge. This has been an important part

of the success of the South African Revenue Service in building an effective organisational culture, and it is also evident in the progress of the Police Service in responding to priority crimes and implementing “sector policing” initiatives. Measurement and monitoring are at the centre of formal contractual public-private partnerships, where the detailed specification of service obligations is tied to explicit penalties for non-delivery. Measurement and monitoring are central to the quality improvement plans for education and health that have been agreed between national departments and their provincial counterparts for the 2006 Budget and beyond.

This House, Madam Speaker, needs to keep track of these projects – needs to keep score, in effect, on the development of Government’s in-house scorekeeping capacity. Progress has to be measured not by the weight and volume and glossiness of the strategies and reports tabled for consideration, but by their practical content, accuracy, reliability and attention to remedial measures where implementation lags behind plans and budget allocations.

International relations

Fifthly, there is a special international dimension to many areas of public affairs.

We have a particular obligation to promote Africa’s reform agenda on the global stage, and we are actively involved in the pursuit of peace and security, promotion of trade and debt relief and investment in good governance and regional cooperation.

Our responsibility for hosting the Pan-African Parliament, support for the NEPAD secretariat and our contribution to building the institutions of the African Union are key long-term commitments. Alongside this diplomatic and institutional capacity-building, South African businesses and public corporations are increasingly building partnerships in Africa and our financial institutions are at the forefront of addressing the financing challenges of Africa’s renaissance. I am pleased to be able to announce that Governor Mboweni and I have agreed on further steps in exchange control reform,

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which will again include special encouragement for investment and joint ventures in Africa.

We will continue to watch closely how these young plants grow and bear fruit. And, Madam Speaker, the whole world will be watching how we nurture the Soccer World Cup project. Planning of transport arrangements is now well underway. Within the framework set out in the Medium Term Budget Policy Statement, R3 billion has been set aside for modernisation of stadiums. Decisions need to be taken over the next few months, with a view to construction beginning next year.

2005/06 Adjustments Estimates

As in the past, Madam Speaker, I need to table a variety of adjustments to the 2005/06 Budget for the consideration of the House. These are of four main kinds:

- Unspent funds from last year amounting to R1,5 billion are proposed for rollover and re-appropriation in the present year
- After consideration by the Treasury Committee, R1,1 billion is proposed in additional allocations for unforeseeable and unavoidable expenditure
- R1,1 billion is proposed for infrastructure projects, in keeping with the announcement in the February Budget that such allocations would be made where project plans were sufficiently advanced
- R0,7 billion is proposed for appropriation in respect of self-financing expenditure.

Against this, savings and under-spending of R2,5 billion are anticipated and state debt costs will be R1,3 billion less than the February projection. The revised expenditure level is R416 billion, or R2 billion less than the main budget estimate.

Details are set out in the Adjusted Estimates of National Expenditure. I wish to highlight the following recommendations of the Treasury Committee.

- R311 million is proposed on the Provincial and Local Government vote, to contribute to water supplies in municipalities affected by drought, and R40,7 million is for emergency infrastructure repairs in the Western Cape and Eastern Cape.
- R32 million goes to the Disaster Relief Fund administered by the Department of Social Development.
- R140 million is proposed as a contribution to the World Food Programme's relief efforts in SADC countries.
- R120 million will go to the Department of Agriculture for farmers affected by drought, and a further R20 million to cover costs related to control of Classical Swine Fever outbreaks in the Western and Eastern Cape.
- R30 million is recommended for emergency housing measures.
- Amounts of R39 million and R21 million go to the Departments of Foreign Affairs and Defence for costs related to engagements in the Cote d'Ivoire.

In addition to these and other allocations to national departments, a supplementary amount of R200 million is recommended for the Primary School Nutrition Programme administered by provincial Departments of Education, in order to ensure that this critical support programme fully meets its obligations.

Infrastructure finance

In respect of infrastructure projects, for which provision was made in the February Budget Speech, I am pleased to be able to confirm that good progress has been made in identifying municipal transport improvement projects, several of which relate to the requirements for the 2010 World Cup.

The first allocations amounting to R242 million will be transferred to municipalities in the present financial year. A further amount of R241,5 million is recommended on the Sport and Recreation vote to complete planning design work and begin construction at stadiums earmarked for use in the 2010 World Cup. Also included in the infrastructure allocations is an amount of R580 million for further work on the demonstration plant of the Pebble Bed Modular Reactor Project.

Over the MTEF period ahead, additional allocations of R31,5 billion are proposed for infrastructure projects, including significant increases in spending on national and provincial roads and refurbishment of passenger rail services. Hospitals, schools, water resources, industrial development zones, scientific research capacity, courts and police stations and public administration will also benefit from further growth in capital spending and allocations.

Madam Speaker, I indicated in February that plans for a rapid rail link between Johannesburg, Tshwane and the Johannesburg International Airport were far advanced. This is a project of the Gauteng Province, but it is an investment of national economic significance and its place in a larger transport development strategy for the Gauteng region is currently under final scrutiny. The overall costs to the fiscus of Gautrain will exceed R20 billion over the next five years.

It is clear that major strategic investments of this kind cannot be undertaken within the confines of the provincial equitable share of revenue and the existing conditional grants. In the Eastern Cape, similarly, completion of the Coega Industrial Development Zone requires funding from the national fiscus, the De Hoop Dam on the Olifants River in Limpopo will be financed in part by the Department of Water Affairs, major housing projects such as Gateway in the Western Cape go beyond the resources of the normal subsidy programme, the Eastern Cape coastal highway project will include several major bridges to be built by the South African National Roads Agency, and the upgrading of major ports and airports requires the resources of the Ports Authority and the Airports Company of South Africa.

Infrastructure investment, in brief, is a shared responsibility of the national government, provinces, municipalities and various public corporations. Financing arrangements vary, and as major projects get underway over the years ahead we will need to adapt and refine our approaches to strategic regional investment projects. Details of the cost-sharing arrangements for major infrastructure projects and the appropriate balance between direct budget support, project borrowing and internal finance of state-owned enterprises will be announced in the February Budget.

2006 Budget framework

We are fortunate, Madam Speaker, in giving consideration to options for stepped up infrastructure funding, to have a healthy fiscal position as point of departure. For the 2005/06 financial year we expect revenue to exceed the main budget estimate by R30 billion, and the budget deficit will be 1,0 per cent of GDP, compared with the February projection of 3,1 per cent.

The revised growth outlook, robust revenue performance and a steadily declining burden of debt service costs as a percentage of GDP allow once again for a substantial upward adjustment in public expenditure plans over the MTEF period.

As announced in February, RSC levies, which are a significant source of revenue at the local government level, will fall away with effect from July 2006. The framework set out in the Medium Term Budget Policy Statement includes R7 billion in 2006/07, rising to R9 billion in 2008/09, effectively providing for phasing in a new tax base or grants to compensate for this loss of revenue, within the new revenue envelope. Other tax policy measures that will take effect over the period ahead include:

- A revised treatment of medical scheme contributions to provide greater relief to lower-income taxpayers
- More stringent parameters for calculating tax benefits associated with travel allowances and company cars

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- Relaxation of exemption criteria for offshore banking activities and of the treatment of restructuring of companies
- Further extension of the tax depreciation benefit for urban development zones.

The February budget will include details of revisions to the rates and thresholds applied to individual taxpayers, and other tax adjustments. As always, there are many options to consider. The tax treatment of retirement funds, taxation of the mining sector and the fiscal regime that applies to the synthetic fuels industry are under review.

Our expenditure plans for the MTEF period ahead include the following changes to baseline allocations:

- R31 billion more over the next three years for the provincial equitable share – to finance improved resources for schools, clinics and hospitals, augmentation of social development and welfare services, implementation of early childhood development and increased investment in roads, economic services and support for emerging farmers
- R20 billion for investment in the built environment – housing, municipal infrastructure grants, water schemes, public transport and community facilities
- R12 billion for higher education, hospital revitalisation, community libraries, social grants and cultural institutions
- R9 billion for science and technology, industrial policy, communications infrastructure and national roads
- R7 billion for courts, police and improved access to justice services, and
- R8 billion for investment in public administration, including government accommodation and modernisation of financial administration.

Over the MTEF period ahead the main budget deficit is expected to be about 2 per cent of GDP and the overall public sector borrowing requirement, which takes account of the investment and borrowing plans of state-owned enterprises, will rise to between 3 and 3,5 per cent of GDP.

Members of the House should also know that in the course of 2005 South Africa's sovereign debt rating has been raised by all three major international ratings agencies, signalling both the improved macroeconomic outlook and the health of our public finances.

Conclusion

The 2006 Budget, Madam Speaker, will provide greater impetus to the infrastructure investment, improved public services and overall fiscal environment required for accelerated economic growth over the decade ahead. But faster growth and broader participation also requires focused reforms in our industrial policy, in small business development and the labour market regulatory framework, better local administration and urban planning and stronger partnerships between government, the business sector and civil society. The Medium Term Budget Policy Statement sets out Government's budget plans for the period ahead, and invites this House and all South Africans to embrace the journey ahead – to contribute to our action agenda for accelerated growth, for all.